LLOYDS BANKING GROUP PLC – FULL YEAR RESULTS – PRESENTATION TRANSCRIPT
(amended in places to improve readability only)

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LBG:
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William Chalmers, Chief Financial Officer
Douglas Radcliffe, Group Investor Relations Director (moderator for Q&A)

Charlie Nunn
Good morning everybody and thank you for joining our 2022 full year results presentation.

I will begin today with an overview of our performance in 2022, including an update on the good start we have made one year into our strategic transformation, as well as outlining what you can expect over the next 12 months. William will then provide the usual detail on our numbers and we will have plenty of time for Q&A at the end.

So let me begin on slide 3. Similar to my update at the half year, I will start with 5 key messages I would like you to take away from today.

- First, our purpose of Helping Britain Prosper is core to everything we do. With this in mind, we have taken significant action to provide support to our customers and colleagues through a period of increased uncertainty.
- We delivered a robust financial performance in 2022 with increased capital returns, supported by strong income growth.
- Although the macroeconomic environment has changed significantly, we remain confident that our strategy is the right one, delivering positive outcomes for all our stakeholders.
- We have made a good start to our strategic transformation, with 2022 largely focused on mobilising the businesses and laying the foundations for our future success. Our investment is fundamental to the prospects of the Group and we are already seeing early evidence of delivery.
- And finally, our confidence in our strategy is reflected in an enhanced financial outlook, particularly as we build through the plan. This includes upgrading our medium term return on tangible equity and capital generation targets.

So, with that, I will now turn to slide 4 to briefly outline how we have delivered for our stakeholders in 2022.

Customers and clients are at the heart of our business. In a year where the environment has proven more challenging due to increases in the cost of living, I am extremely proud of the support we have provided. We have leveraged our digital strengths to provide our customers with the ability to take greater control of their finances. Over 5,000 customers access our digital financial resilience tools every day and over 5 million have accessed our new credit worthiness app.

We have also invested in deep capabilities to help customers build financial resilience and support them with tailored products and plans if they are unable to make ends meet. This includes training more than 4,600 colleagues to provide financial assistance where it is needed. As a result, we have put in place around 250,000 personalised plans, helping individuals and businesses with their finances. Despite the more challenging economic environment, we have not seen a meaningful increase in the total number of customers needing this enhanced support. This highlights the resilience of our customer base as we enter 2023.

Our colleagues are critical to providing this support and we have also made significant efforts to help our people through changes to pay and working practices. In 2022 we provided early cost of living support for colleagues through a one-off payment, whilst many colleagues received a further payment in December. Towards the end of the year, we also made an early announcement on the 2023 pay deal, providing certainty for our people.

Core to our purpose is our focus on building an inclusive society. To that end, we have provided over £2 billion of funding to the social housing sector and lent over £14 billion to first time buyers in 2022, helping more than 60,000 customers get on the housing ladder. At the same time, I am proud of the fact that we provide around 30 per cent of basic bank accounts in the UK.
Alongside this, we have delivered race education training to all colleagues, provided focused support for black entrepreneurs, financed high speed internet in less privileged communities and supported agricultural clients in their efforts to build financial resilience.

We have also made progress in supporting the transition to net zero. This includes our commitment to responsible investment within Scottish Widows, launching a carbon calculator for SMEs and our innovative new partnership with Octopus Energy, which will enable customers to make their homes more energy efficient.

We have also provided over £13 billion of green and sustainable lending in 2022 and developed our first Group Climate Transition Plan. The latter includes important industry firsts, such as our commitment to not directly finance any new oil or gas fields.
So there is a lot going on and, as ever, we are targeting our efforts in areas we can make the biggest difference whilst creating opportunities for profitable growth. We have published our Environmental and Social Sustainability Reports this morning and you will find a lot more information in there.

Turning now to a brief overview of our financial and business performance on slide 5.

The Group delivered a robust financial performance during 2022. Net income was up 14 per cent compared to the prior year whilst operating costs increased by 6 per cent, in line with expectations. Stable BAU costs highlight our ongoing cost discipline, which is particularly important in an inflationary environment. We delivered a return on tangible equity of 13.5 per cent and generated 245 basis points of capital. This enabled an increased total ordinary dividend of 2.4 pence per share alongside a share buyback of up to £2 billion.

As you will hear in my remarks on our strategic progress, we are delivering continued business momentum and seeing real franchise growth. This is alongside improving levels of employee engagement and progress on our diversity goals.

Turning to our strategy on slide 6.

Our purpose-driven strategy has three distinct pillars.

- First, driving revenue growth and diversification across four key areas that cover our consumer and commercial franchises.
- Second, strengthening the Group's cost and capital efficiency, building on our strong foundations.
- And third, building a powerful enabling platform that combines people, technology and data to support our ambitions.

The combination of these priorities will enable the Group to deliver on our purpose, attract and retain the best talent, and grow profitably with our customers. In turn, this will enable us to deliver higher, more sustainable returns and capital generation across both the short and long-term.

Now turning to slide 7 to look at how the changing environment reinforces our strategy.

It is a year since William and I set out the Group's new strategy. The operating environment has changed significantly over the last year and, as I mentioned earlier, our customers are facing a more challenging outlook than we had anticipated. This has also presented challenges for us, as we have focused on supporting our customers and ensuring they remain financially resilient. We have also continued to see shifts in our customers' behaviour to be more digital.

Given the Group's financial strength, it is more important now than ever to deliver the purpose-driven strategy we set out last year. It will enable us to further differentiate how we serve our customers as they start to recover from these economic challenges, whilst we can also strengthen and diversify the Group's earnings. In some cases, we have stretched our ambition even further, such as adding an additional £0.2 billion of cost savings targets for 2024.

Our ongoing commitment to our strategy is reflected in the scale of our investment – £3 billion of incremental strategic spend over the first three years of the plan, or £4 billion over five. In 2022 we delivered £0.9 billion of this incremental investment.

Turning to our strategic progress on slide 8.

As we set out a year ago, we have a purpose driven strategy, focused on driving revenue growth and diversification, strengthening cost and capital efficiency, and maximising the potential of our people, technology and data. We have an ambitious strategy for a 5 year transformation of the Group, with clear deliverables and the financial benefits increasing as we move through the plan. 2022 was a foundational year and we have taken significant action as we have invested for growth and accelerated our efficiency initiatives. We have also reorganised the Group to accelerate the pace of transformation, and have seen good early evidence of delivery across our initiatives. So I am confident we are well placed to deliver our strategy going forward.

I will set out some highlights of our progress shortly, but first, on slide 9, I will highlight some of the initial financial benefits.

You will recall that when we presented our strategy, we highlighted an expectation that the growth initiatives will provide £0.7 billion of additional revenues per annum by 2024 and £1.5 billion by 2026, split 50:50 between interest and other income. As I will highlight on the coming slides, we have made good initial progress, and as we deepen our customer relationships further over the coming years, we expect to build momentum that will support higher, more sustainable revenues that extend beyond the current rate cycle.

In addition, we achieved £0.3 billion of gross cost savings in the year, which supported a stable BAU cost base. As mentioned, we have identified further cost savings in 2024 that will partially mitigate the impact from inflation and create investment capacity. We expect an inflection point in 2024, where the benefits from our strategic initiatives will positively contribute to the bottom line in 2025 and beyond, as reflected in our financial guidance.

I will now briefly highlight progress across our four priority growth areas and I will start with Consumer on slide 10.

We have made good progress on building deeper customer relationships, as well as innovating and broadening our product offerings, whilst improving the ease with which our customers can access them. We have invested in driving improved levels of personalisation and digitisation, resulting in a 15 per cent increase in daily logons, as well as reaching 20 million digitally active customers, two years ahead of schedule. This enables the Group to reduce costs and drive deeper customer engagement. In 2023, we will continue to personalise and digitise our consumer offering, supporting our ambition to meet more of our existing customers' needs.

This morning we announced the acquisition of Tusker, a vehicle management and leasing company, focused on electric and low emission vehicles. This will further develop our motor business in a way that is clearly aligned with our purpose and sustainability ambitions, and supports our growth ambition in SME.

In 2022, our mass affluent business, supported by targeted campaigns, increased banking balances by over 5 per cent. We have also launched new, tailored banking products, including credit card and packaged bank accounts. Our direct-to-consumer investment capability has been enhanced, aided by the completion of the Embark acquisition. This was previously a gap in our product capabilities and we expect both D2C and ready-made investment options to launch in 2023. Our mass affluent offering will be launched in earnest this year, with customers experiencing a differentiated, digital-first model. We also expect an expansion of our banking offering, providing value-added products, services and benefits for customers.

Looking now at progress on Commercial on slide 11.

