BANK OF AMERICA FINANCIALS CEO CONFERENCE WITH CHARLIE NUNN – PRESENTATION TRANSCRIPT
(amended in places to improve readability only)

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Charlie Nunn, Group Chief Executive, Lloyds Banking Group
Perlie Mong, UK Banks Research Analyst, Bank of America (Moderator)

Perlie Mong:

Its great to have you here as usual. I think most people here know you very well, so maybe we can just dive straight in. So, starting with the macro side of things. I think William said last week, "The UK macro backdrop is uninspiring, but not unsupportive." I hope I'm not misquoting him. But do you think there is a risk that we focus too much on the uninspiring and not enough on the not unsupportive? Because if I look at unemployment and credit quality, all of that is still looking quite supportive. And are there any other areas that you think are actually more supportive than we give it credit for?

Charlie Nunn:

Brilliant. So, first of all, thank you for having me. It's great to be here today. Yes, I think William's characterisation is good. We've talked for a while about what we call a very resilient economy, but a slower growth economy. And our forecasts, as you know, have been saying that we get about one to one and a half percent GDP growth, for example, in the next period. But as you say, unemployment stays healthy. And actually, we see for Lloyds Banking Group an opportunity to grow faster than the economy. So, I'll come back to those opportunities. Why we have that confidence in the resilience of the economy, it's primarily because of what we can see in households, individuals, and then businesses. Obviously, the government's finances is a matter of quite a public debate. And we can see the challenges we've got, which is caused by the £400 billion injection through COVID, Brexit and all the other things, the structural issues we've got. But when you look at households and businesses, they continue to improve their resilience. For households, the savings rates actually in quite a broad spectrum, from the bottom 20% plus in terms of income and wealth of households, has continued to strengthen. We've now seen six, seven quarters of real wage growth. We're seeing strong discretionary spending year-on-year. And there's the ability for households to create more demand, if they wanted to. As you will have known from the data, the households have been deleveraging consistently pretty much since the financial crisis. So, households' finances are in a pretty healthy state.

We know consumer confidence isn't at the highest levels, but there is a real opportunity for households to move to a different trajectory. And businesses are the same. Actually, we've now seen six quarters where business cash flows different by sector, have continued to strengthen. They're continuing to deleverage post the COVID period. And the issue for businesses is that business investment is lower, which is part of the productivity issue. So, first thing is real resilience in the underlying economy. The second thing is green shoots or areas for higher growth, we always, when we lay out the strategy of Lloyds Banking Group, wanted to expose ourselves to the higher growth parts of the economy.

And when you look at the policy, and then the government commitments, and then the momentum around some of the big sectors, so infrastructure, green energy transition, housing, obviously some of the advanced and tech sectors, the pensions market and pensions reform, electronification or EVs in transport. We're seeing all of those things have real significant money behind them. Very significant international investors that want to continue to invest in the UK and there's an opportunity for those areas to grow faster and as a result of that, what we are seeing is even our lending and our balance sheet is growing faster than the economy. We still can have £5 billion pounds worth of asset growth, 3% growth in the first half of this year alone. So, we really do think it's a resilient slow growth economy with the potential to move to a higher growth trajectory.

Perlie Mong:

You've mentioned government finances, so maybe we should address the other elephant in the room. I know you've said in the past that you thought increasing taxes on banks would be inconsistent with the growth agenda. Can you share your thoughts on the autumn budget more broadly? We still have two months to go. And is there anything other than bank tax that concerns you?

Charlie:

So, I'm probably experienced enough now not to get into the middle of a political discussion around a budget. But clearly, the budget will be an important event. I don't think it will change the trajectory materially of the economy or by the way, our growth story in the next period of time. But it's clearly a really important event. And it's become almost a clearing event I think for some investors, for the obvious reasons that we know. Look, on bank taxes, because you raised that, the position that we've had, and you heard probably from all of the bank CEOs, is the one that we've seen to date. First of all, both the chancellor and the governor have come out previously and said they don't think that's the right policy decision for this environment. And actually, having a chancellor with the Leeds Reforms, the Mansion House Reforms, and with an explicit statement that says simply a healthy economy needs a healthy financial system, it wouldn't be consistent with prior statements.

