

MORGAN STANLEY EUROPEAN FINANCIALS CONFERENCE WITH CHARLIE NUNN – PRESENTATION TRANSCRIPT

(amended in places to improve readability only)

Tuesday 12 March 2024 – 9.00am

Charlie Nunn, Group Chief Executive, Lloyds Banking Group
Alvaro Serrano, Managing Director, Morgan Stanley, (Moderator)

Alvaro Serrano

Thanks everyone, for making it to the second session. I am delighted to introduce, well, most of you already know him, Charlie Nunn, CEO of Lloyds Banking Group. Before we start, shall we do the usual polling questions to get warmed up?

We are going to leave motor finance out as an option. So, what do you see as most important to drive Lloyds share price outperformance, going forward?

1. Structural hedge and balance sheet structure delivering a resilient NIM medium term – *43 per cent*
2. Strategic initiatives delivering additional revenue growth – *16 per cent*
3. Cost discipline, despite inflationary environment – *4 per cent*
4. Capital generation to reach 200 basis points – *21 per cent*
5. A confirmation CET1 can be paid down to 13 per cent – *16 per cent*

So, a resilient NIM medium term wins by quite a bit. I am sure we will touch on it.

Thanks again, Charlie, for coming. I think it is your third year with us, so, why don't we start. If I look back at 2023, it was a very difficult year. I remember vividly how difficult, in particular, Q3 was for your peers. However, you delivered on your targets and kept the commitments for both 2024 and 2026. What do you think has allowed Lloyds to deliver, despite the sort of very difficult year with intense competition in both mortgages and deposits?

Charlie Nunn

So, thanks, Alvaro. Thanks for having me again. And by the way, what a great set of questions. I would have liked to have seen more on the strategic initiatives, because that extra £1.5 billion of revenue growth that we see coming through in 2026 and we delivered £0.5 billion through 2023, we think is really important. But we will get to that in a second.

So, firstly, 2023, it was a noisy year, and I am sorry for all of the people in the room covering financials because it was a difficult year in that context, with the shifts in the yield curve, expectations changing, and then some one-offs that came through all the banks.

Why did we navigate it? And you need to be humble around this, I think, as any management team. I think we did navigate it well. And what we announced three weeks ago now hopefully you saw, we met our guidance for 2023 exactly as we said we would. On the critical NIM, we guided towards greater than 310 basis points of NIM for the year, and we delivered 311 basis points last year. And we delivered the capital generation and the distributions and then the growth and the strategy that you laid out.

Look, I think there's a few reasons which are very specific to us and our strategy. The first is the inherent nature of our customer base and our mix of businesses. We have always said, with a very broad-based and large-scale business focused on UK retail and commercial, with insurance, that gives you a more resilient customer base, if you manage it well. One of the key things we saw last year is that our deposits performed more strongly than the other high street banks. The non-high-street banks were gaining share last year which we can talk about, but that was partly a deliberate strategy.

So, inherently who we are, who we serve, and kind of the scale that we have in the UK makes a difference. Obviously, really importantly.

Critically, as the yield curve goes up and down, one of the things I have always said to you before is what you want from NIM is a balance sheet that is well leveraged. We have got a 96 per cent loan to deposit ratio, which has a good mix between on the asset side secured and unsecured and retail and commercial assets, and that you manage proactively because there's a massive natural hedge through that balance sheet. And the dynamics of that very stable customer base and that very well leveraged and de-risked balance sheet I think helped us last year. So, that is important.

The execution around the incremental revenue from our strategic initiatives. We delivered 10 per cent growth in other operating income last year, which will be half of the growth in revenue that we have committed over the strategic plan. That helped in terms of the returns and the capital distributions.

And then, you all know Lloyds for good operating leverage, focus on cost discipline, offsetting inflation. And then, you would have seen we took a number of capital actions last year to really recycle capital out of lower-returning parts of the business or doing securitisations of assets that would stress particularly badly and using that to offset the regulatory headwinds we saw. And we knew that that was an issue that affected some of our competitors more than us in that context.

So, I think all of those things made a difference.

When you look forward, that is the key thesis we have laid out. The 2026 story that we have committed to, that we have recommitted to in the last few weeks, that says we can continue to execute the strategy and deliver a greater-than-15 per cent RoTE in 2026 and greater than 200 basis points of capital is based on that story. It is the growth in the strategic initiatives – £1.5 billion of additional revenue by 2026; the stability of our customer base; and being able to continue to get the upside on the structural hedge; and then maintaining that operational leverage on costs and capital.

By the way, thanks for the easy starting question. I know they'll get harder.