Our ambition in SME is to build a diversified, digital-first business. This is a multi-year journey and in 2022 we have laid strong foundations and shown positive growth, including more than 20 per cent growth in new merchant services clients. We are also broadening our product capabilities through strategic fintech partnerships, where appropriate. For example, our invoice discounting partnership provides a solution that allows clients to better manage cash flows. In 2023 we will take further steps to improve our digital offering, with new on boarding propositions, enhanced functionality and insights for clients.

Our Corporate and Institutional offering has made good progress within the targeted parameters that were outlined in February last year. We are also investing in product capabilities that support our clear cash, debt, and risk management offering. This includes upgrading our rates digital product offering and delivering the first phase of our new FX platform. And finally, we have strengthened our originate-to-distribute capabilities, delivering our milestone first strategic co-investment partnership. These strengthened capabilities further improve the Group's capital efficiency. In 2023 we expect to extend the scale of our originate-to-distribute offering, alongside maintaining our clear sector focus and further improving product capabilities. Having highlighted just some of the progress in our growth businesses, I will now look at our clear commitment to the enablers on slide 12.

Maintaining discipline with regards to cost and capital efficiency is critical to our strategy. In 2022 we increased customer engagement and service options through our digital channels, enabling us to optimise our cost-to-serve by, for example, closing around 200 branches and increasing automation of operational processes. With regards to capital efficiency, we continue to demonstrate RWA discipline whilst pursuing growth in capital-lite, fee-generating businesses and enhancing our originate-to-distribute capabilities. In 2023 we will also conclude the triennial pension review, which is expected to demonstrate the significant advances we have made.

Our people efforts in 2022 have included refreshing the leadership team, establishing our new operating model to deliver the strategy and driving greater efficiency, for example by reducing our office footprint by 12 percent as we adapt to new ways of working.

We have continued to invest in future data capabilities, as well as decommissioning 5 per cent of legacy applications and reducing our data centre footprint by 10 per cent. This brings new capabilities to supplement our strategy, as well as greater team efficiency.

I will now finish these remarks on slide 13.

So I hope that was a helpful update. I am pleased with our strategic progress, particularly in the face of a changing external backdrop. Looking forward, it is our intention to provide you with regular deep dive sessions over the course of this year and into the first half of 2024. You will find more detail on these sessions in the appendix.

As you know, our strategy is underpinned by a robust financial framework and a clear link to how strategic initiatives contribute to the delivery of higher, more sustainable, returns and capital generation. Based on our strategic progress, future plans and the changes to the macroeconomic forecasts, we are today enhancing our financial guidance. William will provide you with more detail shortly, but at a headline level we are now targeting a return on tangible equity of 13 per cent in 2024 and greater than 15 per cent by 2026. Both are around three percentage points higher than last year. This in turn drives higher capital generation and we are now targeting circa 175 basis points in 2024, increasing to greater than 200 basis points by 2026. I believe that these targets reflect a compelling proposition for our shareholders and they demonstrate our confidence in the future.

Thank you for listening. I will now hand over to William for the financials.

William Chalmers
Thank you Charlie and good morning everyone again and thanks again for joining.

As Charlie said, the Group delivered a robust financial performance in 2022, based on continued strength in the customer franchise. Net income of £18 billion is up 14 per cent versus 2021, supported by a higher net interest margin of 294 basis points, 4 per cent growth in other income and a low operating lease depreciation charge. We remain committed to efficiency. Operating costs of £8.8 billion are in line with our guidance. This includes stable BAU costs alongside higher planned strategic investment and the costs of new businesses. Asset quality meanwhile is strong. The observed impairment story has not materially changed in the quarter. The full year impairment charge of £1.5 billion includes the impact of the revised economic outlook emerging during the year. Together, this strong performance delivered statutory profit after tax of £5.6 billion and a return on tangible equity of 13.5 per cent.

Tangible net assets per share at 51.9 pence are down 5.6 pence in the year, although up 2.9 pence in Q4. Robust earnings alongside a modest reduction in risk weighted assets and significant Insurance dividends, have driven strong capital build of 245 basis points in 2022.

Let me turn now to slide 16 to look at the ongoing development of our customer franchise during the year.

Our mortgage portfolio continued to grow in 2022. Balances are up £3.7 billion in the year, including £1.2 billion open book growth in the fourth quarter. Credit cards are up £0.5 billion in the year, although flat in the fourth quarter. Motor Finance is up £0.3 billion in 2022, including £0.1 billion in Q4. The order book is strong, albeit the business remains impacted by the ongoing global supply chain issues affecting the industry.

Commercial Banking balances meanwhile are up £1.2 billion during the year. This continues to be led by attractive growth opportunities within Corporate & Institutional and FX, partly offset by repayments of Government support scheme loans, predominantly in our Small and Medium Businesses franchise.

On the other side of the balance sheet, Retail deposits are up £2.4 billion in the year. This includes current accounts up £2.5 billion in 2022, although down £1.7 billion in Q4, given some customers switching balances and seasonality.

Commercial deposits are down £3.7 billion in the year, including £6.4 billion in the fourth quarter. We saw some short-term placements from Q3 in CIB reverse in the final quarter, as we had expected, alongside the impact of management pricing actions and seasonal effects.

During the year, we have also seen Assets under Management growth within Insurance of over £8 billion of net new money.

I will now turn to slide 17 and the strong net interest income performance in a little more detail.

NII of £13.2 billion is up 18 per cent on the prior year. AIEAs at £452 billion are up £7 billion or 2 per cent, largely due to the £6 billion growth in average mortgage balances. The full year margin of 294 basis points is up 40 basis points on 2021. This benefitted significantly from the base rate changes through the year and structural hedge reinvestment, outweighing mortgage pricing pressures. The Q4 margin of 322 basis points is up 24 basis points in the quarter. The margin is driven by base rate movements, but bear in mind that deposit pricing has lagged base rate changes and therefore some of this will unwind in H1. The mortgage rollover pressure increased to 8 basis points in Q4 and this indeed will continue across 2023.

Looking forward, we now expect average interest earning assets to be broadly stable in 2023. We should see low single digit growth in the core businesses being largely offset by reductions in the closed mortgage book and government support scheme loans within Commercial. I should also note that Q1 will see a modest reduction in customer lending given our exit from a legacy mortgage book in January.

So putting all this together, we now expect the net interest margin to be greater than 305 basis points in 2023. This is below Q4's exit rate, given the impact of the mortgage book refinancing, deposit repricing actions and higher funding costs. These will more than offset the expected higher hedge earnings. Within 2023, the headwinds will impact our numbers more in the first half, while the hedge benefit is back ended. While this suggests the margin is likely to dip in H1, before stabilising for the rest of the year, we do expect the margin to be above 300 basis points at all times.

Let me now turn to slide 18 and look at our interest rate sensitivity in a little more detail.

The Group remains positively exposed to rising rates. We expect a 25 basis point parallel shift to benefit interest income by about £150 million in year 1. As ever, this is illustrative and based on the same assumptions as before, notably the 50 per cent deposit pass through. And as you know, the pass through could differ from the 50 per cent illustration and that makes a meaningful difference to our sensitivity. As always, the published sensitivity does not assume asset spread compression, for example in mortgages.

So with that let me move on to look at the individual asset portfolios, starting with mortgages on slide 19.

The open mortgage book grew £6.3 billion during the year, including £1.2 billion during the fourth quarter. The back book is now around £47 billion, down 25 per cent over the year. Customers are refinancing their mortgages in the context of a higher rate environment and indeed we are actively supporting them in this process. As you know, mortgage pricing has been competitive over the course of 2022. Completion margins were around 60 basis points for the year and around 50 basis points in Q4. The mortgage margin picture is now better and more stable than a few months ago. However the effects of the remaining low margin October business still awaiting completion, will continue to impact Q1. More broadly, we are forecasting mortgage new business margins in the year to be below the 75 to 100 basis points we talked about last February. With that said, we do still see mortgages as attractive from a returns and an economic value perspective.

Let me now turn to our other asset books, on slide 20.

Consumer finance balances are £1.4 billion higher than 2021 and essentially flat in the fourth quarter. We have seen a recovery in credit card spend, resulting in balances up £0.5 billion in the year, largely in the first half. As mentioned, Motor Finance growth remains impacted by the issues affecting the whole sector.

Commercial Banking lending is up £1.2 billion in the year as discussed earlier, attractive growth opportunities within the Corporate and Institutional business alongside FX impacts, have been partly offset by clients repaying their COVID loans.

Let's move to the other side of the balance sheet on slide 21.

Total customer deposits of £475 billion are down £1 billion in the year due to lower Commercial balances. Retail current accounts are up £2.5 billion in 2022, further supporting our hedge capacity. The Q4 reduction of £1.7 billion in part reflected a movement to savings offers, both internal and external. Retail relationship accounts are up £1.8 billion in the year, including £0.6 billion in Q4 as customers have begun to seek higher returns on their deposits.

Commercial deposits meanwhile are down £3.7 billion. This includes £6.4 billion in Q4, partly reflecting the outflows of short-term CIB deposits that we flagged at Q3.

