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GOLDMAN SACHS EUROPEAN FINANCIALS CONFERENCE WITH WILLIAM CHALMERS – TRANSCRIPT
(amended in places to improve readability only)

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William Chalmers, Chief Financial Officer, Lloyds Banking Group
Martin Leitgeb, Vice President, Goldman Sachs, (Moderator)

Martin Leitgeb
It's a great pleasure for us here at Goldman Sachs to welcome our next speaker, William Chalmers, Chief Financial Officer of Lloyds Banking Group. First of all, many thanks for joining us. By way of intro, William was appointed as CFO in August 2019, having a wealth of experience working in financial services, as an example, at Morgan Stanley where he was co-head of the Global Financial Institutions Group. William, thank you very much again, first of all, for joining us this year.

William Chalmers:
It’s a pleasure. Thank you, Martin.

Martin Leitgeb:
Maybe let's just start with a broader macro impression in the UK. In investor conversation, one of the key concerns remains the outlook for the UK economy, just in light of the consistently high print in terms of inflation. I was just wondering, could you share your view on the outlook both for inflation and the broader economy, just in terms of what the potential impacts of Central Bank policy action might be?

William Chalmers:
Yeah, sure. Thank you Martin. I think as we look at it, perhaps just to step back for a moment and reflect upon what we said at Q1 where we thought there would be a 0.6 per cent contraction during the course of 2023 and a base rate environment of around 4.25 per cent or a peak thereof. What have we seen since then? It’s actually an improvement in the GDP outlook. So overall, I think the consensus seems to be moving to a better place in terms of GDP outlook for 2023. It is also clearly moving to a higher interest rate place. Now clearly those higher interest rates may have an impact upon growth in the years thereafter, 2024 and beyond, but nonetheless, for now at least the GDP outlook is looking better. I think when we look at the effect of all of that, that is a relatively constructive operating environment, both as to income and certainly as to margin. And as for asset quality, very sound, albeit, I think rate increases are taking a toll on asset growth in the market. So you might get a slightly better NIM, but at the same time you're probably also getting slower asset growth than you might have first thought.

It is, I think Martin, fair to say that as we look at it right now, we'd like to see less volatility. Volatility is not really helpful to anybody. We'd like to see a peaking off in terms of the rates for sure. But as said, at the moment at least, as long as unemployment stays low in particular, this is a pretty constructive operating environment and asset quality is behaving accordingly.

Martin Leitgeb:
Great. Let's move to revenues in particular and the outlook for net interest income. Obviously rates are markedly higher now, up from close to 0 per cent to 4.5 per cent and expected to rise further. What is the outlook in terms of NII and margins for Lloyds and are we at peak or close to peak NIM?

William Chalmers:
Yeah, yeah, it's an important question. I mean, again, I'll just step back a little and say that the rising rates that we have seen since 2022 have had a significant and indeed sustained impact in both our net interest margin and indeed net interest income outlook. I mean that is the important point, I think. For context now, we printed 3.22 per cent in Q1 as many of you will know. As we look at it since then, thereafter rates have been a little bit higher. We did expect a step-down in Q2 and we expected a relatively consistent net interest margin pattern thereafter. I think because of those rate changes that we've seen, it might be that our Q2 margin is a little bit better than we have first thought, but to be clear, it's still a step-down and still a period of stability thereafter. But the step-down perhaps a little bit less than we had thought.

Now how does one think about that in the context of income? Two points I think to bear in mind. One is on that asset growth picture that I mentioned just a second ago. The rates being higher is good from a NIM perspective but not so good from an asset growth perspective, so bear that in mind. And then as we said at Q1, we've also got non-banking interest income, which is about funding the non-banking businesses, helping our OOI for sure, but nonetheless don't forget to take that into account as one translates it into the income consequences of that higher margin environment.

Second point or second area, I suppose Martin, which I think is particularly important is that there is a lot of talk about peak NIM, particularly in the UK market. Over time, and this is stepping back over the medium term, it is I think, important not to confuse peak NIM with peak income.