Alvaro Serrano

We will also give the audience an opportunity to press you on themes. I am very interested to start with digging a bit deeper on the deposit dynamics. The sector data points to a more benign picture of late. It looks like migration to term deposits has definitely slowed down, particularly, in households, maybe even largely done. Has the visibility there, as far as you can tell, really improved? Because I guess there's still TFSME rollover. We have got ISA season soon. Is there anything else that we should bear in mind? And what are you assuming in your over 290 basis points NIM guidance?

Charlie Nunn

It is obviously hugely important for all of the banking sector in the UK with a large balance sheet. As I said, what happened last year was we did see significant outflows from current accounts in the UK. But for Lloyds Banking Group, we saw less decline than the other high street banks. And then, critically, from your point around the slowdown, in Q4, we saw about £1.9 billion of outflows, versus over £3 billion in the prior quarter. So, good evidence that things are slowing down.

And by the way, that is very in line with what we have talked about here before, which is what we would expect consumer behaviour to be as you start to see the expectations of rates reduce, number one, which means that time deposits are less attractive because the time deposit pricing starts to fall. So, if you lock your money up for one, two, or more years, you're getting less. And then, also, we are now 18 months, 24 months into the rate cycle. So, customers that do have money that they are looking to invest have already moved quite a lot of it.

So, we are not saying it has ended, I will come back to that in a second, but it is exactly what you would expect at this stage in the rates cycle and given the expectations around future rate rises. And the good news is we took a whole bunch of actions around pricing products that we launched and then how we managed our customer base to show more stability last year.

And by the way, on the savings business, you will have noticed that we actually grew our total deposit base in Q4. So, people are choosing to open more accounts and save more with Lloyds Banking Group than they are taking money away. And that is really important because while we are still making margin on term deposits and we make an appropriate margin on our instant access savings, where people value the liquidity, but when you look forward, you really want to be relevant to your customers and still be able to be a bank that people want to save with as well as hold their current accounts with.

So, that is good news through 2023. As we look at 2024, we have still assumed there will continue to be movement, but at a slower level. Now, we haven't given specific guidance on the individual types of savings and current accounts, but we have assumed that people will still be moving money out of their current accounts into savings. Our expectation is it will be more into instant access savings than it will be time deposits. Because as the yield curve drops, the returns or the gap between time deposits and instant access will reduce. But, we do expect that churn to continue this year.

And that is all built within our guidance of greater than 290 basis points of NIM, along with the headwinds that come from mortgage margins that will still feed through our business this year and then really start to tail off as we go into 2025 and 2026, which then gives you cleaner growth.

And then the third dynamic around NIM is obviously our structural hedge which, as you know, we saw about an £800 million increase in our revenue from the structural hedge in 2023. I think William has guided that to being about £700 million or £800 million again this year. And we are obviously predicting the same level of incremental revenue in 2025 and 2026, and that builds even further into 2026.

So, us being able to continue to reinvest the structural hedge as it rolls off into this slightly higher rate environment is a critical part of us managing NIM this year.

Alvaro Serrano

You've touched on mortgages. That obviously was the other product that has proven tremendously competitive. I remember at the beginning of your plan you were budgeting, I think it was, a 75-basis point spread. Back then, we all thought, wow, that is very conservative. And the spreads have gone down to 50 basis points, or below, at some point last year. How do you manage the business when it becomes so, so tight? And at what point does it become uneconomical to underwrite some that business?

Charlie Nunn

So, I think even more shockingly, I remember the 24th of February, 2022, which when we announced our strategy, it was the day Russia invaded Ukraine, for those that remember that day, I remember it well. We announced as part of our strategic plan that mortgage rates we thought would be 75 to 100 basis points. Let's keep me honest, because we underestimated the tightness in mortgage margins. But at that stage, we were predicting the rate curve would only get to 2.5 per cent. So, not the 6.5 per cent that the yield curve got to.

But that is what we announced our strategy on. And then, as you say, last year what we wrote was a mortgage business about 50 basis points. Critically, within that, we have seen and we continue to see that new business is at a slightly higher margin. And in the remortgage business, our existing customers, either doing a product transfer or a remortgaging with us, is a lower margin. And the reason the lower margin works, by the way, economically, which I will come to in a second, on your second part of your question, is you don't pay a mortgage broker fee, £500 to £700 or more. So, it is free of the third-party distribution costs. But you also know the customer and you know the risk. So, the cost of capital is better in that context.