So, we think it's unlikely in that context and we've had no discussions with the government or the treasury around the bank tax. Clearly feasible from a political perspective, but not something we've had debates on. And it wouldn't be consistent with previous messages. In terms of the budget itself, look, there's going to be a combination of factors that determine how big any hole in the government's finances are. The OBR will be important, how the government thinks about its own fiscal constraints. The pace and the market's view of quantitative tightening is interesting in this context. I know that all of us will be all over that stuff. Depending on where they get to, our view is very much they need to stay focused on enabling the investment, and the real economy. Businesses need to continue to invest and grow, that's a really important part of this. Incentives to support that would be important.

And then I think what we would hope to see is a balanced agenda between proper reform that enables some level of control and spending, alongside whatever they decide from a political perspective on taxes in order to fill that gap. But when you look at the industrial strategy, the regulatory reform agenda, the focus in the economy taking a higher level, but an appropriate level of risk through things like pensions and pensions markets. The government's current strategy really requires a budget that's in line with that if it's going to maintain momentum and get back to where we started, which is get the UK back to our higher growth trajectory.

Perlie Mong:

And well, you've talked about the higher growth trajectory and looking maybe a little bit further ahead than the budget. Your purpose is to help Britain prosper. Where do you see the best opportunities for the medium term in terms of growth that obviously will be good for the economy, but also good for Lloyds Banking Group?

Charlie:

So, as you know, we are in year four or five of our five-year strategy. We announced our objectives on 24th February 2022 which was actually the day Russia invaded Ukraine, I remember that day very well. And our strategy was to get back to growth, and then really drive investment in our talent, and our people, and our technology to be fit for the future. And the great news is we think we've managed to deliver that over the last period. And we still see that as the path for the next period of time. As you know, a big part of that was our commitment to our shareholders in '26, to get to greater than 200 basis points of capital and greater than 15% ROTE. And we are feeling really confident about that. And the reason for that is when you look at the underlying is how and where we've grown.

So, we, depending on where you come out in your consensus, have been able to grow our revenues by about 30% in that period of time. And the biggest driver of that isn't interest margins, NIM, because we've had to deal with some very significant headwinds on NIM. For example, many of our investors will know we had a significant compression in our mortgage margins. What's been the driver of that? It's been a few things. First of all, a focus on other operating income. We wanted a more diversified, more balanced mix of revenues, and so we prioritised some of our businesses that would grow other operating income. That's businesses like our transport finance business, our pensions business, our bankassurance model of selling insurance to our 28 million retail customers. We're the biggest digital bank in the UK. Regrowing our corporate institutional business trade and working capital.

Our equity finance business, LDC, all those businesses really drive other operating income. And we've been driving an 8 to 10% growth per year. 9% in the first half of this year, up again year-on-year. And that's really differentiating and really important. The second part is what I just described. We built a strategy focused on the parts of the economy that we knew needed to grow, so housing, infrastructure, green finance and transition. I mentioned pensions now a few times, but that's an exciting business, because even before the government's current pensions reform, we knew the pivot towards pensions, pensions contributions, and the ability to consolidate pensions means you can grow that business significantly above GDP. And that's what we've been doing for the last few years. It's working. And we can see that trajectory and momentum continuing. And we think there's a really exciting opportunity in financial services in that context in the UK.

Perlie Mong:

Speaking of exciting new launches, I've noticed that you've recently launched a Premier bank account, which should really complement your broader mass affluent offering. Can you talk about the customer opportunity there and the cross-selling potential?

Charlie:

Yes. Thank you. So, that was one of the initiatives we laid out in 2021, which was to focus more on our... It's a horrible name, mass affluent, by the way. We knew that, but we knew at least we could explain what it meant. We defined that as customers that had either an income or savings of more than £75,000. So, that was the definition back in 2021. Premier's got a slightly different positioning, but it's very much focused on that. And the great news was we are already the biggest mass affluent financial services provider in the UK, but we knew that that was an opportunity for us to really deepen our relationships, bring the full breadth of Lloyds Banking Group, including things like investments, pensions, insurance, obviously our homes business, and then start to differentiate further. And so far we've had good progress. Premier is the next part around trying to really bring a proposition that's differentiated for customers.