Aggregate deposits are around £65 billion higher than at the end of 2019. This deposit growth, of course, increases hedgeable balances and we turn to this on the next slide.

The structural hedge capacity has built in recent periods, based on deposit growth alongside increased eligibility of our existing deposits. This includes a further £5 billion addition in the fourth quarter, to £255 billion. The nominal hedge balance is now fully invested. The weighted average duration of the hedge remains around three and a half years and, in line with the last few quarters, a little below the neutral position of around 4 years. We have around £35 billion of maturities in 2023, weighted to the second half. This gives us significant flexibility looking forward. We saw gross hedge income of £2.6 billion in 2022. As we look forward, we expect this to be around £0.8 billion higher in 2023 and a similar increase again in 2024. This roll of the hedge into a higher rate environment is an increasingly powerful income driver for us as we go forward.

Now moving to other income on slide 23.

Other income of £5.2 billion is 4 per cent higher than 2021. We are building confidence in our growth potential across the franchise. In 2022, including Q4, Retail saw improved current account and credit card performance in the context of recovering activity. Likewise, Commercial OOI saw improving transaction banking and financial markets activity. Meanwhile Insurance, Pensions and Investments benefitted from assumption and methodology changes in the year, most notably as product persistency beat our expectations. After adjusting for this and GI weather events, Insurance other income was slightly up in 2022 from increased new business income in workplace pensions, bulk annuities and protection. The fourth quarter result of £1.4 billion was largely supported by these same trends, as well as the net benefit from assumption changes and weather claims in Insurance.

Looking forward, leaving aside IFRS 17, we continue to expect other income to develop, depending upon customer activity levels and supported by our ongoing investments in the businesses.

To touch briefly on IFRS 17. As you know, IFRS 17 is an accounting change which impacts the phasing of profit recognition for insurance contracts, but not the cashflows. Under IFRS 17, new business income and associated costs, alongside most one-off assumption changes and some volatility, will now be deferred to a new Contractual Service Margin liability, termed the CSM. That is going to be on the balance sheet and these items will then be recognised over the period the service is provided, through the unwind of that liability. This will have a neutral longer-term impact on the Group's financial results, although near term reported other income is expected to be lower. If we applied this standard to 2022, other income would have been circa £500 million lower, although this impact includes larger than usual in-year assumption benefits. The run rate impact is likely to be closer to £300 to £400 million, as we have set out previously. There will also be impacts on below the line volatility items and TNAV from IFRS 17. I'll touch on TNAV shortly.

Moving on, the Group has maintained its focus on efficiency during 2022. Let me talk more about this on slide 24.

Operating costs of £8.8 billion are in line with guidance. This is up 6 per cent on the prior year, driven by planned investment and the costs associated with new businesses. Alongside, BAU costs were stable in the context of material inflationary pressures. Remediation costs of £255 million are significantly lower than prior year and reflect a number of pre-existing programmes. The charge of £166 million in Q4 includes £50 million for HBoS Reading. Our cost:income ratio for 2022, including Remediation, was 50.4 per cent.

Looking forward, we now expect 2023 operating costs to be around £9.1 billion. We are not immune from inflation but we maintain our rigorous approach to efficiency. Consequently, we will absorb a significant part of the incremental inflationary pressures in 2023, through increasing the targeted savings that we announced last year as Charlie discussed.

Looking now at impairment on slide 25.

Asset quality remains strong. We are seeing stable observed asset performance across the portfolios. The impairment charge for the year of £1.5 billion is equivalent to an asset quality ratio of 32 basis points, in line with guidance. This includes a £595 million net MES charge for the updated macroeconomic assumptions, alongside a £915 million underlying charge. The full year charge, pre MES, is equivalent to 20 basis points. The charge in the fourth quarter of £465 million includes £82 million for updated MES, driven by HPI reductions and a slightly weaker GDP outlook at Q4.

Pre MES, the quarterly charge of £383 million includes a long-standing single name Commercial charge. Excluding this would leave a quarterly asset quality ratio of 26 basis points. This includes the roll forward of the Stage 1 provision into a more adverse economic environment which, of course, does not represent actual defaults.

As a result of the provision build in the year, largely in the third quarter, our stock of ECLs has increased to £5.3 billion. It is worth noting in this context that our Stage 3 balances have remained flat during H2 and 93 per cent of our Stage 2 balances are up to date.

Based on the Group's Q4 macroeconomic scenarios, we now expect the net asset quality ratio for 2023 to be around 30 basis points.

As part of this discussion, I will now look briefly at the Group's Q4 economic assumptions on slide 26.

Our outlook as Charlie said is for a mild recession and continued low unemployment in the UK. We now assume base rate has peaked at 4 per cent and starts to fall early in 2024. That settles then at 3 per cent as inflation is brought under control. Unemployment is expected to peak at 5.3 per cent in 2025, while we assume an HPI decline of around 7 per cent this year. That implies a peak to trough fall of circa 12 per cent. As usual, we present the full set of economics and associated ECL provisions in our appendix. And as we progress into 2023, it may be that things are looking a little better, versus where we were at Q4. We will obviously keep an eye on that.

Moving on, I will now turn to slide 27 to look at our Retail portfolio.

Our Retail customers are resilient. The portfolio benefits from our low risk approach and conservative underwriting standards. Early warning indicators remain benign. While arrears trends in some areas have increased very slightly, they are doing so from a low base and they remain modest. Almost 70 per cent of our lending book is mortgages. Within this book, customer household incomes average £75 thousand and the average loan to value is 41.6 per cent. Only 1.4 per cent of balances have an LTV above 90 per cent. Customers have a lot of equity in their homes, protecting both the customers and the Group. Fixed rate mortgage maturities in 2023 have attracted a lot of attention. Over 85 per cent of our maturing customers have been affordability tested to rates of at least 6.6 per cent, well above current levels. Only around 1 per cent of our refinancing customers are on an LTV above 85 per cent.

Let me now turn to slide 28 and Commercial.

We are seeing significant resilience within our Commercial portfolio. We see stable SME overdraft and corporate revolving credit facility utilisation in the year. Average debtor days in our invoice financing business remain below historical levels. The Commercial portfolio has evolved in line with the Group's conservative risk appetite. Around 90 per cent of SME lending is secured while around 75 per cent of Commercial exposure is to investment grade clients. Our Commercial real estate exposure has been significantly de-risked in recent years. The portfolio has an average LTV of 41 per cent and 89 per cent have an LTV of 60 or below.

Moving on, I will turn to slide 29 to look briefly at the below the line items.

Following the reporting changes of a year ago, Restructuring now reflects only M&A and integration costs. The volatility line includes £148 million of negative insurance volatility, largely driven by the higher interest rates. This line also includes the usual fair value unwind and amortisation of purchased intangibles. Taken together, the statutory profit after tax of £5.6 billion and the return on tangible equity of 13.5 per cent represent, as said, a robust performance.

Looking forward and based on the guidance we have given, we expect the RoTE to be around 13 per cent in 2023.

I am now going to pause for a moment on tangible book value. As you can see, TNAV per share of 51.9 pence is down 5.6 pence in the year, although up 2.9 pence in Q4. In line with what we said at Q3 2021, the IFRS 17 accounting change is expected to result in a mid-single digit pence per share reduction in TNAV on implementation at the start of this year. Looking forward, the direction of tangible book value should be positive and should have momentum.

The IFRS17 impact will unwind into TNAV as the CSM unwinds. The negative movements in 2022, driven by interest rates reducing the cashflow hedge reserve, are expected to unwind in line with structural hedge maturities and rates movements. Furthermore, as we grow the business and the pension asset builds, TNAV will also benefit. And alongside, our practice of distributing any excess capital via buybacks will further support tangible book value per share. So, taken together, you can see that post IFRS 17, we anticipate material structural tailwinds to the TNAV to be realised over the coming years.

Now turning to slide 30 and looking at risk weighted assets and capital developments during the year.

Capital generation in 2022 of 245 basis points was strong. Underpinning this, RWAs of £211 billion were down £1 billion in the year, excluding the regulatory changes on 1 January 2022. Lending growth has been more than offset by model reductions reflecting underlying credit performance and ongoing portfolio optimisation.

Healthy banking profitability led the capital generation, supplemented by £400 million in dividends from the Insurance business. We also benefitted from impairment transitional relief and a lower than usual effective tax rate. Importantly, our strong capital generation enabled the Group to make significant pension contributions, including an additional £400 million at the end of Q4. Added together, the total of £2.2 billion of pension contributions this year puts us in a very good position for the latest actuarial valuation process.

The Group's capital position enables the Board to announce a final ordinary dividend of 1.6 pence per share, making a total of 2.4 pence, up 20 per cent on 2021. Alongside, a buyback programme of £2 billion means the Group will distribute a total of up to £3.6 billion, equivalent to greater than 10 per cent of our market cap. The closing CET1 ratio of 14.1 per cent is also very strong and ahead of our ongoing target of 13.5 per cent.

