

BANK OF AMERICA FINANCIAL CEO CONFERENCE WITH CHARLIE NUNN – PRESENTATION TRANSCRIPT

(amended in places to improve readability only)

Tuesday, 22 September 2026 – 9.30am

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Perlie Mong

Good morning. I am Perlie Mong, the lead UK and Irish banks analyst here at Bank of America. It is my pleasure to welcome Charlie Nunn, CEO of Lloyds Banking Group on stage with me today. Charlie, thank you very much for coming.

Charlie Nunn:

Thanks for having me again.

Perlie Mong:

So Charlie, why don't we start with the UK backdrop to set the scene? There continues to be some challenges in the UK macro backdrop, but households and businesses have been pretty resilient so far. So can you describe what you are seeing and what gives you confidence in the medium term outlook? And with the budget coming up in the next few weeks, to the extent you can, can you comment on the new government's agenda and priorities and what they mean for the sector?

Charlie Nunn:

Good. Well, first of all, thank you for having me, and it's great to be here with everyone. We were just commenting before I started, this time of year seems to be the moment when we're waiting for a new budget. It's my fifth prime minister in five years, my sixth chancellor and my seventh economic secretary. So it does feel like a good time of year to have this discussion. Look, the underlying economy, despite those last five years, when I look at the underlying economy, when we look at the 25% share of the whole of the economy that we can see running through Lloyds Banking Group, the story remains incredibly similar. We see households and businesses are very resilient. They've had now three or four years of real wage growth. Businesses probably for not such good reasons have strong or stable cash flows, and the not such good reasons are they've slowed down investment, but their resilience is very, very strong.

And as we've talked about it, our outlook for the economy has been consistent now for a few years, which is what we call a resilient but slower growth economy. And there is the potential to move to a higher growth trajectory if you could re-establish confidence and if we had a policy framework that was encouraging investment. And at this moment, over the summer, we've seen both investor and business confidence slightly strengthen and we're seeing very resilient underlying performance and behaviours. By the way, discretionary spending, big ticket items, the mortgage market which I'm sure we'll talk about, remains very resilient. But our outlook for the economy is 1-2% real GDP growth over the next few years. So some recovery, some increase in investment, very resilient, but our baseline isn't for a faster growing economy. And I'm sure we'll talk about the strategy, but despite that, we still see significant growth opportunities for Lloyds Banking Group.

Perlie Mong:

Great. It's always good to hear a more reassuring take on the UK. In the meantime, the strategy, you have given us your new strategic plan out to 2030, at the half year you were guiding to c.20% RoTE in 2030 without fully marking to market the current rate environment and there are probably other areas where you have maybe applied some conservative assumptions. So if I invite you to lean away from that for a second, what excites you the most about Accelerate 2030? And if everything goes right, what can it look like?

Charlie Nunn:

Great. Well, if my CFO were here, he'd warn me about guiding to different guidance. So I'm not going to take that opportunity. But first of all, let me tell you what we're excited by. Obviously the first thing is we've completed our first chapter, which was the first four and a half, five years. And the key themes there were de-risking and solving the legacy, getting the Group back to growth and winning market share in strategic areas and materially lifting through cost efficiency and that revenue growth, the capital generation and sustainability of that capital generation for our Shareholders. And that's really important because it gives us

momentum and the capacity to continue to invest as we look forward. When we look at what we're excited by going forward, the first thing is we've proven that we can grow our market share in the really big businesses despite a very competitive market, but that's an ever-rising bar. So we're going to continue to invest and make sure we are the leader in all of the big retail and SME segments and in the key businesses that we've chosen we want to be in. So that's the first and most important objective or big objective of the strategy.

The second thing is we have this unique franchise or set of businesses where although we're the leader across most UK businesses in commercial and retail banking and in parts of wealth and other businesses we'll talk about, what we really focus on is being more joined up, more connected and having a differentiated proposition. And we've shown significant growth in specific businesses in the last five years. And when we look to the next five years, there's a massive opportunity for us to use our capabilities, the new technologies to join up even better for our customers and drive that deepening of our relationships with our customers.

