LLOYDS BANKING GROUP PLC – 2018 RESULTS – SELLSIDE ROUNDTABLE
(amended in places to improve readability only)

Monday 25 February 2019 – 5.00pm

LBG HOSTS:
George Culmer, Chief Financial Officer
Zak Mian, Group Director, Transformation
Carla Antunes da Silva, Group Strategy, Corporate Ventures & Investor Relations Director
Jon Burgess, Group Financial Controller
Toby Rougier, Group Corporate Treasurer

George Culmer
Thanks for coming. On our side of the table, obviously Jon Burgess, the Group Financial Controller, after that deluge of questions last week, we have got Zak back. Myself, Carla who you obviously know and Toby who is the Group Treasurer. So that is us.

So as per last time, it is just a chance to ask any questions etc. And there is no set speech or presentation which you will no doubt be relieved to hear. So if you just want to go straight over to questions and we can just take it from there.

Question 1 – Robert Sage, Macquarie
This is a boring question actually, but one of the things that struck me about the numbers was the remediation was a bit higher than we thought and I am just trying to get my mind around what exactly goes into that number. Can you give us a sort of analysis on page 57 but it does not add up to £600 million by any sense of the imagination?

George Culmer
To be honest it was probably a little higher than we thought and at the half year I think we were £250 million and I thought we would probably be about £500 million full year. So the £600 million was a tad higher. I think as we said in the Presentation, on the go-forward we would still expect that to trend down. It isn't ever going to be zero. That is not because we will do naughty things, it's just there will be things that go wrong and there will be remediation that will be required. And as much art as science so the ongoing costs could be £200-300 million. Next year £300-400 million of that order, but I would expect a smaller amount in 2019.

In terms of stuff that goes through there you have got things like packaged bank accounts. You have got things like customers in arrears and that is on both secured and unsecured side of things. You've got to do with things like sort of historic systems issues with regards payments I think Birmingham Midshires has had some there. And you are right you come to quite a big number and we give sort of not tons of detail. But there are things like customers in arrears, packaged bank accounts, secured and unsecured, what else? LIBOR type playing, things like that. But you are right it does come to big number now. These are all big numbers. You know a couple of years ago it was a billion, as you know it is down to £600 million, it should come down as we work through stuff.

One of the things we look at internally is how much is this new stuff coming through and how much is it clearing of the old stuff out and there is much less new stuff that comes through and it is dealing with the old stuff.

Question 2 – Jonathan Pierce, Numis
Can I ask about the capital generation? There were obviously a few things last year that you couldn't have predicted at the start of the year, certainly externally. Is there anything you can point us to this year that could be done to enhance the capital generation over and above just the simple profits? I am thinking the POCI Portfolio in HBOS, didn't realise that was so big. [George Culmer – the POCI one?] Is there anything that can be done there? There is still a big securitisation, well not big, but a couple of hundred million of securitisation deduction as well out of capital, is that one impaired position anything you can do there?

George Culmer
I mean first up, and Toby might comment as well, but and I know we bore you about this and I know you know you've said it is hard to put in cells and all this type of stuff. But the ability to manage the totality of the business and the line of sight around how the business is trending and performing and giving you time to be able to do things and to do things might be to do something like securitisation or whatever, all those sorts of things. It is an advantage. As you go through each year, I am trying to land quite a big ship on a sort of small point. And you are right in previous years whether it has been the wonders of sort of PPI or

something like that have come from left field. But the ability to manage across the piece and whether it is operationally in terms of taking down costs, whether it is looking at the balance sheet size, I do have. There's a tip in trying to land the capital number, I have line of sight and I have the ability to deal with a sort of single balance sheet.

Now life gets a bit tougher as you move into ring-fencing now as I have banks within banks and all those sorts of things. But as I manage across the piece I am able to pull levers to manage capital positions. You know do a bit then in terms of what might come from left field to hit us, as I said, and this was known about and wasn't much to the left field, but I talked about IFRS16 and stuff which I takes I think about 11 basis points off in Q1. That is simply because I have to have an asset on the balance sheet, then I have to risk weight and work my way through that.