What do I mean by that? The effect of higher rates takes time to build into our P&L, takes time to build into our balance sheet and therefore the P&L. We see that picture building over time through, for example, our £255 billion structural hedge. It doesn't frankly matter whether that structural hedge is £250 billion, £245 billion. The point is that you've got an asset that is currently yielding 1.2 per cent and starting to be built into a rates environment that, at the moment at least, is more like 4.5 per cent. So you get a pickup for every £1 billion of maturity within the structural hedge within this higher rate environment. And Martin, as you know, the average life of that structural hedge is three and a half years. So it takes time to build into the balance sheet first of all. And then subsequently to the P&L of the business.

Now at the same time in 2023 and 2024, we've got a mortgage refinancing headwind. We wrote a lot of relatively high margin business a couple of years back that is coming up for refinancing at much lower rates today. But that washes out over the course of 2023 and 2024 and the structural hedge effect if you like, which is basically at the moment, £255 billion of hedge liabilities continues thereafter. So, as the mortgage refinancing headwind plays itself out the structural hedge benefit starts to, or rather continues to, be built into the balance sheet and the P&L. And that accompanied by the underlying business growth, fuelled by the strategic investments that we're making right now is what underpins the earnings growth and ultimately the returns growth for the business that we see out into the medium term. So as I say, I think viewed on a medium term basis, we shouldn't confuse peak NIM with peak income.

Martin Leitgeb:
Great. Maybe just to follow up on that point in terms of what you're seeing on the deposit side. So there's a lot of focus in terms of both deposit attrition, so deposits reducing and deposits migrating into higher yielding categories of deposits, savings or time. I was wondering what are you seeing there and are some of the earlier comments you made in terms of the NIM step down, being maybe less pronounced than originally thought, also related to a better experience there?

William Chalmers:
Yeah, I mean it's a very topical point Martin, and an important one. Again, just to set the context, I think it's important to bear in mind that deposit migration from PCAs, personal current accounts, and instant access savings into fixed term accounts and what we describe as limited withdrawals, that is a fact of life in a higher rate environment. We saw it in Q1, we'll see it in Q2, frankly we'll see it in periods beyond that, including post the last base rate change. This is something that's going to evolve over time. But the key point is here, this is a gradual process. This doesn't unravel somehow overnight. It takes place over many years and that's really our expectation.

Now looking back to your question Martin, and almost by way of illustration of what I just said actually, in Q2 we've probably seen a bit less of that deposit migration than we had previously expected. Hence your reference to my comments for a few weeks back, Martin. We've seen a bit less versus expectations. That's not to say deposit migration is not going on, it is, but it's going on in Q2 at least at probably a slightly slower pace than we had first expected. Now as said, that likely means a stronger NIM in Q2, still a step-down as per our previous comments, but nonetheless, a slightly stronger NIM than we previously thought.

Bear in mind those income effects that I mentioned earlier on as to how one translates from NIM into income. But nonetheless, that's what we're seeing. So as said, deposit migration, it’s a fact of life, it'll continue, but again drawing back to the underlying operating environment that we see as a function of the same higher interest rates that are driving that deposit migration is unmistakably, unequivocally a better place from a profitability and a capital generation point of view.

Martin Leitgeb:
Great. Let me follow up on loan growth and the other comments you made on loan growth. I mean as tradition, obviously number one, what area of loan growth are you most excited about in the current environment and related to that obviously the weakness in mortgage growth, on the back of higher rates, how long could that weakness persist?

William Chalmers:
Yeah, it's a good question. I think at the moment, it's fair to say that loan growth within the sector as a whole is relatively modest. Now stepping back, what do we mean by that? If you look at the mortgage book for example, by virtue of the macro environment that we see, by virtue of the rates environment that we see, that is stymieing or slowing growth a little bit within that market. The housing market is a reflection of that. I suspect that we've got to see a period of stability in rates Martin, in order for that to turn around, which in turn means that as we look at it right now, we expect the mortgage book to be flat, maybe a touch down but only very minorly so, if so, during the course of this year. There's nothing that exciting going on within the mortgage book this year. Now the other part of Retail, unsecured, we're actually seeing decent growth within unsecured, across cards, across motor, across

loans, and that's as a result of many of the strategic investments that we're making, facilitating customer journeys, pre-approvals within acceptable risk brackets, et cetera.

