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

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William Chalmers, Chief Financial Officer, Lloyds Banking Group
Ben Caven-Roberts, Vice President, Equity Research, Goldman Sachs (Moderator)

Ben Caven-Roberts:
Well, I think let's get started. It's a great pleasure to introduce our next speaker, William Chalmers, Chief Financial Officer of Lloyds, a role he has held since 2019. Prior to this, William held various roles across financial services, including co-head of the Global Financial Institutions Group at Morgan Stanley. So William, thank you for joining us.

William Chalmers:
Thank you for having me. It's a pleasure to be here.

Ben Caven-Roberts:
Brilliant, so let's dive right in with the macro.

William Chalmers:
Sure.

Ben Caven-Roberts:
So how are you finding the backdrop for the UK currently in terms of how it's evolving, and if there've been any changes in client behavior over the past few months?

William Chalmers:
Thanks for the question, Ben. We put forward our numbers as usual at Q2 in terms of the macroeconomic backdrop and the update on our forecasts, but I suspect the picture will be one of more or less of stability versus Q1. So what do I mean by that? When we look at our Q1 base case, we expected GDP to play out at about 0.8% over the course of this year. HPI about 1.7% positive, about 4.7% unemployment, and one further bank base rate change down to 4%. When we look at that now, there was obviously some slightly weak GDP news out this morning, but nonetheless, before that, at least GDP was probably tracking up a little bit ahead of our expectations.

Unemployment, payroll reports, probably a little bit of weakness. HPI perhaps a little bit stronger, and then bank base rate, well that seems to be going up and down depending upon the news as to GDP or payrolls for example, so we'll see where that goes, but these are changes around the margin, I suppose, around the edge, and therefore the picture will be more or less one of stability, is my expectation.

The client behaviors, overall I think have been very benign, really. That is to say when we look at it from the asset quality point of view, retail has been stable, even improving over the course of the second quarter. Commercial banking has been very benign. As per Q1, there's one or two idiosyncratic risks. We talked about fiber for example, at Q1, but those are idiosyncratic. They're not forebearers of a broader deterioration at all, at least nothing that we're seeing at all.

So overall, from an asset quality point of view that looks very supportive. We had a £100 million tariff overlay at the first quarter as people will have seen. I think that's probably come out at the better end of our expectations, so we'll look to integrate / release that in Q2, but as said, it's coming out probably slightly better than we'd expected.

And then I think looking at that, therefore in summation, asset quality, it all looks very benign. I think where the volatility may be having an effect, Ben, is in levels of activity. So if you look at levels of activity amongst the retail client base, likewise levels of activity amongst the commercial client base, it's perhaps not quite as strong as it might be in a more fertile, more productive macroeconomic climate, but that's where I think you may see some impact of volatility, rather than anything more significant than that.

Ben Caven-Roberts:
Okay. And if we pivot to Lloyds and the strategy there. So 2024 marks the completion of the first chapter of your strategic plan with further profitability and efficiency improvements targeted to 2026. So as you look back and reflect on how the group strategy is currently progressing, what would you call out?

William Chalmers:
The strategy that we launched in 2022 hit its first major milestone in respect of the close of 2024, as you know. That is chapter one. It's all in pursuit of higher, more sustainable returns for our shareholders as we look forward. Within that, we've got revenue growth and diversification ambitions. That's the growth part of the strategy. We've got cost and capital efficiency ambitions. That's the focus part of the strategy. And then we've got enhancing our enablers, which is basically people, data, technology. That's the change part of the strategy. So that's what's delivering ultimately our higher and more sustainable return expectations.

Overall, I think the account that we gave of ourselves up until '24 was hopefully pretty good. That is to say we delivered on about 80% of our external metrics, or KPIs, from a strategic point of view. Likewise, financially we delivered on the around £0.8 billion in terms of strategic initiative incremental revenues that we expect to see, so strategically and financially, I think we did pretty much most of what we expected to do for that first chapter of the strategy.