But for example, when we started this journey, we only had about 9% share of mortgages more than £500,000. We've gone up to over 22%. We had less than, I think it was 6% share of equity ISAs. We've been up at over 20% of equity ISAs. We attracted about £25 billion worth of additional mass affluent savings during this period. And so, we know that's where customers have more complex needs, where the market's growing fast, and we can grow with them. And so, it's been a great journey so far. It's very competitive, it's very innovative, and we need to stay right at the front of it. And that's what we intend to do.

Perlie Mong:

Thank you for that. Normally as an analyst, after hearing all about growth, we want to follow up with, and how much is that going to cost? But cost control has always been very strong at Lloyds. And you've talked about a flatter cost profile next year. Can you talk about the efficiency gains you have achieved to make that possible and your investment priorities from here?

Charlie:

Yeah, so as I've said before in this forum, I think it has been a pleasure to join an organisation that has a culture of cost discipline and cost control. I've inherited other organisations which aren't like that, and it's certainly one of the core strengths of Lloyds Banking Group. Now having said that, and I think this has been one of my frustrations and probably for you, organisations and financial services organisations have delivered significant cost efficiency, but total costs have gone up, and ours have, and I should just explain that a bit. But in terms of cost efficiencies through this period we have delivered, we announced at the year end results, now £1.5 billion worth of gross cost savings. That's a very material efficiency and productivity delivery in this context. And obviously it's been a massive offset to the inflation we've experienced, but also the high level of investment. And it's been the high level of investment in our growth that's been driving our costs in this last period of time.

So when we look forward, we're going to continue to have the cost discipline. The track record we now have around delivering the efficiencies that you've seen will continue. And of course in 2022 again we asked investors to support an additional £4 billion worth of investment over this five-year period on top of our BAU investment. And that investment's now plateauing, which is why the combination of ongoing cost savings together with a slowing down in the investment in this cycle, underpinned by growth in the businesses, which obviously brings some level of cost, is why we see that the cost base we think will flatten into next year. Of course the momentum, though, when we see looking forward next year, we'll talk more about the strategy beyond 2026, and I think how we look at efficiency and productivity in financial services. There's going to be another wave of it looking forward and we are going to be very well positioned for that based on the investments and the capabilities we've built in this last three or four years.

Perlie Mong:

Well, that's very exciting. So sorry to bring you to a slightly less exciting topic on costs. So motor finance remediation cost. I'm sure you're glad the Supreme Court decision is now behind us. The FCA, however, has estimated a £9 to £18 billion cost for the sector from the redress scheme that they will consult on later this year. I know you said that you're not expecting any further material charges, but can you just give us a bit more colour behind your confidence around this matter?

Charlie:

Yeah, so first of all, what have we provisioned already and why have we made that provision? We've already provisioned, as many of you'll know, £1.15 billion. These are the hardest decisions I think we make as a Board, to make sure that we are doing it in a way that is giving as much clarity and foresight as we can. But know that's a big decision for us, for the investors, for the shareholders of the organisation. That was made up of two parts. An initial provision we made back in January last year on what was called discretionary commission models, which was a regulatory issue raised by the FOS at that stage, and then an additional £700 million pounds that we put linked to the Court of Appeal, and then the Supreme Court has just largely overturned the majority of that issue, but not all of it. So that's the provision we have.

That provision is based... We did it deliberately this way, so we knew that many of our investors and analysts would understand it. We did it the same way we do ECLs. We have multiple scenarios around a very broad range of issues that the regulator and the legal system is deciding on. And then we've probability weighted them based on our understanding of those scenarios. And of course, as you said, we really welcomed the Supreme Court judgment. We think it gave real clarity around the points of law that enables us to operate safely and support customers. We re-looked at our scenarios in that context and we were comfortable that there's no material update needed at this stage. Now we've always said the provision we have by definition could either need to be reduced or increased. But I think what the FCA has now done, as they come out in the next few weeks with their consultation plan, has materially de-risked the range of our provision.