And so it's falling in decent risk brackets, but unsecured is a little bit more interesting. And then on the other side of the balance sheet, within Commercial, I think we're seeing C&I loan growth more or less meet customer patterns, it kind of goes up and down depending on what the markets' and customers' needs are.

Business and Commercial banking is a little tougher for two reasons. One is it is a relatively slow market with liquid SMEs and therefore limited demand for credit. And the second is the bounce back loan dynamic going on, which is a feature of our balance sheet and I suspect others, whereby customers are paying back bounce back loans, which therefore come off the balance sheet. So a pretty muted picture there.

That's the near term. Martin, maybe just a comment or two on the medium term, which is a big part of our story as you know. When we look at the medium term, first of all in Retail concepts, you may or may not have heard of them, like Home Hub and Transportation Hub for example, which are basically activities, ambitions, within each of those two respective areas that will lead to low growth opportunities.

Likewise, mass affluent in both secured and unsecured. We're launching products this year, some are already underway actually, which will heighten ambitions within mass affluent. Likewise Business and Commercial banking digitisation, as some of you will know is a big part of our ambitions, that will be accompanied by a improvement if you like in our lending capabilities away from the traditional real estate backed cashflow lending that we tended to do and that is in tune with the kind of development of the economy we think, and therefore it will present lending opportunities.

Those will take time Martin, to be clear, but we think there's some pretty exciting opportunities underneath it.

Martin Leitgeb:
Yeah, great. Many thanks. Let's move on to other income. Obviously a lot of focus, in particular over the past year, has been on NII and margins. How do you see the outlook for other income growth in the current environment and is this a big focus given all the moving parts and uplift you had in terms of NII?

William Chalmers:
Yeah, other income is extremely important to us. As you know, it's an area that I've spent a lot of time investing in and trying to make sure that we get right, really since I joined. Other income was £1.25 billion as of Q1, that's up 11 per cent on Q4 of last year, 11 per cent on a restated IFRS17 number. What's going on underneath that? To be fair, there are two things going on underneath that. One is the presence of exceptionals if you like, and reversion to run rate. That's kind of point one. Exceptionals: (i) we did a securitisation deal in Q1; and (ii) we saw general insurance improve off the back of an absence of adverse weather. But those are unlikely to recur. They were partly behind that 11 per cent growth. But, also there were some underlying growth patterns behind it as well. So you look at Retail, you look at Commercial, you look at Insurance and there was, it's good to see, some underlying growth going on within that, number two.

I think as we look forward it is a huge focus of our strategic transformation. So two reasons. One is it gives us diversification and protects us from a declining interest rate environment. That's a very conscious decision of our transformation. And two is it's where our opportunities and therefore our strategic investments lie. The two are very consistent. So if you look at, again, mass affluence, to take an example, but equally if you look at things like ancillary income streams in Commercial, merchant acquiring for example, these are areas where we're making significant investments, where we think significant opportunities lie, which will deliver other operating income.

That again will take time. I think in the meantime, Martin, including this year, we would expect to see measured growth within other operating income by which I mean if you look at IFRS17 restated OOI last year, you'll see a number of £4.66 billion. I expect us to comfortably exceed that during the course of this year, off the back of consolidation of BAU, off the back of the delivery from organic and to a degree the inorganic investments that we've made. I expect it will more or less be in line with the pattern that we saw i.e. £1.25 billion during the course of Q1. I think that is a decent type of run rate that we might expect see repeating.

Martin Leitgeb:
Great. Very clear. Let's move to cost. I was just wondering since the flip side of higher rates is obviously higher inflation and risk of a higher cost base, is it a bigger challenge for you in terms of achieving the cost targets?