Just before I go to what level of mortgage margin works, which I am not going to give you the perfect answer on, Alvaro, although I have painful detail around this in terms of our models, I think the good news as we start 2024 is the mortgage market has been a bit healthier, both in terms of volumes – volumes have been back above our long-term rate – and margins. We are not obviously disclosing that fully, but they have been trading at above 60 basis points plus. So, it is good to see that there is a bit more health in the market in term of the volumes, and the margins have stabilized. Now, obviously, we have seen the swap curves go up again in the last few months. So, we will see how competitive behaviour evolves. But I think that is really good for the industry and actually exceeds our expectations in the first two months.

Now, as I always say to my team, one month does not create a quarter, let alone a year, and I am in the business of delivering full years of results and then distributions. So, one month does not really mean anything, but it is a good start to the year.

Now, what level of returns are we comfortable with? And I won't give you the perfect answer, but we all remember the history. Pre the credit crisis, which was a completely different context but where the cost of wholesale funding was higher, people were writing mortgage business at 15 to 25 basis points. When we look at our own models, and many of you know William. William is very, very robust about how we model our returns. We use an externally priced swap curve price.

We use a market view of the transfer price on liabilities. That is really important because some competitors don't, for good reasons, but they would marginally price their cost of funding at something below the risk-free rate. So, we do a fully market-tested cost of funding.

We then add our cost of capital based on the type of mortgage and the risk of the mortgage. And then you have the operational expenses of opening, onboarding, and then paying a broker fee, which is, as I said, £500 to £1,000.

Our models include all of that. Fifty basis points is still very strong through-cycle returns for us. Even at the point in the cycle last year, it was. So, we are comfortable with that.

The one thing – and I have been challenged by a few of our analysts – is I think there is an assumption on the cost of equity, and you will have to have your view around the cost of equity. If you use an implied cost of equity of 20 per cent, which is kind of what our share price says, 50 basis points, depending on your model, will look tight. But if I start writing marginal business at an implied cost of equity of 20 per cent, Lloyds Banking Group won't be generating 200 basis points of capital in 2026. So, you will have to have a cost of equity which is a through-cycle cost of equity that makes sense.

Alvaro Serrano

Do you think this year is the year for mortgage recovery? You have mentioned the first two months. But spreads coming off the lows, approvals going up, rates coming down, it is a good setup for mortgage recoveries this year.

Charlie Nunn

So, we have this heuristic, if you like, or simple view that through time we have seen about £1.5 billion of mortgages being written per day in the UK market; not for Lloyds, per day. As you know, we are the biggest provider in that context.

Last year, it fell down as low as £600 million a day. It was then trading at kind of £800 million to £1 billion a day. And then in first month of this year it is been above £1.5 billion a day. So, it is good to see the strength of the market, which people have been coming back into as the swap curve comes down and mortgage pricing came down a bit. And as I said, it is good to see that the margin has stabilized in that more higher-volume market.

Look, what we have announced in our economic guidance is slightly at odds with what we have seen. Let me just be blunt around that. We still predicted this year based on the fundamental economy that house prices will fall 2 per cent, and that would make you think that the mortgage market would be a little less certain this year.

What we have actually just come off the back of is now five months of house price increases, on average, in the UK. So, we are seeing customers really wanting to come back into the mortgage market, supply increase on people selling as the swap curves have come down. I think that is a really good sign for the economy. We just need to be sensitive to the fact that swap curves have come up another 50 or 80 basis points in the last month after the dip that happened in December on the back of Powell's comments.

So, let's see how it goes, but it is a good start to the year. And from our perspective, that'll provide upside, because you saw we have guided for 2024 that our AIEAs will be greater than £450 billion. That is a relatively stable picture of the top line. Underpinning that, we are seeing some portfolios run off and we got some growth in new business. But if the mortgage market is healthier, it will be good for Lloyds Banking Group at the back end of this year and into 2025 and 2026.

Alvaro Serrano

Maybe we can talk about the 2026 targets, which you have maintained with the full-year results. One of the things that caught my attention from that reiteration is despite the rate curves are very different, you have kept your targets, of course. But two questions related to this. First of all, it comes back to the polling question. Do you think your NII is less cyclical than peers? If so is it, I mean, you touched on some of this, but maybe you can dig a little deeper, is it because of consumer lending? Because of your hedging strategy? What makes it a more all-weather NIM, if I can use the term?

Charlie Nunn

I think one of our competitors used that term. So, I am not going to use that term, all-weather balance sheet.

Look, I think there is two parts to this as to why 2026, we have confidence in the top line. The first is the fundamental structure of our business and our balance sheet, as I said. We have got the most leveraged balance sheet in the UK, when you look at the ring fence banks, from a loan-to-deposit ratio point of view. We have the best mix of assets between retail and commercial. But then, within retail, as you know, we have about a 25 per cent share of the consumer finance business, along with a 19 per cent share of mortgages. So, our mix between secured and unsecured. That does give you a different evolution around how customer pricing and returns go through a cycle. And then we have on the deposit side, the liability side, the biggest mass market retail customer base, which should be the stickiest retail deposits if you manage them well.