Going back to the earlier comments on remediation, I am not expecting anything on remediation but if something comes from left field, again I have the ability to deal with that. Most of the deductions are pension contributions are known, I wouldn't expect anything from there. You could still get some adverse mark to market in terms of asset swaps type movements. They would go through. Obviously things like cash flow has an impact. Then you have got basic operating dividends out of Insurance. There are choices I can make around deployment versus distribution. I am trying to think of other things that could come from left field. Toby can you say anything?

Toby Rougier
Longer term there are some regulatory changes, aren't there.

George Culmer
They are sort of known about. As you go into a year, I have got some impacts in market movements and tend to hedge most of those and then on the insurance stuff which, is sort of below the line volatilities, because I am hedging the capital position as opposed to the earnings position. You can't hedge it all the way. And as I say, things like asset swaps although we have taken down the sort of PV01s on that quite significantly, you know as I say, I don't know conduct type stuff.

Further question
I was thinking more possible positives. So for instance is there anything you can do on the HBOS book about securitisation?

George Culmer
As I say you can always realise positions, the most extreme one of those this year was obviously the Irish Book, you know in terms of capital generation. To your point, it is not so much things like the some of the HBOS because there is the separability. We do have a number of options - we have portfolios like the mortgage book which is separable. So there are always parts of the business that one could either take to securitise on or one could do a disposal of. And we kind of look at day one gains versus capital versus income gone on a sort of regular basis on this stuff. And as I said the Irish one was the most extreme. There are others from time to time that we sort of looked at and the equation never really worked; for example for our residual Dutch mortgages. We have still got £4-5 billion of those where again the maths does not quite work in terms of income foregone day one versus capital. But less so much on the mortgage side of things you have got, one of the things we constantly do within the Commercial business is again looking at the lower returning elements within particularly some of the larger Global Corporate franchises. And we do a regular cut of the portfolio in terms of returns. All are still obvious stuff, but again you are just able to do this quite a decent level of granularity in terms of return. So again I can look at capital deployed in drawn, undrawn, connections across things like the Global Corporate Book and we sort of do that on a kind of regular basis. There is an intensity with which you can go about that and there is a tolerance you can have to, "I know it has never made a return, but this is the year when they are going to do something" type dialogue which one always has with the relationship teams.

But going back to the general point, whether it is securitisations, whether it is some form of disposals, whether it is dealing with expenses or whatever, there are a number of reasons that one can look at in terms of how you look at Insurance for example and how much capital you deploy there or how much you decide to upstream from Insurance. So those are all the various levers I can look at.

Question 3 – Fahad Changazi, Mediobanca
I was going to follow-up actually, you mentioned in terms of the actions you have taken in Scottish Widows, one was the pension transfer, I think it was in H1?

George Culmer
It was in Q3.

Further question
And the other one was, you changed the charging structure?

George Culmer
Yes that's right.

Further question
What does that mean?

George Culmer
All it is the commission that Insurance pays to the Retail business in terms of distributing products. And so we did a review of whether that was the market rate or not and the conclusion of that review was that Retail was slightly overcharging, okay. So it meant to increase profitability within the Insurance business and we were able to distribute up the benefits of that. So that was about I would say about £125 million. Whereas the pension one was about £350 million in terms of bringing that up and those are both sort of structural type things.

Further question
Could you do anything more like that with Scottish Widows?

George Culmer
You can is the answer to that. So and again it is linked to the last question as well. So the Insurance business; we run to about a 140 per cent solvency ratio, sort of buffer. We closed the year, I think I said this on the call, at about 165 per cent. Now that is in pounds, shillings and pence a delta between the 165 per cent is about £1.2 billion. You couldn't distribute all of that as equity though because some of that you just come up as debt repayment. But there is about £800-900 million of that would be equity. Now out of that you would have to pay, we pay the year end dividend, which is about £350 million of that. So I have got a buffer of about £500 million that sits there at the moment. Then on top of that we continue to look at opportunities to be more efficient and more effective within the Insurance business. So things like, without getting too technical, things like matching in terms of hedging strategies that we deploy within the Insurance business. There are still some more things that you can do within that business, it still a growth business because without sounding complete corporate PR, we do genuinely want Scottish Widows to grow and it has been one of the, having been a sort of laggard in the early years, we have reinvigorated that and I think it has got some brand identity and a clear strategy momentum and those sorts of things. But at the same time we still think we could probably be more efficient from a capital management perspective. So there are some more things that we could.