William Chalmers:
Yeah, I think costs are frankly always a challenge for any business and ourselves, we're no exception. Inflation impacts us whether it's wages, whether it's technology, whether it's OPEX, whether it's utilities. We're not immune from these things. That's what led us, as some of you will know, to increase our cost targets for 2024, which is one of our delivery years for the strategic transformation plan. We increased them from £8.8 billion to £9.2 billion. To be clear what's going on underneath that is that we have got about £600 million inflation driven costs. We figured that we could offset about £200 million of those and we passed on £400 million of those, hence £8.8 billion to £9.2 billion. Now it's important also to bear in mind that within that £9.2 billion, we are also absorbing the costs of our acquisitions recently, so Embark number one and Tusker number two. So that's all included within the £9.2 billion, which hopefully demonstrates a bit more discipline beyond what I've just said.

I think along the way, we have the £9.1 billion target to 2023, but I think the point for us is that we are effective cost managers. I hope it's safe to say that we have a decent track record in that aspect and I expect those cost targets for 2023 and for 2024 to be hit.

Looking forward, I think this is a more medium term point, we expect as the investment plan or the investment associated with our strategic transformation tails off and as we start to achieve some of the cost saves, which are part of our ambitions for this transformation, that in turn should allow a flatter cost base going forward, which in turn, in conjunction with the income points that I made earlier on, allows a degree of operating leverage to be built into the business. And it's that combination alongside a stable macro environment which gives us confidence in returns to the business going forward.

Martin Leitgeb:
Great. Let's move to asset quality and I was just wondering how worried are you in terms of the impact that higher rates and higher inflation has on the quality of your loan book and are there any early signs you notice, any change in payment behaviours, mortgages, or other behaviours which you notice at this stage?

William Chalmers:
Yeah, I mean the short answer to that is we pay close attention to inflationary effects on the market, the cost of living impact on customers. It's something that we watch very closely. But to the point, the short answer to that is at the moment the book is performing very well and it's generally very benign, Martin. So if I step back and say what's going on behind that, what do I think is going on behind that? It is a resilient customer base that stands behind what we think is a high quality loan book. What do I mean by high quality loan book? Take a look at mortgage customers for example, average income, £75,000. Take a look at the cards book, prime customers, prime customer card book, by design as a function of the underwriting policies that we adopt. Take a look at the Commercial Banking business, greater than 75 per cent exposure to investment grade.

So these are things that we think over time, particularly over the last 10 years, have built a very high quality customer base, which should be resilient in the context of challenging times. Alongside of that, Martin, we stress tested the book. So by way of illustration there, we've got about £66 billion of refinancing mortgages this year, which will be coming off low fixed rates maturing onto higher fixed rates clearly, but over 85 per cent of that maturing book has been stress tested to rates in excess of 6.5 per cent, which at the moment is in excess of anything that is out there in the pricing market. So, a resilient customer base that has been stress tested.

To your point, Martin, the early warning indicators that we're seeing, we have an array of early warning indicators across the business, Retail, Commercial, Insurance are all pretty benign. Now I can go into specifics as to exactly why that is, but the overall picture is pretty benign, very stable pictures and remarkably stable in fact given to an extent, at least as you say, a slightly more volatile external environment.

And so very few signs of stress. I think one point that is important here that we watch closely is unemployment. And as we look at the market right now, it's a tight labour market. If unemployment stays under control, that is very consistent with the early warning indicators, let's say refused payment notifications, overdraft utilisation, liquidity amongst our SME partners, persistency and insurance that is consistent with all of those things staying very stable, which is what we're seeing today.

And then finally looking forward again, we have provisioned an expectation that this will deteriorate. You've seen our ECL, which is £5.2 billion, that is very ample cover let's say for the type of macroeconomic environment that we portrayed at Q1, which going back to the earlier comments is looking a little bit better now than it did then. And so we're pretty well provisioned that £5.2 billion is £700 million in excess of our base case ECL requirements if our base case economics play out because of the probability weighting methodology within our IFRS9 accounting. So Martin, overall very few signs of stress and at the moment at least very little disruption.

Martin Leitgeb:
Maybe just to follow up with regard to commercial real estate, a traditional area of focus in terms of economic downturns historically in performance and probably compounded this time by changing working habits and pattern, in light of working from home. How do you see the risks in your commercial real estate book?