And then probably the third thing is we've talked about, and we're committing to some new businesses, some new areas where we see strategic potential and future growth. In the last phase, for example, we launched a new rental property business that got to about 10,000 properties, a very significant part of our OOI growth or a material part of it. And we see other new businesses, specifically what we call connected commerce, which is using data to join up between our SME customers and our retail customers, some of the payments and wallets businesses we're launching, which we think is exciting, digital assets, and then how we can use agentic AI to bring intelligence or advice to all of our SME and retail customers, which we just see as a huge opportunity looking forward.

Now you said conservatism, so I'm not going to avoid that. What you'll see from us always is we'll be ambitious on the things we can control and we'll be realistic, I think, about the things that we can't control. And there's two or three parts to that in the plan. We have talked about in this next phase, mid-single revenue growth for the next four years. That would be a decade of mid-single revenue growth we would've delivered and high single digit other operating income growth. We've just come off five years of 8% CAGR on other operating income growth. So those two things are ambitious. We've had questions though as to why our NII isn't higher in that. And that's linked to two things really. The first is we've just assumed that our terminal rate that we think is in our forecast, which is 3.5%, will be the baseline for our reinvestment of the structural hedge. That means it's a weighted reinvestment return of about 3.7%. If you use today's market curves, you would get a much higher number on the structural hedge, about £250 billion worth of deposits being reinvested at that level.

And then the second thing is we've seen elevated competition in deposits and assets, liability pricing in the last period of time. We've assumed the market remains rational, but stays stable and that those margins remain tight through the back end of this period. So I think those two things, if you want to take a different view on those, that could give you more upside in the plan. And then maybe the final thing we can't control is the pace of adoption of AI either by our customers or our regulators. And so we, for example, have committed to a less than 45% cost income ratio by 2030. If AI gets adopted more quickly, the regulators really support it. We're right at the front of all of the use cases that are being adopted in the UK, so we'll push that faster. But we're comfortable we can deliver the guidance, which shows a very significant step up in capital generation and sustainability of it. But there's some upside for those that want to make those assumptions.

Perlie Mong:

Great. Very exciting prospects indeed. And I'll come back to AI later. Now that we've talked about the medium term, I'm going to bring the conversation to the nearer term and ask you a couple of questions on recent market trends. So on mortgages, what are you seeing in terms of demand? Mortgages probably had some pull forward of activities in the first half of the year. What does the front end application volume look like?

Charlie Nunn:

So the mortgage market has been remarkably resilient. Obviously most people are still buying two or five year fixed mortgages so they have been impacted materially by the shape change in the yield curve or the swap curves, which is the primary basis for pricing. But despite that, we've seen volumes stable year-on-year, slightly down year-on-year, but really quite resilient in the current context and market. Most bias towards first time buyers and obviously remortgages, but it's been remarkably stable. In terms of margins, I think William's now guided for 18 months that margins have been about 70 basis points on the mortgage market. It differs by part of the market you're participating in. It came down a bit through the back end of last year and it's strengthened

a bit in the last couple of quarters as we've seen deposit pricing be very competitive. Typically, as you'd obviously expect to see, it come out somewhere in the mix between assets and liabilities, and mortgages has been slightly more stable in that context.

So it's been a healthy market. Last year we grew our assets by £22 billion, which is a very significant organic growth because we saw both opportunities on the asset and liability side at margins that make sense. This year the trading has been tighter margins on both and on mortgages we've been slightly more selective. So I think again, we've guided towards having slower growth than last year, but still strong growth in our asset businesses. But it's been remarkably resilient.

Perlie Mong:

Well, that's great. Staying on the topic of mortgages, I might take the opportunity to ask about the progress you're making on the direct to customer proposition. Your direct application mix is 4% higher than the market. How much higher do you think it can go and what are the economics there?

Charlie Nunn:

So this is really important for us. As you say, actually for the whole mortgage market in the UK, about 85% is broker led and that's great for customers that want to shop the market, but of course it means higher cost for our customers and higher cost for our Shareholders in terms of paying a broker to provide that service, and it makes it harder and more timely for people to engage with the market. We're about 20% of applications, we're actually about 24% of completions are coming through our own broker channels, our own advisors. And that's great because it can be a very, very quick, very turnkey experience for our customers. Because we know the customers, we can offer great deals. So for example, Premier customers get a 20 basis point discount. It's one of the ways we've taken our share of mass affluent mortgages from below 10% when I started, to north of 22% by offering value by joining up the relationship with our customers.