So, I do think just structurally whether rates are going up and you are getting more margin on the liability side of the business based on the way we all transfer-price it, or when rates are coming down. As we saw in 2018, Lloyds Banking Group's NIM was still about 300 basis points in Q4, 2018, when rates were 0.1 per cent. Fundamentally, you have the customer base and the balance sheet to manage a through-cycle NIM that should be around the range that we are targeting.

Now, obviously, the structural hedge is a massive part of that story. And as you will remember, when I came in, in 2022, so in 2021, the structural hedge was returning 1 per cent, or just below 1 per cent, and we had about £250 billion worth of our deposits invested in that structural hedge. What we announced as we exited 2023 is as we have reinvested that structural edge in the last two years, it is now returning 1.5 per cent.

So, one of the great opportunities for us and then for investors in Lloyds is if we can continue to invest that through 2026 – our medium-term view of rates is that rates will stabilize about 3 per cent; but bluntly, anywhere between 2 per cent and 4 per cent –

there will be significant upside on the structural hedge. And that is building in a stability about the revenues for Lloyds Banking Group which we haven't seen in 15 years because of a zero-rate environment.

And what is even better – and hopefully, you and I will be here in 2030 talking together – but if I am not the one sitting here in 2030, whoever takes my role in 2026, 2027, 2028 is going to have that stability for the following three to five years, because the structural hedge has a weighted-average life of three and a half years at the moment.

So, how we leverage the stability of our customer base and then build the certainty around our structural hedge revenue I think is a really important part of our investment thesis. And we are coming off a low. It takes 10 years of zero rates for the structural hedge to reprice all the right way down. We are now pricing on the way up, and that will give us momentum around our revenue.

So, I think it is definitely our customer base, definitely the way we can then manage our structural hedge at this point in the life cycle. And then, although I know you put the £1.5 billion of additional revenue growth as lower importance, actually it is very important in terms of us delivering what we have said we are going to deliver, because it is marginal growth on the existing asset and cost base we have, number one. And number two, as you know, we prioritize businesses which will drive other operating income, which is very capital-lite and very accretive. And therefore, it is great in terms of generating capital for shareholders.

And to get some kind of organic growth, or alpha, out of Lloyds Banking Group at this stage in the cycle I think is a really important part of both delivering the returns in 2026 but giving a different investment thesis for a banking group that is actually been shrinking for a decade.

Alvaro Serrano

Can we touch on that non-interest income revenue stream? Because you grew non-interest income 10 per cent last year. Is that the kind of growth we should look forward to? Because I would say the biggest difference between maybe the 2026 targets and consensus, which is not quite there, is it this line that you think is misunderstood?

Charlie Nunn

I don't think it is misunderstood, but we have been pretty clear on our guidance. As I said, in 2022, we said £1.5 billion of additional revenue growth from strategic initiatives, of which 50 per cent by 2026 would be other operating income. Now, obviously, there's been a really significant shift in the interest rate cycle through that period. We are still completely committed to that. What we announced at the end of 2023 is we have already delivered £500 million of that revenue growth, and it is well balanced. We didn't give you the split between OOI and NII, but it is well balanced in the businesses.

And the growth is across all of our businesses. So, we have examples of strong other operating income growth in our corporate and institutional business, where FX and rates are growing successfully. Our share of UK DCM has really progressed very, very well, and that business is actually slightly ahead of plan. We have growth in our SME business, what we call business and commercial banking, through our merchant services business and some of our trading and transactional services, working capital services, for SMEs. We have strong growth in our insurance, pensions, and investments business through things like workplace pensions, which is a very fee-based business. And then, some of our GI businesses which are progressing well.

And then, on the retail side we have seen good growth in payments. One of the strategic targets I set for the group was that I wanted to increase my share of payments, which has transactional fees linked to it. Just again, the dynamic. We have a business with 25 per cent share of credit cards, but only 16 per cent share of spend. So, great opportunity, right? Everyone said I couldn't grow this business. What a great opportunity to grow the business on the retail side.

And our transport business, which is generating fees, is also growing well. And we bought Tusker last year, which was a smaller salary sacrifice car financing business, and we have significantly exceeded the revenue synergies by bringing Tusker to our whole corporate base in the last 12 months.

So, there is other operating income growth across the businesses. That gives me confidence that if any one business does not work out, because they never do when you have got a portfolio this big, we will still be able to deliver the upside for the business and for investors.