William Chalmers:
Your point is obviously a topical one, Martin, I mean there's been a lot of talk about that on both sides of the Atlantic recently. The commercial real estate book for us has been significantly de-risked over the years. I mean some of you will have tracked that I'm sure, but at the moment it stands at £11 billion net of significant risk transfers which are about £4 billion or so. So the book has come down significantly to that core number that I just mentioned. It is also a book that is relatively well diversified and certainly subject to segment cap. So you mentioned offices there for example, Martin, our office segment cap to give you some idea is £1.5 billion. Now that's the cap, that's not the actual exposure any given moment. That's the cap. Retail, likewise £1 billion cap. So the book is diversified and it's managed to some pretty strict segment caps.

Now when we look at it, it is cashflow based to be clear. So we're not relying upon the collateral behind the CRE to secure the loan, and you would expect that I'm sure. But to give you some idea of what that means, we've got an average interest cover of greater than four times within the book. 85 per cent of the book is greater than two times interest cover. And so these numbers hopefully testify to the fact this is a cashflow based business as opposed to relying upon the collateral behind it. But if we do get into trouble and if we do have to rely upon the collateral behind it, there's a lot of it. So the collateral, we have an average LTV within that book of 44 per cent. That gives you an idea that although we don't expect to get there if we did we feel pretty comfortable.

Experience so far Martin, to your point, again, it's been remarkably stable. We've seen Watchlist actually go down, Watchlist is a kind of early warning indicator type of function within the bank. We've seen Business Support Unit levels within CRE very stable. Business Support Unit is when a loan actually does show signs of trouble, we put it into a Business Support Unit to help it work its way through, very stable. And stage 3, which is evident in our disclosures, has actually come down during the course of the quarter or at least it's come down for the commercial book as a whole, within CRE it's been stable, but it's been stable at low levels. So the experience to date is really pretty robust. I think Martin, stepping back, I don't want to be complacent about it, we recognise the concern in the macro as a whole. CRE is clearly an asset book that people talk about. We're keeping a close eye on it, but at the moment there's not much going on.

Martin Leitgeb:
Last one on asset quality, is there anything to call out in terms of SMEs? So one would expect lower home purchase activity to impact particular SMEs related to properties, is there anything you see, any concerns there?

William Chalmers:
Well first of all, the SME franchise is a really important part of our business. It's about £35 billion to £36 billion thereabouts in terms of quantum. It is as everybody knows, well some of those who watch us know, a part of our strategic initiatives. Digitisation of SME is a really important part of our strategic initiatives. On the specific focus of asset quality Martin, this book has been through some high underwriting standards. It's been stressed by something called the notional stress rate, which is effectively a higher interest rate that we stress test our customers against. It is very cashflow based, but as with the rest of the Commercial book, it is also very well secured. So over 90 per cent of the SME book is backed by collateral, real estate collateral. So it's secured essentially.

What are the early warning indicators telling us there? Again, remarkably stable, so invoice factoring debtor days for example, average invoice factoring debtor days, very stable. Liquidity amongst the SMEs, likewise very stable. Overdraft utilisation, same thing. So at the moment we're not seeing any real signs of disruption. You'll see again, hopefully by way of testimony for those that study our disclosures, stage 3 within SMB, which is what it's called within disclosures, actually fell during Q1. Q4 to Q1 SMB stage 3 fell. Now again, we are provisioning for a more adverse economic environment to be clear, so I would expect that to tick up over time, but that's all as anticipated within our provisioning and so far at least it's not happening.

Martin Leitgeb:
Great. Let's bring this all together and focus on returns. So in terms of the return targets for 2023 or further out, how do rates impact these return targets? I mean obviously in the short term it looks like rates are going to be higher than expected, but there's some concern out there that rates might have to settle at a lower level over the medium term. How sensitive are your return targets?