And of course, we can then also be even simpler for our customers in bringing a broader set of products. And so again, we've increased the cross-sell of home insurance and life insurance. Life insurance in this context, I'll give you the data, has gone from about 7% cross-sell to north of 20%. So those things are easier, more joined up, and better value for our customers for our direct channel. But we obviously massively value the broker channel, and we continue to be number one in that channel as well.

When you look to the future, how far could it go? Look, we'll see. Again, you can't predict always how customers and competitors are going to respond, but when we look at the ability to provide really seamless, quick mortgages for customers, at a price point that recognises the value, we see more opportunity to grow that. But I think the broker channel plays an important role and will continue to be important in this next phase.

One more thought, because I don't want to jump everything to AI, but when you really start to reimagine the future, and of course we're at the front of all of these businesses, the role of AI in an advice journey around homes and mortgages is going to be fundamental. And then digital assets will start to be used to create tokenised mortgages and totally streamline the mortgage process. And so maybe not in the next few years, but certainly as we enter the next decade, being ready for those two things I think gives us significant opportunities to grow further.

Perlie Mong:

Thank you. And then on the other side of the balance sheet, we've mentioned deposit competition a couple of times now. So we'll actually jump into the topic. Deposits are always competitive in the UK, but it does feel like it has increased further this year. What do you think is driving that competition and how are you differentiating your proposition and how are you balancing pricing discipline and customer relationships?

Charlie Nunn:

Great. So this is again, something we've been talking about for probably 18 months. And we saw last summer, specifically the pricing in the deposit market harden. And then just to reinforce your question, in the ISA and tax season this year, so in Q1, Q2, we saw most of the time deposit market price at minus 50 to 80 basis points gross margins. So William will have talked about it at the Q1 results. We decided explicitly to slow down our participation in time deposits, other than where it was really important from a relationship perspective. But it's been an interesting 12-18 months around the deposit markets, and I think it will carry on.

As you say, that's not new for the UK. I remember the Icelandic banks pre the financial crisis being the primary source of competition in time deposits. The UK has always been an incredibly competitive market at different points in the cycle and that's no different today. What's causing it, and then what are we doing about it? Let me just answer those two questions. What's causing it is what you'd normally expect from a macro perspective, which is the growth in the money supply slowed down. Real wage growth has slightly slowed down. The central bank is reducing the money supply both through quantitative tightening and they've reduced their liquidity into the market through a program called TFSME. So they've pulled back on that, which obviously makes a difference. And then you've got a whole series of competitors who can see asset growth but don't have strong stable liabilities or funding that are pricing at very aggressive prices, aggressive as in below negative net gross margins, not net margins, who are pricing aggressively to try and attract liquidity. And so those three dynamics are hitting at a point in the cycle where asset growth is still quite a big opportunity.

What are we doing about it? Look, first of all, we are very, very clear on where Lloyds Banking Group adds value and how we build sustainable capital generation. Personal current accounts and business current accounts are obviously the most valuable, from a relationship perspective and a Shareholder perspective, deposits. We've actually grown our market share in both of those businesses in the last few years, which is something we are very proud of because most people would recognise the growth in fintechs, the level of incentive payments that are being made, the growth of building societies paying for business. Most people would think that the biggest player might be having trouble in that context. Actually, we've grown our market share, and that's really important.

As I say, it's important because that's still in this market, the heart of the relationship for customers, where you can then bring broader products and value to them. But it's also the most valuable set of deposits for our structural hedge, which as you know is longer dated and we think is positioned better for through-cycle returns for our Shareholders. When rates are going up, we'll be slower to get there, but when rates come down, we'll be able to continue to invest for our customers and for our business. So that's the first thing that's important.

The second then is innovating around the product set, especially for the majority of customers around who still are trading liquidity with interest rates. We get very excited and probably most people in this room are shopping the time deposit market, but 80% of people in the country have less than £5000 of savings, 60% have less than a £1000. So 1% on £1000 is £10 a year. I know I can do the maths, but it just isn't going to move behaviour.

So really making sure that the liquidity and investment options are competitive for the majority, which is where you have really stable businesses and the same on the SME side is important. And then the final thing is actually trading time deposits smartly. We operate at a 98% loan to deposit ratio. We could go further if we wanted to, but we are very, very aware, and I know you've heard me say this before, in any week or month or quarter or even year, we're not going to chase market share as the market leader on either the asset or liability side. Otherwise, you can write quite a lot of business, which is negative return for our Shareholders.