Looking forward, we expect capital generation of around 175 basis points in both 2023 and 2024. This is below the outcome in 2022, reflecting the exceptional benefits in that year, that I just mentioned. Nevertheless, it still represents a very healthy level of capital generation going forward.

And as shown today, the Board is fully committed to shareholder returns. We will maintain our progressive and sustainable ordinary dividend policy whilst considering excess capital distributions at each year end, just as we normally do.

Let me now bring this together on slide 31, where I will summarise our guidance.

The Group faces the future with confidence. For 2023 we now expect:

- The margin to be greater than 305 basis points;
- Operating costs to be around £9.1 billion;
- The asset quality ratio to be circa 30 basis points; and
- The return on tangible equity to be circa 13 per cent.

As mentioned, we also now expect capital generation of around 175 basis points in each of 2023 and 2024.

As Charlie mentioned, we are also today enhancing our medium term targets.

Based on both profit developments and expectations of a rising TNAV, as mentioned, we expect the return on tangible equity to be circa 13 per cent in 2024 and greater than 15 per cent by 2026. We have also enhanced our 2026 capital generation guidance to greater than 200 basis points.

Our revised guidance reflects the changing shape of the environment, the development of our plan and our financials. We expect to deliver higher levels of capital generation alongside ensuring lower other claims on our capital, including pensions. While staying focused on our purpose and our customer objectives, our updated guidance is positive news for shareholders.

That concludes my comments for today. Thank you very much indeed for listening.

I will now hand back to Charlie to wrap up before Q&A.

Charlie Nunn

Thanks, William. As you have heard, the Group delivered a strong performance in 2022. Our purpose-driven business and financial strength enabled the Group to provide significant support to customers and colleagues. Alongside, the Group's robust financial performance underpins our increased capital returns. Our strategy is reaffirmed as the best way to serve our purpose and support our stakeholders, as well as put the Group on a higher, more diversified growth trajectory. We have made a good start. Finally, we are enhancing our guidance over the short and medium term as we progress towards delivering higher and more sustainable returns for our shareholders.

That wraps up our comments for this morning. Thank you very much for listening. We now have plenty of time for Q&As. Let me hand over to Douglas who will coordinate the Q&A.

Question and Answer Session

Question 1 – Guy Stebbing, Exane BNP

Morning. Thanks for the presentation and thanks for taking my questions. A couple on net interest margin. First in terms of the net interest margin trajectory over the course of 2023. Thanks for the helpful comments in terms of stabilisation and never below 300 basis points. But if we think about the different building blocks, it does feel like the second half of the year should be fairly constructive. I say that because the hit you get from liability spreads compression maybe is more front-end loaded given when rate hikes came through. Mortgage spread churn, I think you talked about 8 basis points in the final quarter, I would assume that starts to get less over the course of the year. Whereas the structural hedge tailwind continues for the year and actually the maturity profile you talked to suggests it could be quite back-end loaded. So I just wondered whether it could be even slightly better than stable once we have rebased over the first half of the year as we think about Q3 and Q4, or am I getting too optimistic in some of my assumptions around that?

And then secondly still on margin, just in terms of how we should think about deposit moves and the structural hedge notional. There was quite a big deposit reduction in the fourth quarter but it was driven by Commercial deposits, un-hedged deposits. So in terms of what you are seeing today in terms of what you expect to see in the next few months, how are you thinking about the hedgeable deposit component and the experience to date, is there anything there that is surprising you in terms of customer behaviour? Thank you.

William Chalmers

Thank you Guy for the questions. In terms of the margin first of all, and then I will come to structural hedge, a couple of points. First of all, bear in mind that our margin guidance is built upon our macroeconomic assumptions. So that is a start point and I think that is an important point perhaps to make.

Secondly just to lead into your building blocks Guy, as we see the margin over the course of the year, we move from a 294 basis point margin for the whole of 2022, an exit margin of 322 basis points in the course of Q4, to margin guidance of greater than 305 basis points for 2023. What is going on there? It is essentially a series of headwinds and a series of tailwinds that we have built into that margin guidance. If I take each one in turn. The headwinds that we see are fewer base rate increases per my macroeconomic comment just now over the course of the year. That in turn leads us to have lesser lag benefits versus what we have seen, particularly at the back half of 2022. Likewise, we do expect to see a certain amount of turnover in terms of PCAs rebalancing into savings accounts as effectively depositors seek high yielding returns. We've planned for that in the context of our margin. Alongside of that you mentioned the mortgage headwind. The mortgage headwind is quite significant during the course of this year. It is also quite significant during the course of next year, so 2023 and 2024. We do think that once we are past that we have got past the mortgage headwind and at that point you start to see the effects of that. But for 2023 and 2024 the mortgage headwind is quite considerable off the back of the very attractive rate business that we wrote now coming to the end of two year fixes and therefore revolving into mortgage margin, which as you know are much lower now than they were then.

There are one or two other factors going on including increased costs of funding on the wholesale side in particular. That will also act as marginal headwinds. But, then the main tailwind that we see during the course of 2023 is, as you identified, the structural hedge. We have got about £35 billion of maturities this year, but most of that is back end loaded i.e. it goes on in Q3 and Q4 of the year. What that means for the margin is that we expect the margin to be actually pretty healthy in Q1. But we expect these headwinds and tailwinds to play out very much in the course of Q2 and therefore to land in a pretty sustainable place for Q2, Q3 and Q4 through the course of 2023, in line with my comments earlier on about not falling below the 300 basis points mark. So that is how we see it playing out. What do we see as the dynamic within that? Again I would just stress the macroeconomic assumptions that we are making in that context. I would also just, before moving on, make the point that I think your dynamics as you see them unfolding, Guy, are right, but I think they are possibly playing themselves out over a slightly longer time frame versus the way that you are articulating it. So that is hopefully helpful.

Structural hedge. The structural hedge is interesting. Deposit outflows part of that question, I suppose just to put a bit of high level context on this. When we look at the deposit book we have got £475 billion of deposits and we saw £1 billion of outflows during the year. I realise this is about a Q4 discussion rather than a full year discussion, but nonetheless it is important, I think, just to bear that context in mind. £1 billion of outflows off the back of the £475 billion book. But the story as you rightly identify is about what happened within Q4 and how much should we be troubled by that or challenged by that. We saw deposit outflows of £9 billion in Q4. That was split between Commercial Banking of £6.4 billion and Retail outflows of about £1.7 billion. What went on there? First of all Commercial outflows which is the big number within that £9 billion. Three things essentially, one is we flagged at Q3 that we expected to see short-term placements come out of the system in the course of Q4. And indeed that is what we saw. It was pretty much in line with our expectations. The second is that we managed the Commercial book just as we do all books really, in a commercial way. That is to say management pricing actions are part of the story and so we saw some particularly rate sensitive deposits that were less valuable to us leave the book during that time.

And then finally we saw an element of seasonality, to an extent clients managing year-end balances. Now relating that to the structural hedge, none of that Commercial balance outflow was really structural hedge eligible. So from a structural hedge point of view we don't see that as necessarily much of a challenge. The Retail side of the equation, overall we saw a slight outflow in Q4 from PCAs at £1.7 billion. Notionally that should be structural hedge eligible, but the vast majority of outflows as you can tell during that Q4 period are not related to the structural hedge. Looking forward, as you know, the structural hedge currently stands at £255 billion. We felt very comfortable about our £30 billion buffer in Q4. We decided actually to take £5 billion out of that and put that into the structural hedge, so it is now £255 billion. As we look forward we see deposit flows, again a little movement from PCAs into savings, as savers seek better returns. But equally we think our offers will attract both new and existing money within the savings accounts. So I think we see deposits being flat to modestly up during the year and again that gives us some comfort about where we are with the structural hedge.

Question 2 – Omar Keenan, Credit Suisse
Hi, good morning, everybody. Thank you for taking the questions. I just had a question about how you are thinking about deposit costs going up. You mentioned the lagged impact from the Bank of England rate changes and we saw the start of deposit migration in October and November. And I guess we are trying to model something that we haven't really seen play out yet and it took us a couple of years to get to where we are. But then rates have never gone up so quickly. So I was wondering if you could help us think about how you have thought about deposit migration, how you know quickly you think that will happen, to what extent? I just wonder how you arrive at those assumptions? So I would love to know what you are assuming and how you have assumed it?

And then just secondly is it possible to give us a year-end position on the pension deficit, if it has been updated or you have a rough estimate? Thank you.

Charlie Nunn
Thanks Omar. Let me take the first one, and it is great question because as you say this economy in the last twenty years hasn't been through this kind of a rate cycle. We talked last year about our view on this which was partly informed by obviously the UK but also what I have seen in other rate cycles and at this stage we think it is playing out very in line with what we discussed last year. But let me just give you the outline and then you can see if there is follow-up.