William Chalmers:
It's an important question for us obviously. To step back, the guidance that we've given to the market is as you know Martin, 13 per cent in 2023, 13 per cent in 2024 and then greater than 15 per cent by the time it gets to 2026. What's going on there? Essentially the income is consolidating as we get the benefits of rates starting to feed through in 2023 and 2024, but equally being matched by the mortgage refinancing headwind that I mentioned earlier on. At the same time, we've got investment ticking up in line with our strategic transformation and the OPEX associated with that. And therefore as TNAV builds, depending clearly upon interest rates and what they do, that delivers the move to 13 per cent for the next two years.

Looking forward, as said, the mortgage refinancing headwinds play themselves through. The structural hedge tailwind, which is basically as said, just the interest insensitive liabilities hedged into a high rate environment, that continues over the course of the next few years. And then alongside of that, you get the strategic investments starting to kick in and contribute to building the income picture. As the strategic initiatives also lead to a flatter overall cost picture, assuming a steady macro, that improves the return environment.

Now you asked about what happens if rates fall, Martin. If rates fall, provided that it is kind of roughly within expectations, provided that we're not going back to the kind of 2010 or 2020 zero interest rate environment, that might change the numbers at the margin, but that's all it will be. It will be at the margin. It doesn't change the picture and it doesn't change the picture for not just returns, but also for capital generation.

Martin Leitgeb:
Great. I mean higher profitability means higher capital generation and scope for capital return. I was just wondering, is there scope for Lloyds to assess the potential for capital return more frequently and how do you think about the kind of trade off in terms of capital return versus some opportunities which might be inorganic?

William Chalmers:
M&A and so forth?

Martin Leitgeb:
Yeah.

William Chalmers:
I think as you say, higher profitability should mean higher capital generation. That's certainly our expectation. Alongside of that, we're trying to remove some of our other capital obligations. The pension fund is the best example of that. It's a pretty big one and we think we're making decent progress on that. We'll talk more about it probably around Q3 of this year once we get to an agreement with the trustees. That altogether with the income picture or returns picture that I was talking about earlier on leads to circa 175 basis points capital generation this year and next. And then that increases in line with my comments earlier to greater than 200 basis points by 2026. So it kind of follows the profitability picture to your point, Martin.

Capital return, a couple of points that I think are worth making. One is the board, we collectively, are committed to the return of excess capital. We've been doing it by two mechanisms. One is by progressing a sustainable dividend and the second is anything on top of that, giving it back most recently in the form of buybacks. Now we, I think, have a pretty ongoing pattern of capital return to the shareholders, to our owners, which by the way includes me and includes most of the employees at Lloyds. And what I mean by that is that the progressive dividend is paid out twice per year. Then the buyback, although it's only decided upon at the end of the year, is effectively deployed right the way through the year. I mean it's going on right now as you probably know. And therefore at any given moment in time, chances are we are having capital repatriation going on and therefore when we look back we kind of value the flexibility that we have within the capital program that we have right now.

We also recognise the growth potential within the dividend for example, and we feel pretty comfortable with that mechanic and that setup. And so Martin, it's really a question for the board in conjunction with our regular capital appraisal, but I think for now at least we feel it's appropriate. We don't have any plans to change it.

M&A, just very briefly on that. We are pretty judicious on M&A by which I mean if we see something that potentially enhances our capabilities or enhances scale, then we will look at it basically subject to three criteria. Is it going to get us there faster versus our organic ambitions? Is it going to drive more value versus our organic capabilities and is it going to do so at lower risk versus what we might be able to do organically, which includes things like time and other considerations. And if those three tests are passed, then we'll look seriously at it.

But having said that, Martin, I think those things are going to be few and far between. I've done three since I've got here. Tesco's mortgage acquisition in scale it's tiny, Embark about capabilities in D2C investing, relatively small. And then Tusker most recently

about developing a new capability in salary sacrifice schemes in cars. All pretty small. I don't expect that infrequency number one, and size, being small, number two, to change too much.

Martin Leitgeb:
Great. Final question from my side before opening up to the floor. We haven't touched on regulation yet and there have been instances of fragility in the banking system in the US and in part of Europe. I was just wondering, do you see any merits in some recalibration of some of the frameworks? Do you see some risk of a regulatory response in the UK?