Now, looking forward for '24 through '26, we expect to accelerate our ambitions, which is a combination of effectively finishing off that which we did not complete up until 2024, and then extending thereafter. So what do we mean by that? We're looking at things in retail, for example, within depth of relationship. Likewise, the mass affluent. We recently launched a premier proposition.

Within BCB, it's about transaction banking and working capital. Within CIB, it's about OOI. In '24 OOI was c.30% in excess of what it was in '21. We've now set the target for '26 being in excess of 45% greater than it was in '21, so this is about, if you like, completion and about extension.

Then alongside of that, when we get to '26, that £0.8 billion that I mentioned for incremental strategic initiative revenues, that should have grown to in excess of £1.5 billion strategic initiative revenues, and that's the ambition. And then you're familiar with our higher level ambitions around sub 50% cost income ratio, around greater than 15% RoTE ambition, around greater than 200 basis points capital generation ambition, all of which we absolutely stand by and have a lot of confidence in achieving. That's the '26 record.

Overall, I think it's been good progress. We have a lot of confidence in what we can do going forward, but there's obviously a lot of work to do.

Ben Caven-Roberts:
Brilliant. Well, let's dive into the businesses a bit more specifically. So you mentioned retail. You have roughly 20% market share in mortgages there. You posted pretty broad growth across both deposits and loans in Q1. What are the key points you're focusing on, looking ahead from here for retail?

William Chalmers:
Yeah, good question. The retail business is obviously tremendously important to us. It's the bulk of our activity within the Group, and a very attractive proposition from a customer point of view and also from a shareholder point of view. The retail performance, as you say Ben, has been strong. If you look at the Q1 numbers, we showed about £7.1 billion lending growth. We showed about £5 billion deposit growth during that quarter. Now to be clear, it is our expectation that some of that was pulled forward, particularly on the mortgage front. There was some evidence of people looking to get mortgages completed, for example, before stamp duty changes came in, and so therefore you should expect to see continued growth in Q2 for sure, but it will not necessarily be at the pace in the mortgage product, for example, that we saw at Q1, simply because of that pull forward factor taking place.

Strategically in the retail business, we're looking to deliver on three things. One is taking advantage of our scale, so that we deliver competitive customer propositions. You will see that evidenced in a variety of areas, but I mentioned depth of relationship a little bit ago. That's one manifestation of that. You'll also see it evidenced in terms of things like increased proportion of direct from bank mortgages. You'll see it evidenced in linking up of PCAs and mortgages in the same way. This is about basically building off the back of our scale franchise and delivering the benefits of that to customers and ultimately of course to shareholders.

Second area of focus is about growing in high value areas. I mentioned the launch of the premier proposition just a second ago. That is in connection with our ambition to increase mass affluent balances by more than 10% over the '24 through '26 period, a key part of it.

And then the third part of it is around new propositions. We've talked before about our embedded finance proposition, which is labelled FlexPay. We talked before about our transportation ecosystem. This is about enhancing our proposition development with customers in pursuit of our broader ambitions from a franchise and ultimately a return point of view.

All of that is then underpinned by strengthening of the distribution, by which I mean in particular, obviously the mobile proposition. We had in excess of six billion logons in the course of 2024. The ambition for '25 and '26 is to build out that mobile proposition, both in terms of its inherent capabilities and also in terms of its franchise reach. Most notably, insurance, pensions and investments is an example of that, where we're looking to make the bank insurance link much, much tighter and much, much more effective.

Ben Caven-Roberts:
So let's pick up on that final point on insurance, pensions and investments. So you have a growing workplace franchise. You've discussed increasing your protection market share as well. So what do you think is the key signposts on the evolution of that business over the medium term?

William Chalmers:
It's an important business for us, clearly. The key signposts at a very direct level, and those that clearly matter to shareholders, I think are being manifested in the context of OOI contribution from insurance, which was up 8% year-on-year in Q1. Likewise, within that, there are specific components that are performing particularly well. General insurance net of claims income, up 38% year-on-year in Q1. So those, I think, Ben, are the direct manifestations of performance.