And actually the range that Nikhil has given around this, and I think he's joining us later here, isn't he, is quite well aligned with our £1.15 billion, depending on where you end up in that range. But I think it really gives us more clarity now to put this issue behind us. As a management team we work incredibly closely with the FCA to make sure we get a scheme that we think is fully fair and proportionate, and proportionate means on behalf of our shareholders and customers in this context. And I think from a timeline perspective, you're right, they're going to come out with a consultation in the next period of time, it will take a few weeks to consult, and then we'll need to see if we get to a clearer position. With respect to Lloyds Banking Group, it feels like we're in a much more certain place as to where we are. And if there's any new information we'll update you positively or negatively, but I don't think it's going to be material. The other broader context here, which is important, is this government, through the Mansion House reforms and then what they call the Leeds Reforms, has really started to create a different framework for conduct risk. And as Lloyds Banking Group, one of our big objectives when we started this phase was to try and make the regulatory environment more supportive of the real economy economic growth and the financial system as an enabler of that. And we always said one of the biggest areas was to develop a more forward looking and predictable conduct regime. And I think some of the changes we've seen alongside what's been going with motor finance has been really important.

So the FOS now has a 10-year backstop. There's been a review of how we think about interest rates for remediation. It's gone from an assumed 8% to base rate plus one, which is broadly 3% for the last 10 years, which is much more, we think, in line with customers, shareholders, balanced interests. And then there's a whole set of reforms the government's laid out to continue to create a more predictable and forward-looking conduct regime. And we think that's really important so that we can invest, we can innovate, we can reach more customers, but our shareholders can actually feel more confident in terms of what's predictable in terms of returns going forward. So we're going to stay very focused on that agenda as well.

Perlie Mong:

Well, while we're on the topic of regulations, so clearly this agenda about making remediation especially more predictable is very helpful, but you've also been vocal about your views on the whole range of other rate changes that the government is considering. So pension reform, ring-fencing to name a few. So can you talk about how you think the regulations can help support the sector further?

Charlie:

Yeah, so it goes back to the comment I just made. For the first time since the financial crisis we have a government and a chancellor saying that a healthy economy needs a healthy financial system. There's been a set of statements also then from the regulators to say, including the PRA, but to say that we've reached the level of regulation post the financial crisis that is needed to maintain prudential stability in the economy and for the right level of conduct standards, which is the first time we've heard that in 15 years. And then the government ...actually, the previous government put it in place and then this government has enforced it in a more rigorous way, has put in place this secondary objective for both regulators, and as fact has taken this to other regulators to make sure they have an objective around competitiveness and growth.

That's both competitiveness and growth of our sector, and that's relative to other international sectors, other international financial services sectors and companies, as well as the competitiveness and growth of the real economy, which we are the biggest enabler of, actually, Lloyds Banking Group more than any other financial services company. So that's a really helpful context. As I say, I think the initial announcements through Mansion House and the Leeds Reforms do a good job of teeing up a pretty bold set of changes on the conduct regime. There's now a commitment to start looking at the capital regime and other forms of prudential regulation. So the PRA through the FPC are now going to be looking at capital in the next few months.

And of course they're going to have a look at the ring-fencing regime, but based on the interactions that we've had over the last period of time, I think ring-fencing is with us for the next period of time anyway. That's not material by the way, for us. The reason we raised it as an issue is we thought it would take five years for any ring-fencing to be materially changed. And for the 2030s, I think ring-fencing won't help the UK economy be competitive with other economies, but it doesn't slow us down, it doesn't do anything to materially change what we are doing, certainly this decade.

Perlie Mong:

Right. And you mentioned capital review. The capital flight path is probably clearer now that there is more clarity over the motor finance situation. You've committed to paying down to 13% next year. Is distribution still your priority use of capital?