William Chalmers:
Yeah, the events in the US and in Europe in March were pretty dramatic, to your point Martin. Now, I think at the same time again, without being at all complacent about it, they were somewhat idiosyncratic in their nature. That is to say in the US you had unhedged securities books, in Europe you arguably had a less than profitable business model or an unsustainable business model, let's call it. When we look at Lloyds, again, without being complacent, we hedge our exposures, we have a diversified deposit book, we have a lot of liquidity, we have what we believe is a strong and sustainable business model, and so those risks we don't think apply in the same way, Martin.

I think having said that, when you step back, what was interesting there and what potentially has read across for any geography, any sector, any bank, is the quantum and speed of deposit movement of those places. And I guess that's what the regulator will take a close look at. I think if they do, we would hope for a couple of things. One is we'd hope for it to be internationally coordinated. Two is that we'd hope that the regulator considers the interrelationships between the different levers they could pull. By which I mean what is the relationship between deposit insurance for example, and outflow assumptions in the context of LCR? What is the relationship between those two? And then three is alongside of that I would hope the regulator continues to recognise the importance of central bank liquidity as a tool in the toolbox to stop these runs from ever happening in the first place. That is essential I think. So it's hard to say, Martin. At the moment we've heard nothing to be clear apart from what everybody in this room has seen in the press and so forth. I would hope that if anything does change from that, it's done so in a coordinated way.

Martin Leitgeb:
Great. Let's open up for questions from the floor.

Audience Question:
To sort of continue on the potential impact of regulators coming out and increasing capital requirements. We have heard comments that we may need to do something by talking individually bank to bank rather than dividend bans which didn't really work very well in the past. Now it's a bit of a mixed picture because Intesa seems to be hearing nothing, but other banks are indeed hearing suggestions they need to beef up capital, like ABN Amro. How is the situation in the UK? I mean is your regulator able to withstand pressure to move capital up and to front run Basel 4?

William Chalmers:
Yeah, it’s a good question. The overall stance of the regulator, that they said publicly I believe, is that the capital in the system is in the right place and therefore it's a question of distribution between banks. Now probably every bank you talk to will have their own individual story of what that therefore means for them, but for us, I think there are two regulatory developments out there that I guess I would highlight. One is, as mentioned at Q1 and perhaps at the year-end, we're expecting to see the finalisation of the CRD IV mortgage contributions this year. So we put in place about £16 billion of incremental RWAs at the backend of 2021. That was our best guess as to where the regulatory outcome might be. I think with the refinement of our understanding of what the regulator wants, we expect to top up on that during the course of this year.

Not quite sure exactly when that comes, or what exactly it will be to the second decimal place, but we do expect to see that. That is broadly, give or take I should say, anticipated within our circa 175 basis point capital generation. But clearly if it's a little bit beyond what we expect, it won't be. If it's a little bit less than we expect, so much the better. So that's one.

The second one that I would highlight is Basel 3.1, where every bank has its own take on what Basel 3.1 means for them. For us, the bottom line is that we expect it to have a net neutral effect, so we do not expect a capital increase off the back of Basel 3.1 changes. Why is that? Two pretty simple reasons. One is that the benefit of having foundation IRB as we do in many parts of our Commercial bank is that you've already got quite a heavy load of RWAs and therefore the adoption of Basel 3.1 doesn't really change that.

And then the second reason is from the approach in mortgages, which we previously thought might bite in the later part of Basel 3.1, in 2028, 2029 and 2030, by virtue of the mortgage valuation approach that seems to be getting adopted right now, we no longer think that is going to bite as we go through the time period. I don't think that's finalised. We have to see how that finally

gets adopted, but together that means that Basel 3.1 doesn't bite in 2025, and at the moment at least we're not sure it's going to bite either in the later forecast period. But we'll have to see on that latter point.

Martin Leitgeb:
William, thank you very much again for joining us this year. I really appreciate you making time to speaking to investors.

William Chalmers:
Well thanks for taking the time and thank you for inviting me, Martin.