What's going on beneath that? What's driving that performance? I think three or four points that I would make. One is about market share gains. We've re-engineered the intermediary platform. Likewise, we've re-engineered effectively the digital platform within general insurance. This has been a material driver of market share gains within important areas to us, either intermediaries or in the context of direct relationship GI.

That's one. The second one is, I mentioned the bank insurance relationship just a second ago. That is key. There's no point in us owning an insurance company and a bank under the same holding company unless we can actually make the two work together. So what are examples of that? One is take-up rate in the context of mortgages. Where a customer takes out a mortgage with us, we've now managed to double in the last two years the take-up rate of a protection product alongside of that. In terms of specific numbers, 2023 take-up rate protection with mortgages c.7%, now take-up rate in excess of 15%. Frankly, we think we've got a lot further to go in that respect. You should hold us to a higher standard in that respect, and that's what we expect to deliver.

Similar point really, in terms of connecting the two, the Workplace Pensions product is an operating leverage product. That is to say the more scale you get, it drops through the bottom line. We've now got CIB working together with the Workplace Pensions proposition such that CIB is a major distributor for Workplace Pensions going forward. There's more that we can do for sure, but these are examples of where we're trying to get the two businesses to work much more effectively, and that's the second big driver for our performance in this area.

I think the third one is pretty mechanical, I suppose, for want of a better word, which is the unwind of the CSM, the Contractual Service Margin, which is the IFRS 17 now standard. My colleagues at insurance describe it as deferred profit, which hopefully gives you an idea as to where they're coming from. But nonetheless, this is a relatively mechanical unwind and indeed is contributing to growth and performance, strength and performance within IP&I. It's about one third of the overall OOI that is coming from insurance, stemming from that CSM point.

What we're looking for going forward is strategic focus from this business. So workplace savings, general insurance, enhancing the franchise in the way that I just described. That's where the business is strategically focused. You should expect to see growth in earnings, you should expect to see it being manifested in terms of market metrics. So we've set an ambition, top three protection advisor, for example. We've set an ambition, Scottish Widows app being engaged with by more than 1.5 million of our customers, for example. We set an ambition of scale and operating leverage in workplace per my earlier comments, for example, where we've now got an excessive £100 billion in assets.

These are the kind of outward manifestations of market impact, which in turn lead to the expected growth that we want to see another operating income from this business.

Ben Caven-Roberts:
Okay. If we put it next to commercial banking, Lloyds is a leader in UK infrastructure and project finance and is building momentum in other operating income more broadly, what do you see as the key strengths of that business and what are your main objectives for it as you look ahead?

William Chalmers:
It's a third of our business is, not necessarily in that particular order, but commercial banking is a really important area for us. The way that we see it is that it is completely consistent with our purpose to “Help Britain Prosper”. It is one that allows us to make strategic and financial progress off the back of broadening of proposition. And in line with that is one that should offer us and does offer us really quite attractive financial returns. So it fits from a purpose, strategy, financial perspective.

As you know, we split our commercial banking business into two components, Ben, the first of which is CIB. Now to be clear, we're never going to be a Golden Sachs, and nor do we aspire to be, and actually our competitive advantages in that area, I think rest upon that distinction. So if I think about what is it about CIB that is a strength, that is a strategic advantage that gives us a kind of a right to succeed.

The first one is strategic focus. When we set out with CIB in 2022 and we laid out the strategy, we specifically focus the business on cash, debt, risk. That's it. We're not going to aim to do anything else. We're not going to aim to do many of the areas that the larger investment banks do, and it's that cash, debt, risk focus that is a discipline for the business.

Alongside of that, you get the benefit of the group resources, you get the benefit of the group brand, you get the benefit of the group breadth of products. I just mentioned workplace in the context of the IP&I linkage. These are material benefits that strengthen the backbone of the CIB business.

And then the third, and obviously most importantly to people like me is around capital discipline. So capital discipline is incredibly important for us in the context of CIB, simply because it is an area that historically has led to an erosion in returns or at least been at risk of that, we're determined not to allow that to happen.

How have we seen it happen? We've seen it happen off the back of improved OOI growth. So 30% OOI growth since 2021, 45% ambition by 2026. And we've done that in the context of pretty strict RWA discipline. So RWA is expanded but only by about £3 billion in the context of that OOI growth within CIB. And that has allowed it to steadily improve its returns on capital going forward.