The first thing we talked about is normally you see certainly on individuals, commercials and businesses are slightly different but the core of our balance sheet and our structural hedge as you know is underpinned by our Retail customers. They become more price sensitive in a rate rising environment around the 2.5-3 per cent and actually that is exactly what we saw and we talked about last year, that the vast majority of our customers by number, not by value, have actually really quite small deposits and savings balances and so the real sensitivity doesn't kick in until about a 3 per cent base rate. And that is what we saw happening in Q4 last year, there was more sensitivity in customers looking for value on their savings with us, but also switching between different financial services providers.

The second thing we said, and this is certainly how we think about it, as we get deeper into the rate cycle we would be thinking about a 50 per cent pass through. Now I know that is a very blended set of assumptions, that includes churn out of current accounts at almost zero percent rates as well as customers putting money into time deposits and various saving building products that for us as you know will pay 3-5 per cent so there is a set of assumptions around churn where customers are putting their money and what the rates are. But we still think, actually, that is the right way of thinking about this. Our experience is that takes a few years and if you think that in our baseline assumptions rates are peaking now at 4 per cent and we are stabilising at about 3 per cent in 2024. That 50 per cent pass through, the rebalancing customers placing their money in the right place, will happen with that kind of 3 per cent target. So when we think about a 50 per cent pass through that is where we are looking at. And we think that will continue to play out through 2023 and 2024. And certainly that is the foundation of our assumptions. Obviously it is incredibly dynamic market, it is competitive, as you know, in the UK as in other markets and we don't have recent history. But actually at this stage we feel really confident it is playing out as we expected and we have the tools to be able compete for Retail and Commercial deposits as we go through this next period of time.

Omar Keenan
If I just took that right, it is a cumulative 50 per cent pass through playing out over two years?

Charlie
With a landing point of 3 per cent base rates, which is our assumption at the moment.

Omar Keenan
Yeah understood thank you.

William Chalmers
Omar you asked about pensions as well, just before we move on. In short, the expectation for the pension deficit at the end of 2022, which as you know is the final year of the triennial when we negotiate. We do not have a certain number for that right now. It is being finalised but our expectation is that it comes in south of £2 billion. That is off the back of considerable contributions, as you know, over the course of the last two or three years including around £2.25 billion in 2022. It is off the back of asset performance, off the back of the rate changes that we have seen. But again we are very confident that it comes in below £2 billion. What does that mean? That means that while we expect to continue to pay about an £800 million fixed contribution during the course of 2023, just as we did in 2022 and the years before that, we are very hopeful that we will not have to pay any further variable contributions including in 2023.

Omar Keenan
Okay, thank you.

Question 3 – Raul Sinha, JPMorgan
Hi, good morning it is Raul Sinha from JP Morgan. Thanks very much. Can I have two questions as well please. The first one, obviously when we look at the net interest margin progression in Q4, the structural hedge, tailwind of 8 basis points was completely offset by the mortgage margin compression. And looking at the asset side of the balance sheet I can't help being worried about the pace at which you are seeing some of these trends play through. So if you look at your mortgage book, the back book churn is 25 per cent. Can you talk to us a little bit about what you expect there going forward. When we look at a completion margin it was only averaging 50 basis points and if we look at some of the pricing trends so far in Q1, I mean there is a Halifax product which is only 20 basis points above the five year swap rate. So it looks like the asset spread compression might actually get worse. So if you can talk to us a little bit about how you expect the pressure from the asset side to evolve this year that would be really helpful.

I guess the second question is around what you expect your deposit balances to be this year in terms of outflows. So I appreciate they are only down £1 billion last year and obviously some of the outflow in Q4 on the PCA side was surprising but in terms of the decision not to guide to a change in the hedge balances going forward which one of your competitors did, what assumption are you making about your deposit balances? Thank you.

William Chalmers
Raul thanks very much indeed for the questions. First of all the way the mortgage book is playing out, the refinancing of the mortgage book is not really a surprise. I think we flagged it quite well last year and indeed through the course of 2022. So the way that is playing out is not a surprise in the sense that we took a lot of products that were at margins of anywhere between 150 to 200 basis points written during the course of again 2019, 2020 to a degree 2021 which is refinancing in the context of spreads that are, as we discussed today, 50 basis points on average. Q4 I will come back to that in a little more detail. But nonetheless the thematic of that unwind is not a surprise. I think what is slightly accentuated versus when we sat here last February is completion margins are below our 75 to 100 basis points range and so it is refinancing into a slightly tougher yield environment on mortgages. And that is true. And we talked last year about a mortgage headwind of somewhere between £1 to 2 billion playing out over the course of a couple of years. That number now looks a shade above £2 billion as we play out in 2023 and 2024. So you can see circa £1 billion a year by way of illustration. Now having said that, that is all firmly embedded in the margin guidance that we have given including the fact that we are assuming, working on an assumption, of less than the 75-100 basis points in our mortgage completion margin expectations for the remainder of this year and going into next, so that is baked into the greater than 305 margin basis points guidance that we have given.

You asked about back book churn within that. Yes we have seen back book churn starting to accelerate but two points to bear in mind. One is it is very natural to expect some of that in the context of the rising rate environment. You do indeed get some customers who want to refinance onto new fixed rate deals and indeed we are playing our part in encouraging that via communications to those customers and indeed facilitating product transfers. So we are very much staying in that relationship and you know we see it as part of our customer duty to ensure that customers are aware of and able to switch where they see it as appropriate. So that back book churn has increased as a percentage.

The second point I was going to make there Raul is part of the reason why it has increased as a percentage is the denominator. In some cases the balances being refinanced are not changing that much. What you are getting is a lower and lower denominator, the back book is shrinking in size so a given chunk of refinancing represents a bigger percentage of that size. As a result you are seeing a little bit of an uptick in terms of refinancing loans but not as much as the percentage numbers might sometimes suggest.

So that is going on, again that is expected and in some respects it is welcome and we seek to remain in those customer relationships and more importantly it is built into the margin guidance that we have given you.

You asked about completion margins, 50 basis points in Q4. There is quite a dynamic going on there that is worth spending a moment on. During the course of October we, as the biggest UK mortgage lender, stayed in the market. We stayed in the market at a time when many of our competitors came out of the market. We felt that it was our duty to still be there. As a result we were operating in an environment of highly volatile and elevated swaps levels compressing mortgage margins. Because of our competitors coming out of the market we also took quite significant volumes here in that time. What that meant was that if you look at the overall completion margin within Q4 you have got an outsize contribution from that October event. But the spread of new business margins, in particular in November and December, were much more favourable. The trouble was as you know that volumes were much lower during that time. So our overall 50 basis points for Q4 includes an outsized contribution from October but then lower contributions at much more favourable margins in November and December. And as we see that dynamic evolve into the first part of this year, Raul, we are seeing new business application margins in the 80 basis point type levels that have been talked about in the market. So we are seeing a favourable development of new business application margins in the course of: A) the last couple of months of Q4 and B) first month of this year.

The final point that I add on there is that at the same time we have, because we have a big fixed rate book maturing, quite a lot of product transfer opportunities coming along. We see those product transfer customers, customers that we know, decent asset quality, opportunity to extend the relationship, we are prepared to take a slightly lower margin off the back of that customer product transfer opportunity because of those factors. And that will influence our margin a little bit over the course of the year and again that is partly responsible for our margin expectation being below that 75-100 basis points corridor. We want to stay in with those customers that are product transferring because we think they are good customers and so we will.

Overall, that is what completes the kind of mortgage margin picture. The other point I would add to that is we do expect some growth in unsecured balances this year. We do expect some growth in unsecured balances next year too. And that starts to play into the margin, less so this year to be clear, more so in 2024. But that does start to have an effect so it completes your asset side picture.

On deposit balances I will make one brief comment, Charlie may wish to add. You asked essentially what are the background assumptions on deposit balances? Essentially flat to modestly up. That is if you net off PCAs migrating somewhat to savings, rate benefits being sort after by customers, offset by savings offers. And then within Commercial probably a little bit of tracking down within BB and SME, but equally as we build transaction banking in other areas within CIB, a bit of tracking up. So again flat to modestly up within deposits which then informs the structural hedge stance.

Charlie Nunn
So the only thing I will build is an optimistic strategic view which you have got used to listening to from me. But hopefully what you can see through these tailwinds and headwinds. And then the question on asset pricing in 2023 to 2024, I know it is complex. We have got a set of legacy and higher price mortgage businesses repricing which I think has been a nervousness in the market for a long time around how does Lloyds weather through that. We think we will be largely through that through this period of time. We think we are competing and showing we can compete and be resilient around the liability side of the business which enables us to build the structural hedge which becomes this engine of growth as William talked into 2024, 2025 and 2026. So that gives us real resilience and a cleaning up on the legacy mortgage business if I can use that language. We then have these strategic initiatives we are remaining committed to layering on additional income growth for Lloyds Banking Group which is why we are generating stronger capital and cash distribution. And then at the same time the £7 billion pension deficit we had in 2019 we think will be largely through this period as well, subject to the triennial discussion with our trustees, which means the capital we do generate is more available for our Board to talk about distributions. And if you look at that dynamic collectively we are really building a strong engine of strong cash and potential for cash distributions to shareholders that is very resilient when you then look forward on the balance sheet in the economic conditions we are looking at.