Further question
Just to finish this off given the restructuring you are doing within Lloyds Banking Group, I suspect there is restructure going on in Scottish Widows as well, does that mean at some point that will get capitalised as well?

George Culmer
The answer to that is sort of yes on an ongoing basis. So you know in terms of driving down the costs and then take that in to capitalise that, yes although going the other way it was relatively neutral this year because we also have got in fact some additional costs that come from actually having to subsidiarise some of the European businesses as well. And this was sort of broadly neutral in terms of underlying cost savings. And as you know numbers aren't big by the time you capitalise up.

Question 4 – David Wong, Credit Suisse
On the open mortgage book, could you help us understand why you are finding it so hard to grow volumes there? Especially because you actually are less of a London focused lender than some of your peers. So it is pretty high, even growth outside London, it is a bit difficult to grow?

George Culmer
I think new business share was about 16 per cent, about 16.2 per cent or something like that over the course of the year across the piece. And within that we have a focus of we want to push more through the relationship channel and you know the split is still sort of 70 per cent – 30 per cent or something like that in terms of broker. But our market share within the relationship channel has gone up and that is a deliberate focus. It's too simplistic to say today's price, but you know I don't remember too many league tables where we were near the top in terms of mortgage prices and that goes to kind of all the stuff that we have sort of previously spoken about, about overall strategy and what it will do to the market. So the plan here and you will see this from your own observations and stuff, I think prices have come down about 15-20 basis points so we have still had to price down in line with that. But I think we are nowhere near the top of the table. If you look the sort of Barclays stuff I think is pretty competitive at the top of the table. But I don't recall us being too near the top. And we have said a fair number of times that is

still quite deliberate. So look, it is a trade-off versus you know franchise preservation, I have just talked about, I want to grow within the branch type channel, spending money there. And I have got to keep you know intermediaries, when they become accustomed to your product they stay accustomed to your product. So if you don't want to dry up and disappear and all those sorts of things. So keeping that appropriate flow of business going through, we have our commitments and things like that. We have the first time buyers, I think we are still 1 in 5 in terms of first time buyers. We don't tend to be big in terms of refinance type market. But I don't think we have led any of the tables in terms of price for some considerable time.

Further question

And just on the mortgage, and I appreciate a year is quite a long time to think about these days. But sometime in 2020 when you know the industry are going to get hit by higher risk weights because of the model adjustments, do you think the industry will be able to start repricing mortgages upward to offset?

George Culmer

Theory says yes in the sense that and this is as much as things like, the risk weight or the ring-fencing and the amount of capital some people might have to hold against their retail businesses. You know some people might say at some point liabilities are going to floor and all those sorts of stuff. So you know theory would say yes. How that plays out into practice I don't know, just wait and see. But you know you can make a very plausible case as to why it has to go up. But that does not always mean it does go up. And our kind of working assumption is in our sort of guidance that there isn't no material change to the competitiveness of the asset landscape, that is kind of what we assume. But we will assume that it stays pretty tough and we don't see any great big margin widening in any of our numbers.

Question 5 – Andrew Coombs, Citi

Expected loss in calculations. Forgive me I'm still trying to get used to all the new disclosures. Looking at page 35 of the Report and Accounts, you have the ECL probability weighted and you have an underlying basis and a statutory basis. And there is a big difference in mortgages between the two.

George Culmer

That's this wonderful POCI bit. So the statutory basis is with the POCI bit, which is purchased or originated okay, that is held out at about £16-17 billion, I forget the number there, it is on a net basis. So £19 billion gross and then you have got about a billion of fair value. So that is what we call a statutory basis where you have to separate out the purchased or originated impaired. And that is on a statutory basis so that is where you have your £3.3 billion or whatever, okay. But then on the underlying basis which puts the POCI back in, that is the £4.4 billion. So that is the difference between the two.

Further question

So it's the underlying one we want?

George Culmer

Yes well I think the underlying is more useful, that tells you what the real number is against the Portfolio.

Further question

Probably less relevant for you, but given what the ECB is talking about in terms of NPE ratio on retail exposures, increasing the coverage to effectively 100 per cent on 2 year unsecured and 7 year past due secured, not really been talked about with respect to the UK. Do you see any risk of the Bank of England looking at this? I mean your NPE ratio is very low but your coverage ratio is also very low across the mortgage book?