Now, looking forward, we expect income over RWA to hit 5.25% by 2026. That's the metric that we've got out there, which you'll have all seen. That comes off the back of 3% for the same metric in 2021, and therefore that's pretty material improvement over that time. And it gives us confidence that the returns trajectory is going to consistently be in excess of cost of capital, and that's where we want the business to be.

The final point that I think is a strategic strength for this is around building of propositions. Our propositions have typically been quite narrow, probably achieving less leverage than we might otherwise be able to do. So building out things like transaction banking, things like FX, things like DCM capabilities, these are well within our grasp, and indeed that is part of the strategic strength. So that's the CIB picture.

The BCB picture, the strategy there is to be a digitally led relationship bank, which is a bit of a mouthful, but you get the two key points, which is to say digital leadership number one, backed up by relationship banking where it matters, number two. What are the strengths there? Naturally, digital capabilities, mobile onboarding for example, is now 15 times faster than it was when we took the strategy forward in 2022. The franchise, we've got relationship managers up and down the country. That is indeed what you'd expect of us, and that's what we have and we aim to build on that.

And then finally, product breadth. That is developing transaction banking capabilities. We've been developing deposit propositions, likewise working capital capabilities, and of course it consistently borrows off of the CIB products as well. So that product breadth is a key part of it. Where does that take us financially? I think number one, this is an attractive return business. We want to succeed in this business because it is, and always has been, and always will be an attractive return business. Secondly, some of those of you who follow us closely will have seen, we've actually been stalling slightly on the lending front in this, and that is because government-backed lending repayments have exceeded new lending in some of the areas that we're trying to grow in. That is now starting to inflect, and we're starting to see the lending picture plateauing over the course of this year as government repayments taper off and as the lending that we're trying to do continues.

And so that's a good balance sheet picture to see albeit, to be clear, we're at the beginnings of it and we'd like to see some pace injected into that going forward. So those are the financial manifestations of the strategy Ben.

Ben Caven-Roberts:
Very helpful colour. Well, let's wrap it all together and think through the P&L. So NII, you're targeting around £13.5 billion in 2025. Could you talk through some of the moving parts there and what gives you confidence in achieving it?

William Chalmers:
Absolutely. And of course, a critically important part of our P&L. The £13.5 billion in 2025 shows decent growth over the course of '24, as you know, about 6% over £12.8 billion in '24. The big moving pieces of that, and you've heard us talk about this before - net interest margin expected to increase over the course of this year. AIEAs is expected to show solid growth over the course of this year. And then non-banking net interest income, which is basically the fuel or at least part of the fuel for expansion in other operating income expected to grow this year, but not at the same pace, i.e. at a slower pace versus 2024.

So those are the three big pieces, if you'll forgive me, just to tackle each of those pieces in order. Net interest margin, as said, expected to increase resolutely over the course of this year. Pretty much in every quarter - it'll change in its pace. Last quarter we had a six paces point increase. This quarter will be slightly less, but it'll still be an increase and we do expect that increase to continue in its patterns. Again, some quarters being bigger than others in terms of the jump up in net interest margin.

What's going on behind that is the three big moving pieces that we've talked to the market about a lot before. Structural hedge, first of all, £4.2 billion in '24, £1.2 billion growth over the course of this year as maturities refinance and as deposit volumes are at least stable and ideally actually improving slightly over the course of this year in terms of their hedge eligibility. So that's the structural hedge piece, which is a strong tailwind for net interest margin this year, stronger tailwind over the course of next year, and indeed continues to be part of the pattern in the years thereafter.

Mortgages headwind. Again, pretty mechanical, but mortgages were coming off the balance sheet at about a percentage point, i.e. the yield on the mortgages during the course of Q1. They were coming on the balance sheet at about 70 basis points, i.e. that's our completion margin in Q1. That headwind continues to play itself out over the course of this year. It actually starts to taper during the course of this year, and by the time we get to the middle of next, it's kind of more or less extinguished, but overall it's a continued headwind for the course of this year and therefore is a factor.