Raul Sinha
Thank you.

Question 4 – Rohith Chandra-Rajan, BoA
Thanks, good morning, it's Rohith Chandra-Rajan, Bank of America. A couple of quick follow-ups please if we could. Just quickly to follow-up on the mortgage discussion. On back book attritions, so that was £10 billion in the second half of 2022. How do you expect that to evolve going forward?

And then the second one was just on the pension contributions. So William I think you said you expect the £0.8 billion fixed contribution to continue and you have got nothing in for the variable contribution. Does that include the final distributions for 2022 which we paid in 2023? And is all of that reflected in 175 basis points capital generation?

William Chalmers
Yeah thanks Rohith. First of all on the back book we have got about £48 billion or so of back book left now. We are seeing refinancing of between £4 to 5 billion per quarter. I mentioned that although the percentage of 25 per cent maybe ticking up that is because the £4 to 5 billion is staying steady and the denominator is declining in size. So that is what is going on there. I think Rohith as we look forward I don't think we see terribly many changes in that. I think we will expect to see a similar kind of pattern as we roll forward into 2023, of about the same rate in absolute terms which might mean a slightly higher rate in percentage terms. You know as I say, fair enough because we see those customers as in some cases having very low balances, happy to stick with where they are, value the ease with which they can give and take with respect to the SVR. Other customers want to switch into fix and we will be there to help them where they do. So hopefully that addresses that point.

On the pension contribution as you say £0.8 billion fixed contribution we're expecting this year, that is before you get to our 175 basis points guidance. That is already assumed in our run rate P&L if you like, 175 basis points is on top of that. As you say, zero variable rate is our expectation. Now as Charlie has pointed out and we must not forget this, we have yet to finalise negotiations with the trustees. But we have fairly frequent conversations with the trustees and we hope that that will result in the outcome that I have described. So that is our expectation.

In terms of what effect if any, are there any other impacts on the 175 basis points capital from the pensions issue? None. The £442 million that we put in at the tail end of last year was out of the capital that we generated in 2022, not out of the capital that we will be generating in 2023. So the circa 175 basis points is after all of what we have done in terms of the £2.25 billion that we have put in, in 2022, when we start again. And as I say the £800 million is already deducted before you get to that 175 basis points.

Rohith Chandra-Rajan
Thank you.

Question 5 – Jonathan Pierce, Numis (online)
Obviously lots of sizeable TNAV tailwinds this year. Can you comment on whether in aggregate you think consensus TNAV of 52p at December 2023 is about right or whether your RoTE guidance is struck on a different denominator to the market?

William Chalmers
Yeah thanks Jonathan. We deliberately spent a bit of time on TNAV in the comments that I made as you can tell. What do we see during the course of 2022? A number of factors, the build up from attributable profit of course which was welcome. But at the same time the pension surplus slightly changing shape hit it. The cash flow has reserve declining i.e going to negative territory off the back of rising rates, again hit it. When you add to that the impact of dividends and other distributions, there was a further impact again on TNAV. You then get the start point being adjusted by IFR17. So that is the start point which we haven't given precise numbers on the IFRS17 today but you can get the direction I think from the appendices to the presentation that we put out. If you look at a start point around the 46-47p type territory. We then see significant builds from the factors that I mentioned earlier on. The adjustment in rates starts to lift the cash flow hedge reserve. The business growth that we expect to see starts to build capital within the business, again lifts in the cash flow hedge reserve. The pension surplus builds. Likewise the buyback when we distribute excess capital will build the TNAV per share. Those factors are going to lead, as I said in my comments, to positive and material developments within TNAV. And although I am not going to comment on consensus in quite the way that Jonathan would like, we are putting the comments into my script on TNAV for a reason. It is not necessarily going to make up all the difference between what some people see as consensus RoTE and what we are projecting for 2023 to be clear. But nonetheless it closes some of the gap and so we are putting TNAV comments in for a reason.

Question 6 – Andrew Coombs, Citi (online)
You guide to the RoTE improving from 13 per cent in 2024 to greater than 15 per cent in 2026 even though rates are widely expected to decline during this period. How do you rationalise this and what are your base rate assumptions?

William Chalmers
Thank you for the question. What do we see as happening as we go forward into 2026? A couple of points. One is our assumptions on the macro are as laid out. Some will have a different view of rates to us in particular, that is probably the one that I would draw attention to. Having said that as I said in my comments earlier on, compared to the data that we had when we struck the economic

assumptions at Q4, the data that we have had in since then during the course of January has been a little bit more positive than a general macro level. Let's see how that plays out but that has probably being the trend of things so far.

Going into 2026 specifically what happens, again we have given our macro assumptions. What is going on there at an income level is that some of the headwinds that we see, particularly to net interest income are exhausting themselves. We talked a lot today about the mortgage margin for example or the mortgage pressure on the refinancing of the mortgage book. That plays itself out by the time it gets to the back-end of 2024.

The second big factor that is happening through the course of the next couple of years and continues to build is the refinancing of the structural hedge. We have £35 billion of maturities in the structural hedge in 2023, we have £41 billion of maturities in the structural hedge in 2024. We then have ongoing maturities of the structural hedge well into the £40 billions in the years thereafter. The cumulative impact of that and our net interest income is considerable and it doesn't much matter whether rates are 2.75 per cent or 3.25 per cent. Whatever they might be at that year it is still considerable because the current yield that we get on the structural hedge is 1.13 per cent. It does not take much to build in considerable tailwinds to your income developments in the years thereafter. And as you get close to 2026 they will become increasingly powerful.

What else is playing itself out? Again we get headwinds in the next couple of years like operating lease depreciation for example. The way in which the Lex fleet builds, the way in which used car prices come a little lower than what they have been in the last couple of years. That plays itself out by the time it gets to 2024, 2025, 2026. And then we see the cost base developing in a similar sort of way to the way that we described to you before. That is to say that we passed our investment peak number one. We see the benefit of some of the strategic investments cost saves playing themselves through, number two. And allied to the BAU cost savings that we see, we see operating leverage within the business rise. By which I mean those positive income trends allied to some of the savings that we are continuing to make on an ongoing basis within the cost base, starts to build significant operating leverage within the business. That gives us high conviction in the expectation that RoTE in 2025 starts to build to the excess of 15 per cent that we have portrayed by 2026. So hopefully that answers the question.

Charlie Nunn
The only build, because it is exactly the right question, it is what I was trying to get to when you look at the underlying engines playing through the balance sheet and in the business, is obviously if you look at Lloyds Banking Group in 2018 when there were zero per cent rates basically with the Bank of England, we were near 300 basis points of return on our NIM at that stage. So we really do have a balance sheet and a customer franchise that can sustain healthy returns and then when you overlay the dynamics that William just looked on and that is why we have the confidence about the 2026 go forward position.

Question 7 - **Aman Rakkar, Barclays**
Thank you very much it is Aman Rakkar from Barclays. Sorry to labour the discussion around NIM. Your colour around the mortgage margins is really, really helpful in terms of what took place in Q4. But presumably that is going to play out in the NIM that you print in Q1. Your suggestion and some of your comments was that the Q1 NIM is going to be pretty firm which makes sense given you have got the residual effect of base rate hikes. So I think your guidance probably suggests something like a 20 basis point step off in NIM in Q2. You know maybe 15 to 20 basis points to kind of sustain the full year guidance that you are pointing to. Can you confirm that kind of quantum step off and can you help us just apportion exactly what is coming from mortgages versus the deposit catch up? I think we need some more detail about exactly what you are assuming in Q2 in terms of mortgage maturities, in terms of a catch up on deposit costs and mix because it is a really quite a remarkable step off in the NIM.

William Chalmers
Yeah. Aman I am going to be able to partly answer that question for you and partly not answer it for you I am afraid. So what do we see going on during that time? I portrayed the main factors - the puts and takes over the course of the year. It is the case that we have already made some pricing decisions in terms of pass on to depositors that have been announced but not yet impacting the margin. They will play their way through during the course of Q1 but particularly during the course of Q2. As you start to get full quarterly effects as opposed to partial effects. That is a big part of it playing out.

Second part, when you look at the mortgage roll-off, the impact of the mortgage roll-off depends upon the particular cohort that has been refinanced any given moment. If you look at the mortgage roll-off in Q4 it was around 1.55 per cent yield for that cohort. If you look at it in Q1 and Q2 of next year it is looking more like 1.8 per cent. So the particular cohort that you are refinancing at any given time makes quite a big difference on the margin dynamic within that quarter.