As I say, what is important is the obvious point. It diversifies our revenue streams. It makes us a little bit less NII sensitive, although NIM is obviously progressing well in this period as well. But critically, that revenue growth is very capital-lite. So, it enables us to bring a stronger capital generation for shareholders.

Alvaro Serrano

Very clear. I have got to ask you about motor finance. You have taken £450 million provisions. Some analysts were as high as £1.5 billion, £2 billion, estimating potential liabilities. I fully realize that it is difficult to know what the final outcome is going to be, but maybe you can help us understand the moving parts. What have you considered in that £450 million? And what should we be looking out for in terms of next steps?

Charlie Nunn

So, first of all, I said it was a noisy 2023. I think there was lots of noise. This is one of the things that made your Q4 probably less easy – so, apologies for that – from an investor perspective.

But we really thought that provisioning this £450 million, well under the accounting standards we thought we had to do it and we thought it was the right thing to do in the context of what we saw. There is really significant uncertainty around this number, and I will just break it down for you in a second. Not least because we only have one case that has been decided on behalf of Lloyds Banking Group or Black Horse by our financial ombudsman, called Mrs Y, for those that have gone deep on this case.

And so, that one case is very hard to use as a precedent, if you like, across the book. And actually, when we look at the business more broadly, we do not believe we have breached regulation or the law during the period that is being discussed. And the lower courts cases that have been running through our books in the last year or 18 months, we have actually won 75 per cent of those lower court cases.

So, we really do need clarity from our regulator as to what the decision points are that are going to impact this business. Because our starting point is we do not yet understand what customer harm, if any, is as a result of this issue.

So, why in that context did I provision and how did we provision? We provisioned for the simple reason that when you move from a provision being possible to probable, from an accounting standard perspective we are obliged to provision. I think it is good, by the way, for you to have that transparency.

And there is two parts to the provision we have put in place. One is our operational expenses of supporting the activity of the regulator and responding to customer complaints. That alone should require an institution to provision, because we are already incurring those costs. There is no uncertainty around that. There are some costs. And so, part of the provision is that.

We have not given the split between the two, but I am sure this may be one of the areas that people will question either here or later in the one-on-ones I have.

And then the second part is our estimate of a reasonable remediation amount if the FCA or the higher courts conclude there is a remediation to be done. That is based on a number of variables. And what we did, so that you have confidence as this goes forward, is we looked at each of the variables a bit like our multiple economic scenarios in our ECLs. We laid out different scenarios, and then we probability-weighted them back. So, we have got worst-case scenarios, and we have got best-case scenarios and then we have looked at the probability weighting around those.

There are two or three big, big variables in this that will make a difference. The first is, is there a reasonable rate that customers should be remediated to. The financial ombudsman did not really try and tackle that. They just went with a zero percent commission rate because there is no precedent for them to set an alternative, we think. But that is a very material shift on how much this will ultimately cost the business, because a lot of the contracts that were done through this time period were done below the communicated rate, not above it. And so, if there were a reasonable rate, the number of customers impacted would fall dramatically, and then the amount of any remediation per customer would also change. So, that is one really big variable.

The time horizon is a variable. So, the FCA is looking from 2007 to 2021. The regulator only took oversight in 2014. Our commission models only had downwards adjustment from 2017. So, a downwards commission model hasn't been tested yet. So, there is lots of time horizon variability.

And then, I will give you a third big factor is if the FCA does conclude there is a subset of commission models where there should be some remediation, deliberately, a lot of conditional language there, so, if that were to be the case, then is it a proactive or a reactive campaign? And we have done lots of these as an industry over the last 15 years. If it is reactive, about 30 per cent of customers tend to have a repayment. If it is proactive, you get to about 80 per cent.

So, you can see there is real variables, significant uncertainty around the variables. We have all of the data on our side, and we have modelled it all. So, if anything changes or we get clarity, we will just explain to you what is happening. But this is a very sensible provision, and it could be less and it could be more based on those variables.

The other thing I hope you have got some confidence from is by recommitting to our 2024 and 2026 targets and actually reducing our CET1 target, which I am sure we will come to in a second, for 2026, we hope that would give you confidence not just as a management team, but you know our board and our regulators will have looked at our capital generation, the trajectory we are on, and what something like motor finance could create as uncertainty. And that should give you confidence that both our board and our regulators can see that reducing our CET1 target in terms of the capital we need to hold is a bit of a confidence boost in this context.

Alvaro Serrano

So, everybody, to make sure everybody knows, we do have the CEO of the FCA on Thursday presenting, in case anyone wants to dig deeper into this theme.