Deposits. Two factors to bear in mind there. One is churn, we've had a pretty strong ISA season actually over the course of Q2, which has been a contributory factor to that churn. And then the second is bank-base rate reductions. And bank-based rate reductions as many of you will know effectively have a lag effect in terms of our ability to pass those on to the market.

Now, we've been doing a lot to actually reduce that lag effect through management of terms and conditions of deposits, and that has been successful and it's reduced our negative interest rate sensitivity, which is great. But nonetheless, that deposit movement, churn and bank-base rate lag effects, that's a headwind for the course of this year. And again, it will taper out as we go through the year and it'll taper out certainly into next, but it will be a headwind for what it's worth. So that's the margin picture as said, kind of resolute and robust improvements right the way through this year, some quarters bigger than others in terms of the specifics as to the margin improvement. AIEAs, solid growth, I think, over the course of this year. When you look at our AIEAs in Q1, £455.5 billion, those were decent. They were going to then be caught up by the significant lending that I mentioned in the course of Q1, the £7.1 billion.

The new lending in the course of Q2, the activity point that I mentioned earlier on, is still fine. It's still pretty decent growth, but it's not at the pace of Q1 for the reasons that I mentioned around catch-up relating to stamp duty and the like. So, AIEAs is showing solid growth, but again, quarterly strength coming off the back of Q1 lending and it'll ebb and flow depending upon our patterns of new lending during the course of the year.

And then finally, non-banking net interest income, although it's a negative number in our net interest income makeup, you should want non-banking net interest income to grow because it is a support for other operating income. Now, what we'll see during the course of this year is growth, but actually most of that growth coming from volume as opposed to from rates. And that's obviously a good thing because it fuels insurance, pensions and investments. It fuels corporate banking. It fuels, again, the vehicle business, the transportation business. This is all delivering OOI growth patterns. But as said, more a volume story than a rate story and at a slower pace of growth versus '24.

I think, Ben, when we look at that, to be clear, we feel pretty good about our c.£13.5 billion net interest income guidance this year. As always, there are risks around things like customer activity and behaviors, the risks around competition. I suppose the risks around rapid bank-base rate reductions. But actually, we stand back and we say all of those risks, notwithstanding, we feel pretty good about that £13.5 billion over the course of the year and feel able to cope with any of the issues, if you like, or risks that the market might throw at us.

Ben Caven-Roberts:
Very clear. A shift to other income, you've seen pretty strong growth there with Q1 up 8% year-on-year. We've touched on some of the strategic initiatives across the various businesses, but if we wrap that together and think about the trajectory for revenues moving forward beyond just NII.

William Chalmers:
Yeah, really important area for us. Just take a step back, I think as everybody in this room knows, our strategy is effectively to diversify from net interest income dependency. Net interest income is great, but on the other hand, you don't want to be solely dependent upon it. And so, our strategy is very much to diversify and thereby do that through other operating income in pursuit of that higher, more sustainable return ambition that I talked about.

That's what the strategy is all about and that is why we've had significant incremental investments over the course of this strategic period in basically OOI generating activities. It's also why by the time you get to '26, you should expect to see about 50% of that incremental £1.5 billion of strategic initiative revenue that I mentioned earlier on landing in the OOI space. And that is in contrast to the OOI share of our P&L makeup right now, which is more like 25%. So, you can see we're disproportionately weighting investments towards OOI generation, which in turn will disproportionately weight revenues towards OOI balance, and that's very deliberate.

You mentioned growth and we would expect growth. We obviously hold the investments to pretty strict return disciplines. We've seen growth within OOI over the course of '24 of 9%. We've seen it in Q1 of this year of 8%. We expect to see a continuation of that pattern over the course of 2025. Now, to be clear, it'll ebb and flow a bit in component parts over the course of any given quarter. Right now, I think in common with many banks, we're seeing slightly slower growth in CIB other operating income, for example. That's coming off the back of slightly slower markets. So, you're going to see that in any given quarter.