And so if you just put that in the context of the last 24 months, last year we saw opportunity to capture market share in time deposits and mortgages, and we did that and we wrote £22 billion of assets. This year, we're not going to do that same level of growth on either the liability side, and I think it'll be a slightly slower asset year growth, but that's the right decision for the franchise and the sustainability of Lloyds Banking Group. And it means we'll be ready to compete when the market is in a different place.

Perlie Mong:

That's great. Let's move on to the fee income side of the business then. Growth in OOI has been consistently strong in the last few years, as you say. We continue to expect high single-digit CAGR growth from here. Can you help us understand where that growth is coming from? How much of it is selling more products to the existing customers and how much of it is expanding product sets and geographies?

Charlie Nunn:

So obviously this is hugely exciting for us. We think this is one of the key points of differentiation for Lloyds Banking Group. And obviously the context is the UK has relatively low other operating income as a percentage of total income, and that's a consequence of the financial crisis and regulation bluntly, if you think about it. And the backdrop for our commitment around this was we knew regulators and the UK economy had realised that customer outcomes, on the back of punitive sales practices, punitive approaches to fees and growing

those other businesses, and then capital regimes, had encouraged the banks to sell all of these businesses, had resulted in a bad place, bluntly.

Now in the last cycle, as you say, we grew these businesses at 8% CAGR. This year we're already 11% up year-on-year, partly because of the acquisition of Schroders Personal Wealth and the build out of our wealth business. By the way, the acquisition cost our shareholders nothing. We were really pleased with that deal, and gave us good capability. So we're seeing good momentum in those businesses. And as you say, we think we can continue to grow them at that kind of high single-digit rate.

We've gone from about 30% share of our income that was other operating income, to about 34%, 35%. We were going to guide towards a number, but I think it's a hard one to guide towards because it depends on the other side of the revenue stream, i.e. NII. But we're heading towards 40% through this strategic plan, whether we get there or not or whether we get past it will depend on a whole bunch of things we don't control. And I think that's a much healthier place for an organisation to be because through cycle returns and then the profitability of these businesses is really important to be able to give that consistency of returns and capital generation.

So how are we doing it? We're doing it through two themes I think are important. The first is a very diversified set of businesses. So from transport finance, through payments businesses, through workplace pensions and life protection, through our rates and FX and corporate institutional businesses, working capital, all the way through to Lloyds Development Capital, which is an equity investment business, and our professional management rental property portfolio that we've grown from zero to 10,000 homes.

It's a very diversified set of businesses and that's important for the obvious point, but we have lived this in the last five years. In any one quarter, one of those businesses will underperform or outperform. On average, you can start to deliver that kind of sustainable growth level. And even though we are a UK centred organisation, we have by far the broadest range of products and most diversified set of products. So that's the first thing. And of course, all of the businesses we have connect or join up across the bank. So we sell our transport finance business to our retail customers and our SMEs and corporate institutional customers, our workplace pension customers are sold both ways into our corporate franchise, and then we can target the underlying employees with other propositions and services from our retail bank. I won't go through every example, but every single one of these businesses benefits from the scale of the franchise, and going forward, the scale and value of data and technology and AI.

The second way of thinking about it is there's kind of three quite different types of businesses in there. There are businesses which are a bit more like banking-based businesses, which are more predictable. So transport finance is basically like a lending business with a three-and-a-half to four-year duration asset. And the workplace pensions business, we actually book a lot of the value upfront as a liability on the balance sheet, the CSM, and then it predictably rolls off. So the nice thing about those businesses is they're much more predictable, much more stable. We then have a set of businesses which are more transactional, but we are focused on growing market share and we've done that successfully, whether that's home insurance, life protection, parts of the transport business, which aren't financing businesses, or in fact our rates and FX and DCM businesses underpinning our corporate and institutional businesses. We're showing we can get market share gains and grow those businesses. And they are therefore really about showing differentiation and growth, which will enable us to grow faster than our market and faster than the economy.