George Culmer

I have not heard anything from the Regulator in that respect or a hint that they might go down that route whatsoever. So in all our various discussions with them there is nothing there, no. I mean the whole IFRS9, I mean as I said last week, the whole living with IFRS9 and trying to understand what it is telling you, what the sensitivities are, comparability's, because I am sure you are all trying to compare with others. We look at everyone else's as well and you know how does everyone's basis compare to begin with and it is interesting to see what other people have done as we move through the year.

Further question

What do you think is more important, the macro assumptions or the Stage 1 versus 2 versus 3 split at the bank?

George Culmer

It sort of depends you know. It depends how much you move your macro assumptions and if you go from 12 months, to lifetime, but it also depends a bit you know, one of the things we were noticing was that we were picking up quite a lot of Stage 2 because we were having a number of very high quality moves through 2 or 3 stages, but actually probability of default was only changing by a fraction of a percentage, but we separated out into different categories, in inverted commas, those that deteriorated but didn't generate much of a big P&L charge because the lifetime loss was very small. But at the same time did give you quite big movements from Stage 1 to Stage 2. So I can't be completely helpful with that because it sort of depends on the economic circumstances and who knows. But it is painful and by painful I mean it's difficult to understand how it works and what it does and what the volatilities are and all that sort of thing.

Question 6 – Jason Napier, UBS

A question on other operating income. The reiteration is £6 billion remains the sort of the ambition. We are aware of things like gilts gains and overdraft changes and so on. What are the structural growth components of OOI, the dependable core of it being flat?

George Culmer

As I said, my expectation for 2019 is that Insurance should be ahead, Commercial I would like it to be ahead and I think Retail will probably be down. Those are the elements to that. The Insurance being ahead is kind of more than saying the picking up momentum and continued new business growth. It is a continuation of volumes of bulks, it's not bulks not leaping ahead. It is a sort of continuation of volume allied to strong individual corporate pension type sales coming through would be my bet for Insurance.

For Commercial you have got some staples in there in terms of the GTB, Global Transaction Banking, just fee based services, cash management type services. The bit around there with things like Financial Markets which had a sort of relatively quiet year last year and in terms of how those levels of activity come through and we wait and see. And then on the Retail side of things, in terms of why Retail would be down, I have still got things like ATM away fees. I have got things like package bank accounts; lower sales of, fees for mortgage advisory, those sorts of things going through. So I just stay in touch within the Retail perspective. But I pull together as I said the gilts, whatever it was this year, £270 million, it is not going to be zero and I talked about the level of mark to market last week and so we are not looking to make up a £270 million headwind.

Question 7 – Fahed Changazi, Mediobanca

Can I ask on since you mentioned it the bulk market. 2018 was a very strong year and next year is likely to be strong given what L&G is doing.

George Culmer

Are you talking about the market here?

Further question

Yes. In that context you are looking to stay around the £2 billion ish mark?

George Culmer

It is of that order, but the advantage we have on bulks and sorry I know this is going to sound like corporate PR, but it is for real is that if I don't like the price I don't do the deal. And which I know you might say, you would say that wouldn't you. But it is slightly different operating out of a subsidiary because I don't quite have that first line pressure as a PLC speaking to a market. And if the price isn't there then we won't deal. So we always have a bit of latent volatility in that irrespective of what the volume is in the market. And you are right, there have been some big figures. And sort of it tends to be why we are not, we don't play too much in the big headline type deals which tend to be very keenly priced. But we certainly expect the market to stay strong and our expectation would be probably similar type volumes but you know, if the return isn't there we won't do it. And I know that sounds a bit pious but that is how we look at it.

Question 8 – David Lock, Deutsche

Can I ask on car finance. So last year car finance was up 8 per cent. And certainly reading the newspaper headlines it does not feel like car sales are going to be up this year as they were last year so you are clearly gaining market share. Your main partner who is Jaguar Land Rover which is obviously scaling back a little bit. I know some of it is China, but some of it is UK as well. How do you feel about the car finance market for you next year? I mean you have been talking about a slowdown for a while, but just if we could unpick that, that would be great.

George Culmer

And, do you remember the per cent Jon we expect for this year, but it will be low. I am just wondering whether the JLR has flowed through completely. I want to say about 4 per cent or something like that.

Jon Burgess
It's low single digits.