[Fire alarm in venue – transcript edited for clarity]

William Chalmers:
Okay. Well, if you don't mind, I'll just look over the noise and we'll get on with it. So, yeah, it'll ebb and flow with respect to component parts with any given quarter. But overall, we have a lot of confidence in this trajectory.

One of the reasons why we have confidence in this overall trajectory is the fact that it's very broad-based. So, you'll have heard us talk before, for example, about the strength within Retail - transportation and cards as two drivers within that business. You'll have heard us talk before about Commercial - markets and transaction banking, for example. Likewise around insurance - I mentioned GI a second ago, likewise, the unwind of the CSM.

And then finally, a business that we call Lloyds Bank Group Investments, which is basically the equity investments parts of the business. LDC, Lloyds Development Capital alongside Lloyds Living, the homes ownership rental business that we run. That means that the OOI streams are relatively broadly based, which gives us comfort, if you like, and confidence in the OOI trajectory going forward. That's where we stand on OOI, key part of our strategic story, delivering financially. We expect it to continue to be the pattern as we look forward.

Ben Caven-Roberts:
Brilliant, brilliant. Okay. Costs, hopefully, won't trigger another alarm, but you target around £9.7 billion pounds this year. That implies something around a 3% increase. Could you run us through the moving parts there, particularly as you're looking forward to a sub 50% cost income ratio in 2026 and how you're balancing investments and inflationary pressures?

William Chalmers:
Yeah, absolutely. Absolutely no cause for alarm on costs, and I hope that is testified to by the fact that our track record on costs has been pretty good. That is to say when we set out a target, we deliver on it, and that is the expectation for the £9.7 billion that you mentioned this year. That's what we'll do.

A couple of comments to make in respect to that £9.7 billion, first of all. That £9.7 billion is up 3% on last year. If you strip out national insurance, it's actually up 2% on last year, which gives you a better idea, if you like, of the run rate. There's a couple of different things going on within that overall cost trajectory, that dynamic, and I'll just go through them.

First of all, it's investment. You expect us to off the back of what we've said, but also in the interest of securing a long-term success of the bank to continue with investments, and that's exactly what we're doing. And that's driver number one. Driver number two is volume increases. So, we talked just a second ago about OOI, likewise net interest income generating activity. Those are driving volume increases, so it's healthy cost growth, if you like. And then, of course, there's inflation, which we're all having to deal with. It's ebbing away a little bit versus what it was, but it's still a factor. And the fourth driver then is efficiencies, which are significantly eating into inflation and volume-led cost increases. Now, those are coming off the back of investments. They're coming off the back of BAU measures, but it's a roll forward effectively of the £1.2 billion in gross cost saves that we achieved in '24. We expect that to tick up by another c.£500 million over the course of this year. And it's allowing us to attack rather the sources of cost growth.

When you look at Q1 our costs were up £2.55 billion, so that's up 6% year-on-year. So, you might ask, well, how does that fit with our overall 3% up over the course of this year? And the reason for that is because that £2.55 billion was influenced by front loading of severance costs. If you strip out that front loading of severance costs, which is quite material, about £80 million of incremental front loading versus what it was Q1 of last year, then the underlying costs increase was more like 3%. And therefore, you can reconcile it with the overall cost expectation for increases this year once you strip out that front loading of severance costs. It won't be the same in Q2.

The cost saves, three or four points within cost saves are worth mentioning. Where are we getting these cost saves from? In summary, strategic investments, a big part of our program is not just to generate income, but also to generate cost saves. Property, for example. Technology, for example. So, that's point one, strategic investments.

Point two, change driven' saves. We've got a huge change agenda. We're trying to make that change agenda progressively cheaper to achieve any given unit of change. One example of that is that we've opened Lloyds Technology Centre in Hyderabad in India. That offers us more capability at lower cost versus the historic alternatives and therefore reduced cost of change is a second big driver of cost saves.