What else is going on? It really just is again the macroeconomics that we have portrayed there. If you don't get the base rate changes in quite the way that we have played them out or rather put it another way you get base rate changes that exceed those that we have played out, you are going to see that make a difference on the NIM. That will reintroduce some of the factors that we saw during the tail end of last year. So overall I am not going to give you a precise number for how it is going to roll off from Q1 into Q2, Aman, but you get the inputs to that point. Pricing changes, mortgage cohort refinancing, macroeconomic changes. They play their way through and yes there is a solid step off between Q1 to Q2. Precisely what that will be depends upon how things play out including the current price in the market. What will mortgage spreads be as we refinance a large part of the book? As said new business applications are looking pretty good but we also want to maintain product transfer share. So there is a lot of variables at play here, but a solid drop off between Q1 and Q2 I think is a fair expectation.

Charlie Nunn
And William, just because I know you said earlier, then the fact that the structural hedge is delayed until the second half in terms of the positive impact that will have. So that is why we think there is stability and resilience in the back end of the year as William had said previously.

Aman Rakkar
Thank you so much. Can I just get a second on the £2.5 billion legacy book exit. Two questions, what kind of impact should that have on things like NIM for example that we should be thinking about?

The second is that looks like a de-risking strategy around risk-weight inflation under stress. Why are you doing that? Are you worried about the impact of the stress test on, you know, the PRA buffer or your target capital ratio, why are you doing it?

William Chalmers
It is a good question Aman. It is worth putting in the context of the overall way in which we manage capital within business. When we look at what assets we finance on the balance sheet versus what assets we finance off the balance sheet, there are occasionally opportunities to grab value from taking assets off the balance sheet and refinancing them into the capital markets. That is a practice which as you know we have long undertaken within the Commercial business as we sought to manage what we described before as the tail of the Commercial business. Are there ways in which we can enhance value for the business and ultimately shareholders by taking business into the capital markets versus financing it with all of the regulatory capital charges that we get on balance sheet. Same analysis applies to the mortgage book. Where we see a piece of the mortgage book that is unduly penalised by regulatory capital charges there are going to be cheaper ways of financing that mortgage book by taking it to the market. And that is essentially what we did with the legacy book of £2.5 billion that you described. We were very pleased with it because essentially it is a NPV positive transaction from our perspective, it creates value for our shareholders. It also has the side benefit of lightening up on our ACS charges next year. It is not a huge book so it is not going to be huge in its impact, but this is a book that soaks up quite a lot stress capital in the context of the PRA ACS exercise. Getting it off our balance sheets at the margin is helpful.

Question 8 – Ed Firth, KBW
Hi it is Ed Firth here from KBW. I just have two questions, one was a detail question. I noticed your Stage 3 balances in the SME book were down a lot in the quarter. I just wondered if you could just highlight what was driving?

And the second question is, it seems sort of strange I guess at the moment but I would like to ask about costs and in particular flat BAU costs. And I am just wondering how comfortable you are that that is good enough. And I guess the background is we have rather lost sight of the digital new entrants over the last year as everybody has made a fortune on NII. But you know they are still banging away in the background and they are talking 30-40 per cent returns on equity. They are all massively deposit long. They are all now producing some pretty extraordinary offers and delivering off margins that I suspect you would really struggle to compete with. So I am just wondering how comfortable are you over the next three to four years? One of the problems we are having on deposit pricing is actually the massive new entrance with cost bases that are way lower than yours?

William Chalmers
Sure thank you Ed. Stage 3 balances first of all Ed and then I will talk briefly about the cost base before handing over to Charlie on the competition point. Stage 3 balances as you know have been very consistent actually through the course of the year. So Stage 3 balances we had £10.75 billion at the end of the year, that is versus £11.4 billion, or thereabouts, in September. Interestingly enough Stage 3 balances therefore going down during this time. And actually if you look back at them after the 1 January 2022 adjustments, they have been stable right the way through the year. If anything they have been coming down through the course of the year in its totality across all the businesses. So we are pleased with the performance of the book and Stage 3 balances are testimony to that point. There is a broader point around performance of the book as a whole which as you

know we took about a £1.5 billion charge during the year. About £595 million of that was a net MES charge about £915 million was underlying. And that underlying also being influenced by things like Stage 1 roles as I mentioned in my comment earlier on.

So the reason I say that is just to reinforce the point that the underlying performance of the book across all of the Retail and Commercial aspects of it has been very benign during the course of the year and we have been very pleased with it so far. Albeit, we clearly have to remain vigilant in the context of the toughening economic environment.

On SME in particular that has been subject to those same trends Ed, there has been a similar pattern within overall SME performance. So far it has been pretty good. I mentioned in my comments the things like invoice financing, debtor days, for example have been very stable with use of overdrafts, revolving credit facilities, likewise. It has all been pretty benign. The other bit of noise if you like that we get within the SME business when you look at Stage 1, Stage 2, Stage 3 is bounce back loans. Those are sometimes responsible for slightly different numbers than you might first expect. It is still categorised according to the accounting stages albeit we don't incur the loss clearly if a bounce back loan does go bad. So that maybe behind your question.

On the cost point, just very briefly, when we look at the cost base for 2023 we put forward £9.1 billion, 2024 £9.2 billion. As you know that is about £400 million in excess of what we said in February of last year which was £8.8 billion. What have we seen there? We built into our budgets cost increase expectations of around £300 million over that time. We think we are going to get closer to £900 million to a billion. That is about £600 million in excess of what we expected, i.e. the difference between £900 million and £300 million. We are going to be offsetting that about £200 million of that, we are going to be taking and absorbing about £200 million of that. That is the £1.2 billion that Charlie referred to in his comments. But we are going to let about £400 million flow through. We actually think that is pretty good in the context of the inflationary pressures that we absorbed in 2022 we are going to up our savings again a further £200 million to offset a material amount of the inflation that we expect to see. And I think it is testimony to the discipline within the Group and the efforts and the cost savings that we see in BAU and the strategic initiatives.

Charlie Nunn

Great, let me come to the strategic question. First of all thank you for non NIM rate cycle question, it is great to get it. I think it is good to point us back to that. And so just a couple of thoughts because I think this is discussion we are going to continue to have all the way through the next few years together. But I think it is right, the fintechs and the neobanks do have that lower cost point.

A couple of thoughts from my side. Firstly, interestingly through the last six months and then as we look forward there has always been smaller players actually the building societies and smaller banks and now some of the fintechs that have been, they have needed to look at higher rates to attract the funding. That is not the biggest area we see our customers going actually. They are still choosing between the big high street banks when we look at the big volumes. That is not to be complacent, but just when you look at the competitive dynamic if customers were really chasing with their money higher rates they would have already been going to an alternative provider even in the last 12 or 18 months. And as you know the vast majority of our customers only have £1,000 to £5,000. So that is the first thing I think is important which is in terms of savings and rates. They aren't our biggest competitor today but we certainly need to continue to stay focused on them.

And the second thing is you just need to unpack our businesses a bit and where we make money and I think there are two businesses where I think what you are laying out we agree is where there is a really strong focus around building more digital engagement and efficiency and I will give you that in a second. But there are other businesses that are quite different. Let me give you two examples. Our asset businesses, so mortgages, cards, loans and the transport business, which is where you know over the last decade the majority of the economic profit in the industry has been. 80 per cent plus up to 100 per cent of those products are distributed through third parties. They are not to relationship bank customers. The basis for competition there isn't about the fintech game and in fact the fintechs actually don't really participate in that. And interestingly when the rate cycle comes back the other way which we all need to be thinking about and with my circa £800 billion pound balance sheet I am worrying as much about the next rate cycle as I am this one. You know that is how you build sustainability of returns.

Similarly on our Corporate Institutional Banking business which we think we are seeing good early momentum around and we think can be very creative. Again it is not really a cost:income game that they can compete in. I think the two businesses which is where the strategic focus there has been very focused in our strategy is around our core relationship brands and in our SME business. And that is really where the fintechs, the kind of ones you are talking about, have been focused. The great news is we have the biggest digital bank in the UK. Our digital engagement is growing faster than anyone else is. And today we have a breadth of products and an ability to serve customers at scale that no one else does. The challenge is the one you have laid out which is the fintechs are coming with a different operating cost model. How that plays out over the next few years we are very, very focused on it. From my perspective the efficiency and where we really build propositions for parts of the market that want a digital only service, we absolutely have within our strategy building out those service models. It doesn't fully answer your question because we could spend the rest of the morning talking about it, but I don't know if that helps. I certainly though think you need to unbundle the big asset businesses on the retail side from the relationship banking, transactional banking, businesses. And then the other parts of our business model that really generates through cycle returns. And think at the other side of the rate cycle for those businesses. But thanks for the question, that was nice.