And then the final thing is innovation. And we've got some really exciting things, especially in the connected commerce, digital assets, wallets space, which no one else is going to be doing and which we think could give upside. And the range we gave for our 2030 targets was kind of upper single-digit growth or high single-digit growth. If we deliver the innovation and it adds value, we'll be at the top end of that range. If we don't, we'll be more in the middle of that range. But that's where we're seeing the growth and the portfolio of businesses. And at the heart of it, if you haven't got scale, you don't have the data and the digital assets we have and you can't join up from a cultural and a technology perspective with the breadth of products, you won't be able to compete with us.

Perlie Mong:

That's great. I'm glad you mentioned innovation because clearly the success here partly reflects the investment decisions you've made in the last few years. And you've said in the previous strategy cycle that you have

invested £4 billion above your normal run rate. What were those investments in and how do they support the current cycle? And looking forward, how are you assessing investment opportunities from here, especially in relation to AI?

Charlie Nunn:

I'll try and answer the question, Perlie keep me honest, because it's a hard question to answer in terms of detail. But broadly the investments we've made historically and in the future have been in kind of three buckets, things which really are around differentiating and driving growth. And I know that's a simple statement to make, but when you're winning market share and you're driving increasingly connected and digitally led services, there's investments in those digital services, the data, the frontline colleagues and RMs, to drive that growth. So that's one area.

The second is around operating efficiency and risk management and capability to be what I call a better, faster, cheaper organisation. And as you know, we delivered over £2 billion worth of gross cost savings in the last phase. We've committed to another £2 billion worth of gross cost saves. And so there's a whole series of investments in that space.

And then there is finally a set of stuff more around dealing with our legacy and ensuring we remain a resilient, well-regulated business. And it's harder to put those investments into hard dollars or hard sterling, sorry, still very U.S. centred. But they're really important both for ensuring the resilience and trust in the organisation today, but building and future-proofing some of the capabilities for tomorrow. So some of the big investments we did around our data environments, for example, to modernise and port the data into really reusable environments, even before we knew of a generative AI, they have been foundational for our ability to then innovate and drive pace on what we're doing going forward.

So that's the kind of framework. We run a very disciplined process as you'd expect around both ROI and then tracking benefits and returns, and you should expect that from us going forward. And we've kind of given you a broader number this time, which is we're spending about £13 billion over the next four years, £3 billion per year, in that investment portfolio. When we look forward, the mix is similar. We're still driving operating efficiencies, improvements in capabilities, and then driving this significant revenue growth that we talked about. And as I say, in some cases it will be frontline colleagues and capability to drive the extra activity at the frontline. Sometimes it will be around new digital services and then acquisition strategies to drive the revenue growth. And sometimes it's much more traditional cost. So we still have opportunities to drive customers to support themselves through digital engagement rather than through our colleagues to optimise our real estate portfolio to demise legacy technologies and applications. And those investments are important for the future as well.

Perlie Mong:

I know AI is something that you're very excited about, so I'm not going to miss an opportunity to ask you more about it. You've previously said that from your experience, technology tends to reduce margins in banks, but allow you to scale to the extent that that increase in volumes more than offsets the fall in margins. So where do you think we are in that cycle and are there products or areas that you are actively building scale to prepare for that eventuality?

Charlie Nunn:

It's such an important question. We've all been looking at the financial services markets for a long time. Look, I started by electronifying trading floors in the early '90s. And for those that went through that, many of us will have gone through that, you saw massive reduction in costs, massive improvements in efficiency, phenomenal volume growth. We ended up deploying low-latency trading by the end of the '90s and massive reductions in costs for both institutional and retail investors.

My favourite one is that at the start of the '90s, it would cost about £200 to call a stockbroker to buy an equity. And by the end of the '90s, Ameritrade launched their first \$5 trade. I was on the West Coast building that with Ameritrade. So that's our history. That's what financial services does. At the same time, if you create differentiation and growth, that's sustainable. So when you just take out cost, typically you should expect over a period of time the efficiency will be competed away, but the differentiation and growth and scaling you can get can be sustainable. That's been my experience, whether it's in retail, corporate, SME or institutional activity.

And so when we look at the AI opportunity in front of us, we have got a mixed portfolio, and I'll be simplistic, between efficiency, better, faster, cheaper stuff, which is going to be a hygiene factor and important, and we are right at the front end of that in this market, but also differentiating for customers and trying to drive growth. And we think you need a portfolio of both things if you're going to really be positioned for the future. And what's so exciting about agentic AI, more than just generative AI, is it's a technology that's going to enable us to do things we've wanted to do for 30 years, but you can really make it happen in a controlled way if you do it in a controlled way in this next period of time.