Maybe a last one, which you have already alluded to. With the £2 billion share buyback announced at the full year, despite the motor finance provisions, the reduction of the capital target to 13.0 per cent, what is behind that reduction? And why now, the timing? It is obviously convenient to give reassurance, but why now? And what's behind that reduction?

Charlie Nunn

So, we review the capital that we need to hold with our board regularly. We do it multiple times a year. Because we are highly aware that for our investors, if we are comfortable holding less capital, that means we can distribute more. And that is one of the, obviously, things we are fully committed to and have been committed to in the last couple of years.

Now, there are three things that we look at. One is the business risk of the business. The second is the regulatory uncertainty. And then the third is kind of the economic uncertainty or environment we are looking at.

And when we looked at this in Q4, we felt at least two of those had come down significantly, and I will talk about them individually in a second, and that we still had the right principles around how we manage economic uncertainty. And the critical thing there is we still have a 1 per cent buffer built in within our 13.0 per cent target.

So, in terms of business risk, as you know or many of you will know, we have done a lot to de-risk the business in the last two or three years. Some examples. We had a pension deficit of over £7.3 billion in 2019. As you know, we have now paid that down and exited that completely. That means there is less draw on capital going forward from the pension deficit. That is a massive change for the group, as you know, and it is a really important one that William and I were very committed to getting clean so that you had more confidence in capital distributions when we generate capital.

We had a legacy portfolio business of mortgages pre-2007 which has got, as you know, significant stressed assets. You will have seen we have been shrinking that deliberately at pace, and we have halved the size of that book. That is partly why in the regulatory stress test, the ACS, we materially improved our performance in last year, which I will come to in a second.

You will have seen our commercial real estate book. We have taken actions both to reduce the size of that exposure and use SRTs to de-risk it. So, we have materially de-risked that book.

And then you will also have seen the quality of our unsecured lending has performed very, very well through a more stressed economic environment. I know we have not had unemployment, but we have performed very well and we have maintained discipline.

So, significantly de-risking of the business.

And I think the ACS results that the regulator announced last year – we went from the lowest-performing high street bank to the highest-performing (i.e., the least stressed) – is indicative of those changes.

So, that is the first factor.

The second one is regulatory uncertainty. And I spent a long time trying to work out when I was going to recommit to UK financial services. One of my core beliefs is we need more certainty around the regulatory environment to have confidence that we can build shareholder returns. Some of the capital uncertainties have been Basel 3.1, the implications of IFRS 9, and then CRD IV. And as you know, some of that uncertainty has been around since 2015, 2016.

What we can see is we now have clarity on those issues. So, CRD IV, as you know, we as part of last year's performance increased our RWAs by £5 billion, and we are guiding that we think there is another £5 billion needed by 2026. That is in our plans. So, you don't need to adjust for that. That could be more or less, but that is a lot more clarity on CRD IV than we have seen.

Basel 3.1, we haven't yet had a final announcement, but we are pretty confident that the impact on us will be a net zero impact. There's parts of our business that will benefit, some parts that will have a slight drag. So, Basil 3.1 has gone away. And as you know, we are now consolidating IFRS 9 in our capital and our stress position.

So, the regulatory uncertainty around capital is materially different. And that clarity has come in the last three to six months. And then, as I said, in terms of economic uncertainty, the 13.0 per cent CET1 still has a 1 per cent buffer for economic uncertainty. And so, that is really important.

One last thing on this is particularly important for our debt holders. If I just say it bluntly, I have got more regulatory capital today than I had before I joined, and I have de-risked the business. So, the RWA density has gone up. So, even with a CET1 of 13.0 per cent, I am holding more equity in the future than I am today.

So, I have got a de-risked business, with a de-risked level of regulatory uncertainty. If I had not reduced the CET1, I would have thought you, as my investors, my equity investors at least, should have been hounding me and saying, why not? Because I am now holding more RWAs for the same business and I have de-risked the business.

So, that is the way we certainly thought about it with our board, and we had good conversations with the regulator and the regulator supported us.

Alvaro Serrano

Very clear. I think it is time to open it up for questions from the audience. There's one over there, please.

Unidentified Participant

Thanks. Are there other products outside of motor where you think the regulator could interfere again or be draconian? Because motor, it was not like all the clients were complaining.

Charlie Nunn

Great. So, again, we always have to be humble around this one. So, when I came in, we did a review of the £450 billion worth of lending. Obviously, some of other assets through derivatives have exposures through things like LIBOR. But we went through that in detail.

The good news, if you like, is motor was highlighted as an area where there may be issues, but we had no clarity around what the issues were. It was not until we got a decision from the financial ombudsman in December, a final decision, that we realized that that issue was now crystallizing in a way that meant we had to take a provision.