Question 9 - Chris Cant, Autonomous
Good morning it is Chris Cant from Autonomous, thanks for taking the questions. One quick point of detail and then another one thinking about your 2026 RoTE please. So could you just give us a sense of within your non-SVR mortgage book how much is 2 year versus 5 year, just so that we can think a little bit more about how that book churn progresses from a volume perspective. You made a comment about the variable NIM but just in terms of volumes, that would be helpful.

And then on the 2026 I guess your future gazing a little bit there in terms of how the broad deposit trends play out in a higher rate environment. If I think back to pre-financial crisis about 4-5 per cent of system deposits would have been non-interest bearing, and it is now about 19-20 per cent. What are you assuming there in terms of where that might get back down to with a structurally 3-4 per cent base rate environment? I am just trying to think about how much hedge attrition you might be baking into your 2026?

And on a related point you talked about sub 75 basis points mortgage spreads for 2023. Again if I think back to pre-financial crisis when we would have had a similar liability margin environment, spreads would have been 20-25 basis points and I appreciate the years immediately pre-financial crisis were quite competitive, but why wouldn't we get back down to those kinds of levels if yourselves and other large institutions are expecting to deliver well into the teens returns? Thanks.

Charlie Nunn
Great let me have a go at the second one, and then William you can back fill when I don't fully answer it. It is a great question again and also there is a bit of crystal ball gazing as you say. And then I think the data is helpful for 4-5 per cent current accounts versus where we are now in the industry around 20 per cent. It is one of the things we have been looking at. I think the first thing that will play out over time, that kind of change and that is what we say pre-crisis in other markets where they had been through interest cycles. I am not going to give you the exact percentages we built within the plan if that is alright Chris, but I will tell you how we think about it. The second thing is typically what I see is how sharp people get around only retaining the minimum in a current account versus using alternative savings is partly linked to inflation and of course what you have seen in our base rate assumptions is we do get back down to a 2 per cent inflation level which means that people with meaningful savings aren't seeing a level of deterioration that they felt at the moment or last quarter and that is really important when you look at consumer behaviour where the vast majority of consumers, not by value but by number, are operating in pretty thin transactional accounts relative to their spending. So whether we get exactly back down to the 4-5 per cent I don't know because we can't crystal ball gaze. Our assertion would be it would take a number of years and it would really depend on how inflation played out and how people thought about their savings and/or investments being affected by inflation. When you get to that stage by the way the maturity around how you can help customers around getting a return that does defend their savings and or investments, and also our strategic investment in our investments capability, becomes really important. There is an interesting dynamic where investments returns which are in the 50 basis points level start to become attractive to encourage people to put money into simple investments relative to deposits. So there is a whole broader spectrum or way of competing. I think it is a good way of looking at the market but I think it is a few years out and based on the economics I would be surprised if we get to that place.

On your question on mortgage margins my guess is we all spend a lot of time in that 2005 to 2007 period. The dynamics are really very different as you know. And I think structurally there are some differences post the financial crisis. Not least the model of originating to distribute the mortgage portfolios and not worrying about the capital costs. And then the regulatory implications around how you have to manage funding and the duration mismatch on interest rates is all very, very different today. So I think it is a structurally different kind of set of economics around the mortgage businesses. And as you know one of the consequences of that is the customer base, along with the growing house price market, has really changed. And I know it is an average and I hate averages, I always tell you I hate averages but I am going to give you an average. The fact that the average mortgage customer at Lloyds Banking Group has an income of £75 thousand and obviously the LTV is now down at 41 per cent. And you can see in the appendix, we give you the 2010 data around the LTVs in the mortgage portfolio versus our 1.3 per cent above 90 per cent today. It is a radically, radically different market. So we have a clear view as will all the other providers in the UK around what level you can sustainably provide through cycle returns for mortgage customers. I think the 2005 to 2007 period is materially different and would be hard to repeat going forward. However the question around how does competition play out and how do we compete, you know William has talked about how we are thinking about it in this period.

The other dynamic is if you are in 2026, if you have a view that rates are now coming down you then start to have a really important discussion around which balance sheets and which organisations are best placed to deal with a lowering rates environment. And as you know to really deal with that you need balance between assets and liabilities. You need a good mix of assets. You need to participate meaningfully in consumer finance otherwise you are not going to be able to generate the spreads in a lower income environment. And you need to have strong risk management and capital management discipline. So you will have a view around that between the different institutions in the UK, but that is why we have confidence when we look at 2026 and beyond.

William Chalmers
Chris, just one point to add to Charlie's comment there and then just to give you some further guidance on the five year, two year point that you mentioned. One of the factors that we are looking at closely right now is to what extent inflation has an impact upon the overall balances that we have within the Bank, both on the current account and also on the savings side. So to what extent does that come through in terms of payments, salary cheques for example, what is the lasting effect of that upon the balances? Alongside of that and the higher interest rate environment you obviously get the benefit of that building into balances too. But then finally post Covid in particular, what is the nature of people's precautionary balances in the banks? We do think that is systemically higher than it used to be, but it is at the moment a question that we are trying to figure out within the business as to what does it actually mean and how does it play through?

Just separately Chris you asked about the five year two year. I think it is 60 per cent five year and then about 40 per cent two and three year.

Chris Cant
Thank you.

Question 10 - Ben Toms, RBC
Morning, it is Ben Toms from RBC. Firstly on other income. If I take your Q4 number deduct out the one-off, and deduct out a quarter of the IFRS17 headwind that you flagged and then put that into future years grinding 2-3 per cent higher as you go through the years. Is that the right way to think about other income growth from here?

And then secondly on the pension. You have talked about the triennial coming up this year. Your pillar 2A came down in H2 for presumably partly because of pension risk. Is there something to play for here when we get the triennial, is there more pension risk sitting in the pillar 2A? I know you won't be able to quantify it but is there something material that could develop there? It is important I guess for an institution where you have talked before about potentially re-evaluating management's capital target. Thanks.

William Chalmers
Yeah thank you. I think first of all on OOI when you look at the underlying that went on during both Q4 and during the year as a whole, as said in the slides, that gave us reason to build confidence in a performance of the underlying OOI businesses. And as you know it has taken some time to get there. I mean I have been quite cautious in terms of our overall OOI trends within the last couple of years. But I think what we saw in Q4, to a degree what we saw in 2022 as a whole, is encouraging in the sense that if you strip out the effective assumptions, if you strip out the things like GI weather and you look at the underlying within Retail, within Commercial, within Insurance, you see signs of progress. Within Retail it is customer activity in things like PCA, the Lex business, the Cards business. Within Commercial it is things like the Markets performance. Within Insurance it is things like Workplace Pensions, Bulks to a degree Protection. And these are developing a little bit of momentum and we see year on year improvements both 2022 over 2021 and also Q4 over Q3 even on a relatively micro basis like that.

When we look forward Ben, you are right to strip out the IFRS17 effects that we see. If you took those kind of literally you will go from the performance that we have seen stripping out the IFRS17 you get down to about £4.7 billion. When you look at the underlying performance that we expect for 2023, we expect to outperform £4.7 billion. So a little bit of growth that we will follow through on and deliver during the course of 2023 would be our expectation Ben. I don't want to get too excited, it is linked into the achievement of our strategic initiatives which are big OOI drivers for us in the years going ahead. 2022 is just the foothills of that but we do expect building to over the course of the year.

On the capital point, yes you are right we had a benefit from pensions liabilities coming down which helped our Pillar 2A charge come down to 1.5 per cent during the course of the year. Looking forward there is more to go for there from a pensions side so if we continue to reduce the pension deficit we should see some benefit from that in Pillar 2A. Having said that we have pointed out in the past one or two regulatory uncertainties out there and you know the regulatory playing field if you like is still being played out as we speak. Things like CRD IV, all the issues that you will be aware of. So overall that leads us to be comfortable with where we are in terms of our capital guidance of 13.5 per cent. Recognising, final point Ben, that we do intend to distribute down to that over the course of 2023 and 2024 as we have indicated previously.

Douglas Radcliffe

Okay thank you very much. I think we have actually taken most of the questions but if indeed there are any further questions as normal please do give us a call in the Investor Relations team. Just briefly before finishing let me just finally hand over to Charlie just for a couple of closing comments:

Charlie Nunn

Well just to say thank you very, very much for attending. I know we are the last UK financial that has been announcing my guess is a number of you were up at 4am yesterday for HSBC. So thank you very much for joining today. As Douglas said, any questions we are going to hang around a little bit now for those in the room. Any questions please follow-up and we are looking forward to the next results in Q1. So thanks very much.

END

FORWARD LOOKING STATEMENTS

This document contains certain forward-looking statements within the meaning of Section 21E of the US Securities Exchange Act of 1934, as amended, and section 27A of the US Securities Act of 1933, as amended, with respect to the business, strategy, plans and/or results of Lloyds Banking Group plc together with its subsidiaries (the Group) and its current goals and expectations. Statements that are not historical or current facts, including statements about the Group's or its directors' and/or management's beliefs and expectations, are forward looking statements. 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