Third is our usual stuff, third-party management, matrix management, what I'd describe as BAU cost saves. And then the fourth bucket is basically Other. And by Other, I mean productivity changes, which is people like me saying to their teams, "Look, I want you to deliver the same for, let's say, one or two FTEs lower than what you did last year." That type of routine productivity change. And then, finally, the bucket of other also encompasses things like defined benefits where we've been saving a bit of money off the back of basically assumption changes. Nothing more exciting than that.

But it's those four components that are delivering the cost saves that we expect to see over the course of this year and indeed into next. And then, Ben, to link it up to your question there on cost income ratio it's the roll forward of those types of cost saves as mentioned, the £1.2 billion in '24, further £500 million this year and then going into next year, which allows us to deliver a cost base which is not flat but is flatter in terms of its trajectory going into '26 than it has been in recent years.

You add that to the income generation that I've described both at net interest income level and at the other operating income level, and you see those two together give us significant operating leverage, which in turn gives us confidence to getting just below the 50% mark for our cost income ratio in '26. To be clear, it isn't going to be below by much, but it will be below.

Ben Caven-Roberts:
Brilliant. Well, I think we should open up for audience Q&A very soon, but just one final question before we do: asset quality, you're guiding to roughly 25 basis points this year, what factors do you see driving that and how do you judge the quality of the loan book overall at the moment?

William Chalmers:
Yeah, in two words perhaps, pretty good, Ben, would be the way I'd summarise it. Now what do I mean by that? What I mean by that is that asset quality has been very strong and consistently so across Retail and across Commercial Banking for some time and if anything, the trajectory, the direction of travel in Q1 and indeed in Q2 so far, is at the margin a little bit of improvement, not by much because it's already pretty good, but it's a little bit of improvement. Now, specifically what's driving that, I think there's effectively a strong franchise, a low risk appetite, and despite this morning's soft news, a pretty stable macro. It's those three things that effectively are delivering that asset quality outcome.

AQR in Q1, 27 basis points. That is driven by, as many of you'll have seen, by effectively an MES charge that we took in the context of tariff volatility and if you strip that out, it's more like 24 basis points and I mentioned earlier on that we'll be looking to kind of integrate/release that point over the course of Q2, but stripping out that tariff-related overlay, 24 basis points, which is basically consistent with our full year guidance.

Now interestingly enough, if you actually take a closer look at the numbers and you say, well actually Q4 retail benefited from some model calibrations, which is technical quarterly visitation that we do, if you strip that out, the direction of travel in underlying in Retail was more benign going into Q1. Likewise, if you strip out fibre from Commercial, which is effectively a function of government policy around implementation of the fibre network in the UK, if you strip that out, the direction of travel within Commercial, likewise, is improvement in Q1. This is what I mean by the underlying being benign/improving over the course of Q4 into Q1, and indeed we've seen that direction of travel basically be maintained going into Q2. Looking forward, new to arrears, again, stable to down, down in mortgages for example, but really very benign in the context of the Retail business.

Stage three within commercial, strip out fibre, very flat, nothing going on that we can detect and so all looking pretty good. And then the early warning indicators, whether that is things like cards, minimum repayment levels, whether that is things like working capital utilisation or liquidity within the BCB book, very, very benign. Nothing that we're seeing that causes us any cause for concern if you like. I do think that's off the back of a decent book, strong foundations, mortgages we're lending to people with excess of £80,000 household income. Unsecured, we're lending to people with on average £45,000 income. LTVs within mortgages, 43%.

Over 70% now of our mortgage customers are paying a rate in excess of 3%, so three quarters have normalised for the high rate environment that we're in with no detectable sign of increases in arrears. In fact, if anything, quite the reverse.

So some strong foundations and that's all built off of a very well-provisioned book as you know, the ECL of £3.75 billion, which is actually higher like for like than it was pre-pandemic. So Ben, when we look at the AQR and more importantly everything that's going on behind the AQR, we feel really comfortable.

Ben Caven-Roberts:
Brilliant. Well, let's see if there are any questions from the audience. Okay. Maybe two if we can take them quite quickly. I'm conscious we have 29 seconds left.

Audience Question:
Unfortunately, I have two questions if possible. The first one is could you describe a bit the benefits of removing ring-fenced banks for clients and for the bank? And the second one is about your comment of opening some IT centre in India. Just theoretically speaking, isn't it a bit against your Lloyds Bank idea of help UK prosperity or growth?