George Culmer
In terms of our expected growth in that particular line and that would be moving back in line with a sort of market type weighting and with the flow-through of JLR. The lower new car sales are slightly sort of a double edge stick, because what happens is you may have, less new business volumes but it is good for second hand prices and things like that. And you know when we came into this year you know we continue to monitor again as we said in the Presentation for those who return at the end of contract, we still make quite a significant profit at auction on those vehicles, which is a good lead indicator. But my expectation would be this year would be, in 2019 would be in the sort of 3-4 per cent type growth.

Further question
There weren't any kind of funnies in 2018, I was just thinking there was a huge spike in sales I think due to some regulation in Europe and all car makers were trying to sell as much as they could?

George Culmer
There were and there was an element the car makers also not being ready for the new models and I can't remember what the reason for that was. It was the WLTP regulation in Q3, it made it a bit lumpy. Yes it was a bit lumpy. But I would expect 3-4 per cent this year.

Further question
Just one other thing is just to finish off all the other bits in the spread sheet. Intangible amortisation and fair value unwind, could you give us a steer on where those are going?

George Culmer
Yes so I think they were combined about £400 million this year and most of that is still HBOS coming through, but I would expect between the two of them about £100 million off next year, sorry 2019 okay. I forget for 2020 but those two will be down about £100 million in 2019. And then it may not be quite at the same rate, but if that gets me down to £300 million and this is more, I can't remember now, but it is actually like £250 million or something like that by the time we get to 2020 for the combined. **[For the combined?]** Yes for the combined. They are 300 and 100 something like that.

Further question
There was a reference to MBNA?

George Culmer
Yes there is a bit in there about MBNA in that 300 number. They dropped by about 190 and then I think it is about 50, the number slightly up, I might have to check that in 2020.

Question 9 – James Invine, Soc Gen
Can I just follow-up on JLR. Is that up for renewal this year?

George Culmer
It is either back end of this year, 2020 isn't it. Yeah, 2020.

Further question
António was being quite vocal I guess. I think it was last year he was saying it was the best business that you can do across the whole of the Group.

George Culmer
It is good business. I mean it is a good business in terms of you know the whole credit experience and that type of stuff and it is a good contract and JLR also very pleased with it I should say.

Further question
So it is not that they are going to read António's words and come back looking for a better deal?

George Culmer
I don't know what they might do. But it is a good deal. 2020 did we say it is up for renewal. So we will see what happens then.

Further question

Can I ask on the open banking customers, is there anything more that you can tell us when you signed up 36,000, how many bank accounts from other providers are they linking? Are they accessing the App a lot more often because they have now got this functionality?

Zak Mian

We have seen a small increase in activity when people use aggregation. So it is a little bit of that people are signing up in this first wave are more likely to be active. So I think it is too early to tell, we are just now coming to the end of the first 3 month period where we are seeing people as it were who first signed up and have to renew their terms and conditions to be aggregated. So they we looking for what are the drop off rates. So do we see that customers who sign up initially and then actually they get bored looking at that account and notice they can't do anything with it. So I think the degree to which this whole point of the slow burn of people will sign up over time it will become before they get more familiar with it, and then more and more features come in that they can do it across more and more types of accounts; savings and credit cards; and the APIs for payments and things like that, come online, I think will start seeing customers use it a bit more aggressively and basically talk to each other about it which will drive that volume.

Further question

Are you waiting until those more enhanced services are available before really pushing it? I know you've got it in the App at the moment.

Zak Mian

Yes we are signposting it, we are trying get ahead of it, we touched on last week, a little bit we can see more customers are engaging in some of the other things they can see because they can't see that in other places. Actually at this stage there is a little bit of interest. So we are seeing more people hit the page that describes what is open banking about, but a big drop off in terms of if and when embarking into the process and saying yes I will sign up to it. So some of the interesting research we have seen is a cohort of customers reacting adversely to the word 'open banking' because they see it as, does that sound like you are going to put my banking details in the open? You get, even the language I think is to some customers, just because it's new and unfamiliar and I think more of that over time will disappear and it will become, you know people will become similar as they are with the normal long-term banking.

Further question

When someone signs up for that are you using that, if they ask for a loan are you then checking their other bank accounts and using that as part of the credit scoring?