So, I have looked across the portfolios. There are some other smaller issues, some of which have been in the press. So, shared appreciation mortgages, you will have seen that we have done some deals on that. But based on what I know today, there are no other material issues like motor commissions. And bluntly, six months ago on motor commissions, we knew it was a risk, but we did not expect the decisions in the way we have now seen them come, because of the facts I laid out earlier. We had no evidence that it would breach regulation or the law at any stage over the last 15 years, and we still do not have evidence of customer harm. But we will see where the regulator gets to on that issue.

The one bit which I will always stay humble on, and I know you are highly aware of, and it is a slightly significant issue for me to say, but again, with Nikhil here later in the week, it is a good chance to challenge him on this – is if what I said is true, that we find out we didn't breach the law or regulation, but still there is some retrospective remediation, the real issue is I don't know what I don't know, if I can put it that way, the old Rumsfeld issue. Is there in some future stage going to be some reassessment of something that exists today? I cannot give you confidence on that. I do not believe there will be, and there are no conversations, but that is the one issue I know that you as investors have got as an uncertainty around the way the industry is operating.

Just to give you some confidence on that point, many of you know me. We are in very proactive discussions with our regulators and our government about this issue. I believe it is one of the issues that is suppressing the overall investability of UK financial services, this specific point. And so, you have seen – I would not disclose anything I should not disclose – you have seen the conversations that are publicly now being had and the roles, the focus we have got on that as an industry, and I am leading on some of those conversations. I do know we need to give you greater certainty around this issue. And so, I am very focused on

working with the current government, a potential future Labour Party, and the regulators to say how can we get more confidence around this specific issue.

I hope that is okay. That is a very honest answer. I never want to sit here on the stage and tell you something definitively when you can sit there and work out that I could not actually give you that commitment.

But I have got no concerns at the moment.

Alvaro Serrano

Next question, please in the back.

Unidentified Participant

Could you just say a few words on the impact of the FCA conduct rules on deposit backward prices?

Charlie Nunn

So, the FCA has not come out with anything specific. What they have come out with is they have done an assessment on the back of consumer duty that was launched last July, and there is another implementation this July, or summer. They have asked us to look at how we are managing pricing on our deposits, and they are doing an investigation around that.

Some of you will have seen they have also been proactively supporting some marketing campaigns to customers around our pricing. So, we do not have any specific findings or issues.

Broadly, the FCA's position has been the one I think we would all hope it should be, which is pricing is a matter for competition. And they have been very focused on ensuring that the competitive nature of the market is working effectively. And what does that mean, more specifically? That means that customers can understand what their pricing is and what their products are. That there is no inertia – so, there are no customers left behind, if I use that kind of US military language. Where we as an institute, as a bank, will know if customers are not accessing their digital screens or they are not seeing the rates and they have got money tied up at lower rates. So, are we proactively contacting customers? And then, if customers do want to switch products, that there are not any constraints.

What we have done is put a very proactive program around our customer base and communications. For example, we contacted over 15 million customers last year to show them what their savings options were and what the alternative prices were and even how much more they could get on their savings if they were to choose an alternative product. We opened 4.9 million, about 5 million savings accounts last year across our digital and physical channels. And as I said, we actually grew our deposit base.

So, we believe the market is competitive. We have got really strong proof points that our customers do understand their options and we have got lots of customers choosing. Just in the spirit of this conversation, we are worried about churn, we have got customers moving, choosing to move their money out of current accounts into instant access savings – we have two types of products – and into time deposits.

Now, the really important thing for me, customers do not just choose on rate. And this is where I think the debate has to really be focused on. Sixty percent of our customers have less than £1,000. Whether they get 0 per cent or 5 per cent on that, that is £50 a year. When they are facing £1,500 increases in energy prices, £50 is not the determinant that they are worrying about.

So, people are choosing to leave their money for three reasons. One is trust in the institution. That remains, as you know, critical in moments of stress. And last year, lest we forget, we had banks failing in other parts of the world.

The second is their liquidity needs. And customers are really, really sensible. They understand if they need cash for liquidity, that has a cost.

And then the third is the interest rate. And that is why we have a breadth of products that allow customers to choose for them and for their deposits what's the right choice between those three factors.

And the value exchange is on all three. It is not just on the interest rate. So, for example, last year we introduced a product called our limited withdrawal product – it had a better marketing name. It was kind of halfway between instant access and time deposits. And what it said was, "We will give you a better rate than our instant access, and you can withdraw money four times a year. And you can withdraw 100 percent, but if you start withdrawing more than four times a year, it will go down to the instant access rate."