William Chalmers:
Yeah, good question. Can I just make sure I understood the first question?

Audience Question:
In terms of ring-fenced bank, removing this structure, what's the benefits for your clients?

William Chalmers:
Yeah, absolutely. Well, maybe just to deal with the second first and then come back to ring-fenced banks. No, I don't think it's inconsistent at all really with the "Help Britain Prosper" purpose of the bank. In fact, I think it's consistent with. Because what we're doing is effectively complementing the UK setup, the UK workforce and skill set. We're able to access, as I say, a broad range of skills at efficient price points, which in turn helps us to deliver ultimately very competitive and I hope compelling customer propositions. And it's that kind of breadth of capability that delivers better propositions. It's that efficiency that delivers, if you like, more keenly priced propositions. And again, it is complementary to the setup that we have in the UK. So I think we are really pleased with the developments there. We see it as totally consistent with the workforce and in fact the level of integration of the UK and the Indian setup is growing all the time. To be clear, to an extent here, we're somewhat catching up with competitors to be clear, but we see it completely compatible with the purpose.

The ring-fencing point is interesting. I mean the debate on ring-fencing is effectively to say, look, what we've seen since ring-fencing was conceptualised and introduced is a significant change in terms of resolution and recovery, in terms of capital levels, liquidity levels, funding levels, in terms of derivative central clearing. These types of things have materially reduced the risk in the system and of course with respect to any individual bank. Therefore it is only natural to reconsider what the role of ring-fencing might be given that evolution.

Now, realistically, I think it is more likely that we see changes around the edges of ring-fencing such as the Skeoch report introduced and maybe one or two things that might go beyond that, and that's helpful. We'll take that type of change. But I think over the longer term, it is appropriate in the context of everything else that is going on or has gone on, to have a debate about whether the ring-fencing regime is still appropriate in that context. But I think that's going to take time. We are not looking at that to progress change or force change in the near term. It's more a longer-term picture. Ultimately what will that help us deliver? It'll be about reducing customer friction, giving us more strength if you like, to deliver on what we're aiming to do.

Ben Caven-Roberts:
Maybe quick fire.

Audience Question:
Hi William. I was wondering what your thoughts were on the outlook for UK deposit growth and then as a second part of the question, specifically for Lloyds, I think you mentioned in your comments that you were talking about the stability of the deposits and that they were even improving in terms of hedge eligibility.

So I just wondered if you could remind us what the sort of structural hedge capacity is, then might we even see the notional start to grow again, which might add stability to future revenues?

William Chalmers:
Yeah, maybe a couple of points on deposits and Ben, I appreciate that we're coming up against time. So in that context, £5 billion deposit increase in Q1. We expect to see continued growth in deposits in Q2, but two points to make around that: one is it will not necessarily be at the £5 billion pace within Retail at least. We may see a bit more strength actually in Commercial Banking, but the Retail pace, which is responsible for most of that £5 billion isn't necessarily going to carry on at quite that pace in Q2, but growth to be sure.

The second is that I think in the context of perhaps what the Chancellor said about potentially ending ISAs as well as the market customers, that is, feeling that now is the time to get a fixed rate if you're going to, before fixed rates starts to come down. We've seen a strong ISA season frankly, we've also seen terrific market share in that ISA season, which is brilliant. We expect to see 20% plus market share in the ISA season, but it is a slightly stronger ISA season than we'd expected, which in turn is what led me to make the comment earlier on about a little bit of churn going on there, which in turn is a non -hedge eligible deposit.

Now, where that leads us, I think, is for the hedge in territory that's very similar actually to where we were at the full year and at the Q1. We do expect to see not just stability, but a pretty modest tick up in terms of hedge eligible deposits, which should enable us to build on volumes in the hedge as we go through the year. That remains our base case.

Ben Caven-Roberts:
Brilliant. Well thank you so much for joining us, William.

William Chalmers:
Pleasure. Thank you very much indeed for taking the time.

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. 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