Zak Mian

That is all part of the downstream work to begin to leverage and exploit, to say how do we start giving customers more value by being able to look at this information. Can I make opening that credit card or that loan simpler rather than having to, the customer would have to type in lots of information about you know their expenditure before we can make that credit score and deal. I think all of that is, this is your next experiment stage and the industry as a whole is still you know getting to grips with exposing this information, getting the standards right, but it is still relatively early days.

Question 10 – Chris Cant, Autonomous

If I could have a basic one on NIM. If I got my maths right, I think your 4Q NIM was something between 291 and 292bps.

George Culmer

I think it was 292.

Question

And could you give us, you used to give us the helpful disclosure, there was a brief spell where you gave us a sort of quarterly NIM bridge so that we could actually see that. It wasn't really obvious in any other data.

George Culmer

Q4 to Q4?

Question

Yes, exactly and you used to give us a quarterly bridge where we could actually see where your quarterly NIM is. We haven't had that for Q4 and that would be really useful.

George Culmer
Okay, I am sure we could do that and we might even have that here, but you are talking about Q4 to Q4?

Further question
The quarterly NIM bridge you used to have, I can forward you on the disclosure. It looked like it was something between 291 and 292.

George Culmer
We probably have it here. It was 292 and we should have disclosed that. Because on that quarterly bit, we have like AQR, cost:income ratio and something else. Because I had to write it in on my deck [talking and laughing...] it was the quarter on quarter yeah.

Further question
Yes and one other minor point. In Retail within the capital consumption over the next couple of years and the other impacts on your capital generation. You talked about these RWA impacts, how much they are going to be. But I noted that your risk density in the Retail division did step up again this year. I can understand it last year or 2017 with the MBNA acquisition. It is less obvious what was driving it over the last period and are you sort of, should we be expecting it to step in 2020 as mortgage changes or are you in some way bleeding that in over time?

George Culmer
No I would expect a step in, in 2020. And allied to that as well in terms of maybe not be in entirety, but within things like the Retail mortgage book you get the interaction between HPI and front book, back book. So for example which proves we have had a very strong HPI coming through, that has been a suppressed RWA growth. When you go to lower HPI and if you have got front books coming on at LTVs of 60-70 per cent versus some lower in the back book, that gives you a sort of natural, slightly maturing fusion in the RWAs within Retail. So I would expect all other things being equal, in a low HPI environment for that to step up slightly as you move through Retail.

Jon Burgess
A couple of model changes, one on motor finance and on the mortgage book as well, which happened this year to take us in the wrong direction in terms of increasing density.

George Culmer
But at the moment I wouldn’t really bleed in the 90 to 180 and the through the cycle stuff. So the scheduled 2020 drop. Others may change their mind in the future but at the moment we assume they will come in in 2020. And we will get you the NIM walk, there is no reason not to share that.

Question 11 - Fahad Changazi, Mediobanca
Could I ask if there is any update on IFRS17?

George Culmer
No IFRS17 I mean, just like IFRS9 awful I am afraid. So that now comes in, it has been delayed by a year hasn’t it and is now going to come in in 2022 I would say. So 2022 and IFRS17 basically will move you away from sort of an embedded value net present value type reporting of profits and will look to much more smooth profit over the period of the contract and what it will do to our numbers, without going through the specifics of it. It will suppress, it will take down reported profitability. Importantly though within Insurance capital is still going to carry on being calculated according to Solvency II type basis so you will have lower reported earnings under an IFRS17 than an IFRS9 basis. But in terms of capital position that will still be determined under a Solvency II type basis. So it will take earnings down a bit and you will lose new business strains, not new business strains, new business profit, quite the reverse! So some interesting product choices again which we haven’t started thinking about, but things like bulks and all those types of stuff and relative attractiveness and you know over a period of earning will be interesting, not just for us but the entire industry, the insurance industry.

Further question
To go towards that, as said, you have to make a choice about profits versus the hit to equity. Would you care about the leverage in Scottish Widows or because of Solvency II is still fine that wouldn’t actually matter?

George Culmer
From a capital perspective, from a balance sheet perspective our rate doesn't change and so I don't see that it would have any impact upon that. Has it finally settled on 2022? Or there is still a chance it might go out further still. I mean it is appalling because you have got to completely go back and rebuild all your models and all those sorts of things.

Further question
So no change to leverage position on the back of that?

George Culmer
That is correct.