And we thought that was – by the way, it was pretty distinctive - we thought that was a really important product, because it really explicitly gave customers that choice between liquidity and current account with no return, tying money out for one to two years above the base rate in our time deposits as they were at the end of last year, and then two forms of liquidity accounts, instant access accounts.

So, that is how we are competing. We will continue to engage the FCA strongly. We will see if anything comes out. My view is that has got to be the basis on which you have a healthy deposits market.

Alvaro Serrano

We are going to squeeze the last one from Greg.

Unidentified Participant

Hi there. Nice to see you again.

Charlie Nunn

Nice to see you.

Unidentified Participant

For the £450 billion of AIEAs, it sounds like lending growth is picking up again or, frankly, strong at this point. How do we think about that incremental loan growth? Is it a shift within the average interest earning assets in order to maintain the CET1? Is it that you can take on the additional lending growth and you're okay with the LDR where it is or it increasing? Just how can I think about the overall balance sheet growth if loan growth is better?

Charlie Nunn

So, a couple of points. The first thing is I don't think a 96 per cent loan-to-deposit ratio is necessarily optimal. We have not given guidance around this, but you can imagine we have debated. I think a bit more leverage would be ideal ultimately, but obviously nothing like we saw in the past. If William were here, he'd probably be worried, my team would be worried. But 100 per cent to 105 per cent is completely doable. So, I actually would like from a pure returns and through-the-cycle returns perspective even a bit more leverage on our balance sheet, so we are not constrained from a funding or a capital perspective on AIEA growth.

There are two or three things that are probably just worth looking at. The first is this year I have talked to you a lot about my job is to recycle assets and costs from lower-returning areas into higher-returning areas. Now, what does "lower-returning" mean? That can mean, obviously, lower margin, but it can also mean assets that have particularly ugly stress characteristics where I have to hold lots more capital under stress, given the regulatory environment. So, I still think there's opportunity for me to do that.

And there are some parts of my balance sheet which are going to continue to run off. The two big ones, I still want to run off the legacy mortgage assets. I have halved it basically, but there's still some runoff there. And then, as you know, there's government-backed lending on the SME side. There is about £8.5 billion left of that. And that will run off. It has been running off at about £0.5 billion a quarter, I think. That will continue to run off. So, actually, there is some runoff that gives me capacity before I grow.

And that is the main reason in what we thought was a difficult kind of resilient but flat economy, why we were not going to grow significantly this year. We were going to continue to optimize, let the runoff happen, and then grow the capacity back. If the market is stronger, then I want to grow with it, and we will do that.

We will have the one other issue – I said there's three issues. So, I would like to grow, but in the context of the balance sheet reshaping. The final issue is obviously competition. And I hope what you've all felt – I know you asked me when I came in and said, "Are you just going to go and trash mortgage margins based on growing market?" You will have seen I have not grown market share and I typically have not been #1 in the mortgage rate tables. So, you cannot blame me for the mortgage margins.

But we will compete sensibly around our big-asset businesses. There is no point me chasing margins down and having a bigger balance sheet. You would not thank me for that. And I think we have done it very sensibly in 2023, and we will continue to be sensible.

The one strategic issue is, as you will remember from 2010 to 2020, our mortgage market share fell every year, from 30 per cent to 19 per cent. If we cannot trade in kind of the range we are in now – and that does not have to be 19 per cent – you would not keep the leverage on the balance sheet, and I would not be sitting here in front of you saying I have got the all-weather balance sheet, in Alvaro's language, that you want me to have.

Classification: Public

So, there is a complex strategic dynamic around how fast I grow AIEAs, but I am not going to go and chase volume growth that is dilutive to our shareholders.

What I will say – and William will do this – if we continue to see the good momentum that we saw in January and February, we will give you upgrades, sorry updates, on how we are seeing AIEA growth as we go through the year. Let's work through it together.

Alvaro Serrano

Great. Thanks very much. We have got to leave it here. Thanks, Charlie. Very interesting.

Charlie Nunn

Thank you very much, everyone. Really good to see you.

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. 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 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, targets, 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; acts of hostility or terrorism and responses to those acts, or other such events; geopolitical unpredictability; the war between Russia and Ukraine; the conflicts in the Middle East; the tensions between China and Taiwan; political instability including as a result of any UK general election; market related risks, trends and developments; changes in client and consumer behaviour and demand; exposure to counterparty risk; 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 and other disasters; risks concerning borrower and counterparty credit quality; risks affecting insurance business and defined benefit pension schemes; 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 including risks as a result of the failure of third party suppliers; 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) and decarbonisation, 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. The information, statements and opinions contained in this document do not constitute a public offer under any applicable law or an offer to sell any securities or financial instruments or any advice or recommendation with respect to such securities or financial instruments.