Let me give you some examples. Look, I'll talk about two just to be quick, on both sides. We've launched something called an InvestAI agent, which is allowing our customers to have a conversation with an agent about what is risk, what is compounding, how should I think about my risk appetite, what are investment options, what would a financial plan look like for me today, later in my life, how do I think about goals. The stuff that we all in this room understand, but the vast majority of retail customers and even SMEs in the UK don't have an intuitive understanding of. And under the new regulatory regime in the UK, we're in a sandbox working with a regulator. In the next month or so, we're moving that to what they call targeted support that can get them through to an understanding of what they might want to do. And then by next April, if we can get the regulator comfortable with the outcomes, we'll move into actual product recommendations.

That'll be the first time the UK's ever had mass market intelligence around investments available to retail customers. So really differentiating, really exciting if you've got the kind of franchise we've got with 28 million people, 22 million of which are logging on seven billion times a year with a pensions platform, a self-directed platform and great simple investment products. And we still have people they can talk to if they get nervous, you need to have that combination of things. So that's one example. You can multiply that by a big factor across all of our businesses and across the different activity we're doing. But we've come up with this phrase for our vision for customer's experience, whether they're a sophisticated corporate or individual, which is to be simpler, smarter, more connected. And if you use those words and look at the way financial services delivers today, we're nowhere near being actually simple. Smart, you can say for intelligence AI, and then connected is properly connected across product services today, tomorrow, the breadth of products we have across financial services.

So that's an example on the differentiation side. I could wax lyrical on this for the next two hours. On the efficiency side, look, it's what everyone looks at. What I think is really important on the efficiency side and what we've already learned in the first three years of this is the vast majority of use cases aren't that complex. They do require a use of generative AI. They typically don't require frontier models. And if you build to use frontier models, the economics won't work. But I'll give you an example. We have 2,000 people helping customers who have a declined fraud card, a debit card on a fraud activity on the telephones. That's a 12-step process. Very quickly, we identified 50% of the time was taken up by four steps, and we could build an agent that was better at predicting what the customer's issue was and whether or not it was a fraud. And they could do it in less than a few seconds as opposed to five minutes. So the customer got the resolution quicker, there was a significant efficiency opportunity, and the risk management is better.

And we built that, deployed it, created iterated learning. And we know we can get, if the regulator gets comfortable with those outcomes and we can prove it, we could do all 12 steps. But we have hundreds of journeys across the bank, which are going to create that kind of better for customer experience, more efficiency for the bank, and actually better risk management. And you need to deploy that with highly qualified engineers, great product managers, and a culture that empowers that level of change. And that's what we're doing. So I'm really excited about the next five years.

Perlie Mong:

So I think William said last week that any discussion on UK macro and taxes etc, should be taken together with what's happening on the regulatory side of things. So I mean, the treasury has proposed reforms to ring-fencing to create a more agile and proportionate regime, and the new growth allowance could enable banks to provide up to £80 billion of additional lending. I know this is something that Lloyds Banking Group has been supportive of. So how do you expect the benefits of those proposals to come through?

Charlie Nunn:

It's a really good question. If I take a step back, this is an obviously complex moment because we have a new administration for this Government. And I've obviously had a chance to meet the Chancellor a few times in

the last few weeks, but we actually don't know what choices they're going to make on a whole series of areas, including on ring-fencing. What he has said both privately and publicly is they recognise that growth is the most important thing to get going in this economy, which is important. They recognise that businesses, including financial services, will be the core to enabling that growth and that for businesses to drive growth, they need to be more profitable. That's quotes from our Chancellor and the Treasury in that context. And he said on top of that, he's going to keep the existing regulatory reform process, it's currently going through Parliament called the Financial Services Markets Bill, and critically some of the FOS reforms, which historically have been the most difficult political reforms to push through around consumer duty. He's going to keep those going forward at pace and certainly that's what we've seen.

So really interesting set of positions, very consistent with the last administration and for that matter, because I've got the history, the last Government's as well, whether they were Conservative or Labour, because at the heart of it, that conundrum around to really build a more equitable and successful UK society, we need growth and the Government doesn't have the finances, however it organises its fiscal policy, to drive that growth without the private sector. And there's a good recognition now that financial services is at the heart of all of those choices. So I think that's a very positive backdrop for us. Let's see what specific choices come in the next few weeks.