Charlie:

Yes, we've said from the very start, actually, and I hope people, now that I'm over four years in, can really see that we've got a track record around this. We said we were going to create a very strong and sustainable capital return and capital generation business that works through the cycle, and that's where our growth in 15% ROTE in 2026 and greater than 200 basis points of capital is very differentiating. And we said we thought if we had the additional investment that was already included in that, we would always look to return excess capital at the end of the year and our discussions with the board to shareholders. And that's what we've done, and you've seen the track record on us building our sustainable dividend every year. We've grown basically at a 15% CAGR and then we've done a buyback, which based on our discussions with our investors has been the right combination between the two.

We still think that's a really important part of our investor proposition and we're completely committed to that next year. Now, two builds on that, none of which say that we won't continue to distribute at the level we're talking about. The first is we also, with that level of growth in capital distributions, are growing our balance sheet. I smile because when I joined this organisation, I spent a lot of time with analysts in my gardening leave, and a number of people said to me, "Lloyds Banking Group's TNAV has been 50p at the start of the last decade and it's 50p now. How are you going to get growth?"

And I said, "Well, if you don't grow the balance sheet, you don't invest in the business, and you give your retained earnings back as capital, by definition the TNAV doesn't move." So we're now proving that we can grow the balance sheet profitably and deploy it. I just mentioned earlier, for example, having grown the balance sheet by 5% in the first six months of this year, and we think that's really important and a really important use of capital for our investors so that we can... Because we're generating strong returns on that capital. And then the second thing is... And we've done a couple of them. We've always said, we'll look at what I characterise as infill M&A, where it brings distinctive capability or things we can't do ourselves. We're already the scale player in virtually every part of the UK, but where it brings new capabilities that we can bring to market, we'll do that.

So one of the great examples is the Tusker EV financing business that we bought. And we've more than tripled the size of the fleet within two years. So it's exactly the kind of distinctive capability, number one in its sector, plugged into our distribution. We can bring real value to our shareholders and really create synergies that are positive. And so we'll look at those kind of infill acquisitions. But I think at this stage, given who we are, we should continue to see very strong distributions to shareholders.

Perlie Mong:

Well, I mean now that you've mentioned M&A, what other capabilities would you like to add to your franchise? You have a lot of business footprint, so anything specific in mind?

Charlie:

No, I mean it's in the areas we've laid out as strategic priorities, I think where we don't start with 15 to 30% market share and the leading capabilities. So what are the kind of areas, obviously in our insurance and pensions business and some of our wealth businesses there's opportunities to look at capabilities. In some of our SME financing businesses there's capabilities there that we don't have relative to the market that we continue to look at.

We've looked at capabilities, we've taken equity positions, not done outright buys, of some tech companies that bring distinctive tech capabilities to deliver the next level of innovation. You've heard me say it many times, we're by far the biggest digital service in the UK, 23 million people with 7 billion logons to our digital apps. So how do we continue to be at the forefront of digital and take that forward? We'll continue to look at those kinds of things.

But as I say, the key theme for us is a distinctive capability that we can scale. And if we can see those things in areas that we've committed to growing to our investors, that's great. If not, we'll just continue to do it organically because we tend to be the leader in most segments and sectors anyway.

Perlie Mong:

Yeah, that's great. So we are now more than halfway through your current strategy cycle, as you said, and we've talked a lot about your organic plans.

I wouldn't want to get ahead of myself, but when you look ahead to the next strategy cycle, what are the areas that you're particularly focused on and what can drive returns even higher?

Charlie:

So yeah, our guidance goes out till 2026 and my team is here so I'm not going to you guidance beyond 2026, otherwise I'll get myself into trouble! And I think one thing we will be clear, we will come out with our new strategy before year-end results '26. So we'll do it at sometime next year. I'm a big believer that when you've got an organisation moving, you want to sprint through the finish line into the next phase of your strategy, not take some weird pause and then slow down before you start mobilising again. So that's what we'll do.