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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. Words such as, without limitation, 'believes', 'achieves', 'anticipates', 'estimates', 'expects', 'targets', 'should', 'intends', 'aims', 'projects', 'plans', 'potential', 'will', 'would', 'could', 'considered', 'likely', 'may', 'seek', 'estimate', 'probability', 'goal', 'objective', 'deliver', 'endeavour', 'prospects', 'optimistic' and similar expressions or variations on these expressions are intended to identify forward looking statements. These statements concern or may affect future matters, including but not limited to: projections or expectations of the Group's future financial position, including profit attributable to shareholders, provisions, economic profit, dividends, capital structure, portfolios, net interest margin, capital ratios, liquidity, risk-weighted assets (RWAs), expenditures or any other financial items or ratios; litigation, regulatory and governmental investigations; the Group's future financial performance; the level and extent of future impairments and write-downs; the Group's ESG targets and/or commitments; statements of plans, objectives or goals of the Group or its management and other statements that are not historical fact; expectations about the impact of COVID-19; and statements of assumptions underlying such statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will or may occur in the future. Factors that could cause actual business, strategy, plans and/or results (including but not limited to the payment of dividends) to differ materially from forward looking statements include, but are not limited to: general economic and business conditions in the UK and internationally; political instability including as a result of any UK general election and any further possible referendum on Scottish independence; acts of hostility or terrorism and responses to those acts, or other such events; geopolitical unpredictability; the war between Russia and Ukraine; the tensions between China and Taiwan; market related risks, trends and developments; exposure to counterparty risk; instability in the global financial markets, including within the Eurozone, and as a result of the exit by the UK from the European Union (EU) and the effects of the EU-UK Trade and Cooperation Agreement; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the Group's credit ratings; fluctuations in interest rates, inflation, exchange rates, stock markets and currencies; volatility in credit markets; volatility in the price of the Group's securities; tightening of monetary policy in jurisdictions in which the Group operates; natural pandemic (including but not limited to the COVID-19 pandemic) and other disasters; risks concerning borrower and counterparty credit quality; risks affecting insurance business and defined benefit pension schemes; risks related to the uncertainty surrounding the integrity and continued existence of reference rates; changes in laws, regulations, practices and accounting standards or taxation; changes to regulatory capital or liquidity requirements and similar contingencies; the policies and actions of governmental or regulatory authorities or courts together with any resulting impact on the future structure of the Group; risks associated with the Group's compliance with a wide range of laws and regulations; assessment related to resolution planning requirements; risks related to regulatory actions which may be taken in the event of a bank or Group failure; exposure to legal, regulatory or competition proceedings, investigations or complaints; failure to comply with anti-money laundering, counter terrorist financing, anti-bribery and sanctions regulations; failure to prevent or detect any illegal or improper activities; operational risks; conduct risk; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; technological failure; inadequate or failed internal or external processes or systems; risks relating to ESG matters, such as climate change (and achieving climate change ambitions), including the Group's ability along with the government and other stakeholders to measure, manage and mitigate the impacts of climate change effectively, and human rights issues; the impact of competitive conditions; failure to attract, retain and develop high calibre talent; the ability to achieve strategic objectives; the ability to derive cost savings and other benefits including, but without limitation, as a result of any acquisitions, disposals and other strategic transactions; inability to capture accurately the expected value from acquisitions; assumptions and estimates that form the basis of the Group's financial statements; and potential changes in dividend policy. A number of these influences and factors are beyond the Group's control. Please refer to the latest Annual Report on Form 20-F filed by Lloyds Banking Group plc with the US Securities and Exchange Commission (the SEC), which is available on the SEC's website at www.sec.gov, for a discussion of certain factors and risks. Lloyds Banking Group plc may also make or disclose written and/or oral forward-looking statements in other written materials and in oral statements made by the directors, officers or employees of Lloyds Banking Group plc to third parties, including financial analysts. Except as required by any applicable law or regulation, the forward-looking statements contained in this document are made as of today's date, and the Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward looking statements contained in this document whether as a result of new information, future events or otherwise. 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