On ring-fencing reform, which was your specific question, yes, they have created this proposal to allow 10% of the assets within the ring-fence to be enabled to enable new growth. That would be important for us and so we are very supportive of it. There's some other operating changes within ring-fencing that we think would make sense as well. We have the FPC review of capital going on at the moment, which is independent of both the Treasury and the Bank of England, but it does have representatives of both on the FPC. And so far, their proposals haven't reduced the level of capital to support real economic growth, but there are some proposals on the table for that, and so we'll need to see how that comes out.

For example, for those that do want to go into the details of our capital stack, the domestic OSII buffer, which we think materially overlaps with other buffers. If that were offset or reduced, it would make it lower cost of equity and therefore more available funding to the real economy in the UK, and obviously that's our job. We support real customers, whether they're corporates, institutions, SMEs or individuals to borrow and to invest in the economy. So that's still to go out in front of us.

And I probably, because you're going to go there, is have I had any discussion around bank taxes or reserve remuneration? Look, the answer is at this stage, no proactive outreach. As I said, I've been with the Chancellor three times in the last few weeks. He hasn't raised it. That doesn't mean they're not going to consider it because it's always on the list. As you know, just tactically, about three weeks before the budget is when they finalise what they're going to do.

But I think importantly for us, I know William shared this, for every 1% increase in a bank surcharge, if that were to happen, and I don't think it's guaranteed, let's be clear, I don't think it's clear that that's the path they're going to go down, given everything I just said. But for every 1%, it would be about £75 million of profit. If that were a 2-3% increase, £150-£200 million, 50 basis points on our RoTE, none of that would change my guidance, and I don't think it would change the investments and the strategy we've got in place. And if they did a reserve remuneration change that looked a bit like the Swiss model, it would be a similar impact. So these things, they'll be driven by the politics. We are very clear that we don't think that would be the best thing for supporting the real economy. But look, our focus is on delivering our strategy, our shareholder proposition through cycle and building this stronger, more sustainable bank.

Perlie Mong:

That's great. I'll just check for last minute questions. I think there is some towards the back.

Speaker 1:

Maybe just to round out on the macro, we've had a significant move up in the rate environment. How's that filtering through the customer base? Are you seeing any sort of attenuation of CapEx, I think you almost pointed to a little bit earlier, and then on the mortgage side?

Charlie Nunn:

Look, at this stage, we're still guiding from our expectations which is that rates will be stable through this year and the terminal rate will be 3.5%. Obviously the market's been in a very different place all year. We are having a discussion at the moment as to whether that is our forecast when we get to Q3, but I still think that's not a bad starting point for now. As you say, specifically on mortgage customers and those looking at five-year mortgages, they've seen an increase in the cost of their mortgages. They were being priced at around 4.5%- 4.75% at the end of last year. They're now up about 5.5% and some are going up to 5.9%.

We're seeing no deterioration in any of our portfolios. As you know, all of the mortgage customers have been stress tested to 7%-9%, depending which cohort they were over the last few years. So we're not seeing any change in behaviour. And yes, of course, I think the latest data I saw is depending on if it's two year, five year, interestingly, some of the two years are not getting an increase, but for those people stepping up, I think on average it's about a £200 per month increase, which is material. We're seeing for those customers, they have the capacity to do that, and it's not materially changing their spending capacity either. So it's obviously a very important change for those customers, but it's not driving any concerns that we have at this stage around risk on the portfolio. And we're seeing exactly the same on our cards, loans, and SME portfolios, which look both based on the current backward-looking data and our forward-looking early indicators, incredibly resilient and strong relative to history.

If the follow-up around that is when do we get nervous? I suppose we got to that question in 2022/2023 when we got up to 5.25%. Even then when we were stress testing, broadly my view is you'd have to get towards 7%- 8% interest rates to see a material impact on customers struggling to make ends meet, partly because they've been originated now for 12, 15 years with that as their stress test case. And of course, the big driver in the UK of a more level playing field around challenges on the portfolio will be unemployment, which is still really quite resilient.

Perlie Mong:

That's great. We're almost out of time now, so I'll draw the session to a close. Thank you very much, Charlie, for joining us today.

Charlie Nunn:

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. 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