Now, what do I think are going to be the themes? Look, the first thing was getting the biggest UK-centered financial balance sheet and bank growing, maintaining or winning market share - and then growing at an 8 to 10% CAGR in our combination of businesses that drive other operating income is a brilliant starting point. And that momentum will make a difference to our investors, to our investor proposition, and we need to maintain that. And so I think that's clearly one of the things we see.

The world continues to change. It's a very competitive market. We're proving we can more than compete and win share where we want to win, but we're going to have to continue to invest and innovate in those areas and we should be able to maintain that growth.

A part of that, as you will all know, has been us revaluing our structural hedge. And the great thing for Lloyds Banking Group is we have a different structural hedge to other players in the market by design. It's a longer dated structural hedge and it's been a significant source of the value creation through this first phase, but not the majority. But it will still be a tailwind depending on your views of the market as we leave 2026. So it will still give us some upside into '27 and then depending on your view of the longer term rates market, for the rest of this decade, it will be supportive of our businesses and our growth.

The second thing I think is obviously, we're a bank that's great at cost control and has delivered significant efficiencies. I talked about the £1.5 billion we delivered through the first period of time. When we look at the maturity of our capabilities now, the way the market's operating, and then how new technologies and the combination of generative AI with agentic, so agentic AI, we think will provide opportunities for another change in the level of productivity. But also support growth, enable us to differentiate and deliver propositions that don't exist in the market today, which we're really excited by. We think that'll be a material part of this next phase as well.

And so we're very excited about the phase beyond 2026. We are going to deliver our 2026 results. We have confidence in those and we really believe, as a management team, that doing what we said we would do is important. As I said, delivering almost a 30% increase in revenues at those greater than 15% ROTEs, and delivering the level of capital we're talking about is a material achievement and we want to deliver that. And then we're going to grow from there, so it's going to be a fun few years.

Perlie Mong:

I'm very looking forward to that. Well, you've mentioned structural hedge and the slightly different shape and duration versus other peers. I think one of the questions that we all think about in the analyst community is to what extent will these benefits, if you like, get shared with customers versus shareholders? So when your structural hedge gets rolled in '27 and '28, that would probably give you a bit more competitive advantage versus some of your peers who might have already rolled through their structural hedges. Is that how you would think about it in terms of competition?

Charlie:

So I think the first point is to focus on competition I think is really important. The one thing as a management team you can't control is what your competitors do on pricing. And as you say, the UK is a very competitive market. Look, the good news in that context is we've proven in the last few years we can, for the first time actually since the financial crisis, either maintain our market share or grow market share without massively compromising margins or where margins have got tighter, do it in a way that still generates shareholder value. And so mortgages is probably the great example actually. As I said, we've had another 5 billion of growth this year. Last year we were trading at around 20% market share. Margins are being stable around the 70 basis points and through cycle, we know that's going to be very attractive for our shareholders. In the 15 years or the 12, 13 years before that, Lloyds Banking Group gave up 1 to 2% market share per year. So it's really important that we know how to compete and maintain margins even in this very competitive dynamic.

I think you're right, our structural hedge will be differentiating relative to some of our peers in that next period of time. But at the same time, I'm never complacent. I spend a lot of time looking out at the market. The nature of competition is getting more complex, right? You're getting obviously some fin-techs with greater scale. We've got other UK banks operating now with a very clear focus on the UK.

And we've got international competitors who are increasingly looking at the UK and our core businesses. So for us, we just need to raise the game. We've proven we can compete with them, we can win share, and we can do it at margins that are very accretive. We're going to have a differentiated underlying ballast for our structural hedge through this period of time.

Actually, what's going to be even more important, which I don't talk that much to the analysts, is the change in the management team, the capabilities, and some of the technology that we're using, and the pace at which we can then respond to competition and compete. And that's been the biggest change we've made in the last three years that gives us some confidence that we can face into that next three as well. Do I think margins are going to get completely competed away? No, I don't.

Perlie Mong:

That's very reassuring. With 10 minutes left, maybe I will open the floor up for questions. Anybody's got a question for Charlie? Gentleman over there, please.

Audience Member:

Sorry, it's probably small technicalities, picking up on a comment you said there that we review the capital distributions once a year. You're the only one in the sector who does that because everyone else does it the half year. Because if I was the board, I wouldn't change it while motor is hanging over you. I think it would send either positive or negative signals and create unnecessary headaches. So if we think about motor being put behind, is that something the board will reconsider into next year?

Charlie:

By the way, first of all, thank you for the question. It's something I've proactively brought to the board a couple of times since I've been in this role actually. So it is something we have as a discussion with the board on a regular basis. A number of our investors have asked us that question. To date the board's decided as you say that the current plan we have is the right one. So we'll have it open to current review. Again, it is very much a discussion for the board in that context.

As you say, there's some other uncertainties going on at the moment. I also think when we look at the new strategy, it'll be a meaningful part of the discussion and we'll be in those discussions over the next six months. So I'm not going to make a commitment either way. I want you to know we do discuss it, we do take investor feedback and definitely we'll continue to review it.

Perlie Mong:

Any other questions? Well, if not, then I always have more. And sitting next to the CEO of the largest mortgage bank in the UK, I can't finish the discussion without asking you to comment on that. So what are you seeing in terms of volumes now that the seasonal effect from the stamp duty change is over? Has there been any changes in terms of price competition?

Charlie:

Yeah, so I gave some of the stats around our performance, but obviously we saw a significant increase in volumes in the first quarter pre the stamp duty changes. We were surprised and I think the industry was surprised that the volumes stayed stronger in the last quarter than we thought they might do. They did reduce slightly, but overall, the first half of the year has been strong.

And of course there's been some changes from a regulatory and a government perspective that's enabled us, especially for first time buyers, to look at affordability and support customers in a slightly broader way. So that's supported some of the volumes in the market. So we're looking at this in a very supportive way.

Our forecast for house prices, by the way, of all the forecasts we do, it's the hardest one to get right, we upgraded slightly to 3% for this year. At this stage that looks pretty good. So we don't see that there's a massive either spike or increase in house prices, although it differs by house and property and location in the country. But it feels like it remains a supportive market at this stage. And you're right, competition is hot and is tight. What you've seen us print in the first two quarters is around 70 basis points of margin. That's a pretty complex makeup of both retention business, new business, and then all of the different types of the mortgage market, including buy-to-let. But we feel confident in those margins; it is a tighter margin market, but we feel confident around that circa 70 basis points at this stage.

The other thing that's been complex in this market, which you'll have all been seeing, is when swap rates move, we see that margins and pricing aren't stable for a period. They either widen or narrow, and it takes a while for them to get to some kind of equilibrium. And of course in the first half we've seen quite a change in swap rates. So let's see how this stabilises in the second half.

So supportive market, we seem to be trading well in that context. We're growing the business; it's very accretive. So we see that as one of the continued growth engines for Lloyds Banking Group.

Perlie Mong:

Fantastic. And I don't want to forget about asset quality, so maybe I'll ask it in a slightly different way. I think you've previously noted that 70% of customers have less than £5,000 of savings. So far customers have been pretty resilient in terms of credit quality and spending. But with the Autumn budget, as we talked about coming through, maybe more pressure on household finances, especially if we see a further tax rise in the next couple of months, what's your expectation for that resilience?

Charlie:

Yeah, very much the same. So I think a couple of things in that context. I said up front that we see the top 80% by income of people in the UK, remember we have half the households in the UK, so I have this unique lens on UK household finances or individual's finances. The top 80% have been increasing their savings and their cash flows. Obviously saving rates are at a higher percent, a higher rate, and debt ratios broadly have been coming down. So I think the first thing is that's a pretty supportive environment from a credit perspective.

The second thing is obviously Lloyds Banking Group has a very specific risk appetite. And on the retail side, which is where you were at. But on the retail side, we basically only do prime lending. And so where we would see the stress is typically in the bottom 20% of society by income and wealth. And obviously a lot of those people would typically be on benefits or have some form of benefits. By the way, they'll have zero or negative savings; they won't have £5,000. That's very distributed to the top end. And we will support them in different ways. We will support them with everyday banking services and appropriate support where it's needed. But they tend not to be within our risk appetite. And of course, on mortgages, again, when you look at it, the average household income is over £70,000. So double the average individual income. So they tend to be families that are more financially resilient.

So the real driver of ECL that would be different from our forecasts is if we saw unemployment materially spike, because that then isn't around financial resilience, it's much more around individual circumstances. And as you know, actually we've been slightly above the market in terms of our baseline forecasts. The market's come to us, but we are still seeing unemployment in our guidance stay pretty strong at about 4.8, 4.9%, maybe get ticked to 5%. And all of our guidance, all of our forecasts are on that basis. So, no, we feel good about both the economy but also our strategy for how we're supporting customers in that context. And we expect, and we'll continue to see a pretty benign environment from an ECLs on an impairment's perspective.

Perlie Mong:

Fantastic. Unless there are any last-minute questions. That gentleman over there.

Audience Member:

Roughly how much, this year, are you spending on AI? How much do you think that probably increases next year? And are you getting any material cash costs savings at the moment from any of that, or it's more just kind of non-cash productivity improvements?

Charlie:

On AI?

Audience Member:

Yeah.

Charlie:

So we haven't disclosed the amount we're spending on AI, so let me give you some context on that, but I think it is a brilliant question. So look, we have 800 AI models live at the moment, including a significant number using generative AI and a few use cases combining agentic AI and generative AI. I'm sure you are all over this. And the traditional forms of AI, which is typically machine learning as you know, is already driving massive productivity efficiency and credit decisioning benefits across the bank. And we already have; one of the key use cases we've talked about externally is we use a generative AI tool to support all of our contact centre colleagues. It was over 10,000 colleagues, and it saw a very material productivity lift in that context. So we haven't given specific numbers, but we're already seeing significant value from it and we are using these tools extensively across the bank.

And we definitely see, as I just said earlier, that the opportunity to use specifically agentic AI as we get into the next few years is going to create significant opportunities. Again, we haven't disclosed the money around this, but we are investing significantly around it.

I think the really important point is when you try and do this at scale in a regulated market is that you do it with the right foundations. And so we started this in the back end of '22, implementing the data environments and the AI tool environments and then building a set of engineering and data scientists who would enable us to leverage obviously generative safely, but then also generative combined with agentic. So that's in a very, very good place for us to then start to deploy it at scale across the organisation.

And then the third thought around this is I always think the long pole in the tent here for really exciting use cases, which aren't just about faster, better, cheaper, which is what most organisations are talking about, but are actually about extending and changing how we serve customers in new ways and then provide new growth. The long pole in that tent is going to be the regulation. And we are already working with, in a regulatory sandbox with the FCA around some use cases that use agentic AI directly with customers. And so that's exciting because if we can build confidence around how we do this safely, with our regulator, that'll give us confidence going back to where we started this, around how can we then scale that across the UK and then be a leader in trying to drive that innovation.

So we'll come back. I'm sure we'll talk about this more in our next phase of our strategy, and I'll take that as input that you'd like to see how much specifically we're investing. We'll see if we can give you that number. I know the number, but I'm not going to say it now. We'll think about how we tell the story because we think it's a really significant opportunity for us, and I know we're a leader in this context. So that'll be fun. Thank you.

Perlie Mong:

As usual, much to look forward to. Thank you very much, Charlie, for joining me today. I will draw the session to a close now. Thank you.

Charlie:

Thank you.

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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A number of these influences and factors are beyond the Group's control. Please refer to the latest Annual Report on Form 20-F filed by Lloyds Banking Group plc with the US Securities and Exchange Commission (the SEC), which is available on the SEC's website at www.sec.gov, for a discussion of certain factors and risks. Lloyds Banking Group plc may also make or disclose written and/or oral forward-looking statements in other written materials and in oral statements made by the directors, officers or employees of Lloyds Banking Group plc to third parties, including financial analysts. Except as required by any applicable law or regulation, the forward-looking statements contained in this document are made as of today's date, and the Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained in this document whether as a result of new information, future events or otherwise. 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