Question 12 – Chris Manners, Barclays
Hi George. Could you tell us a little bit about your deposit pricing strategy, how much tactical balances that you might be able to detune if you don't grow that quickly? Also about, I guess we have had the rate hike in August, how much did you pass through to the customers and how did that strategy work vs what other banks did?

George Culmer
Okay so in terms of the first bit. I mean tactical balances, again Jon jump in, I think we are down to about £12 billion or so I want to say in terms of tactical balances, is that?

Toby Rougier
£13 billion.

George Culmer
Yes of that order. And that is down from about £20-£30 billion about 2-3 years ago. So there has been quite a significant run down was we have stood off rates on those. You know the pass-throughs and the go forwards, we talk, I can't remember if we have actually given a precise number but we sort of say a few, if you assume about half, you are not far away. But it was quite a misleading half because, for example, some of our Wealth balances we put through 100 per cent you know on others we didn't touch at all. If you aggregate it up it comes to around about the half. And on the go forward in terms of rate hikes I won't say what we are going to assume.

Further question
About 50 per cent pass through I guess, call it roughly, maybe it is 40 per cent maybe it is 60 per cent if you want to give a precise number, how much, what would the stock of managed rate deposits be that we should be looking at that 50 per cent times 25bps?

George Culmer
Oh I see in terms of this over, I don't have the balances to hand in terms of the stock to apply that to.

Toby Rougier
It is broadly in our NII sensitivity number.

George Culmer
Yes I mean it bleeds into the £80 million in terms of the pass-through. That is not quite the answer to your question.

Further question
Well if you are making call it 12.5 basis points, just wanted to work out, is that on £50 billion, £200 billion because to get to your £75 million number that would indicate you have not really very much of managed rate savings. I was just trying to understand.

George Culmer
I don't have the amount. We will check and come back, but I don't have the amount.

Question 13 – Martin Leitgeb, Goldman Sachs
How do you think about your funding strategy over the next 2-3 years? I mean previously there has been some shifts from Lloyds Bank Retail to some of the corporate deposits. Do you see that potentially to reverse at some point a little bit in terms of the funding ratio? And more broader maybe in terms of what is left of the Funding for Lending scheme or TFS? I am curious as to how you think of rolling those over.

Toby Rougier

So like to fit it into two parts. I will start with the customer balance sheet and then I will talk about the non-customer balance sheet. So the customer balance sheet, we tend to run that between the loan to deposit ratio of somewhere between 105 and 110. I think we were 107 in the year, so broadly flat on the year. And what we see is if you put aside the asset side for a moment, what we see on the liability side, you see a flow into current accounts and that is organic flow typically into current accounts and that enables us to make choices in terms of what we do on the savings, in the savings pot of our business. And more recently that has been to optimise that tactical savings book. I have got the number on £17 billion. We have optimised that tactical savings book which is a great source of funding because you can turn it on and turn it off, but it is typically quite expensive. So that is the customer side.

And then we have the sort of wholesale funding side which is the other thing and sort of I guess a couple of things that have been going on there. So we have seen over the last few years we have seen a lot of the crisis funding that we did in the sort of 2012/2013, we have seen that sort of reprice which has been helpful. At the same time that we have been building MREL in our holdco funding which is slightly more expensive than the opco. So for us that transition is broadly complete. So we now have £20 billion of holdco funding in place. We have an MREL ratio of about 32 per cent which is roughly where we needed to be by the end of this year. And so the only other feature that has been going on on the wholesale side is the repayment of FLS. So last year I think in aggregate, if I remember these numbers right - so our wholesale funding went up about £20 billion in total in terms of gross minus maturities. We repaid about £13 billion of FLS, £12-13 billion of FLS and then increased the liquidity buffer by about £7 billion of a flat loan to deposit ratio. That is typically how it works.

Question 14 – Jason Napier, UBS

A question for Zak. Before results there was some excitable coverage in the FT about 3 per cent re-performing parts of the Group, I wonder whether you might give us a sense of ambitions and what's really at stake here?

Zak Mian

Yes so we kicked off with Thought Machine early last year, or back in the year before and still a very young company. We see huge promise in the technology, smart people and smart things. But we are actually working with them to work out how to build out their road map in parallel with our thinking about how would we use something like this, where could we use it? What order would you consider we do it in? And that moment they have got a core product and there's lots potential things to bolt onto it. And at this stage we are just continuing to look inside our portfolios so what are the good tests we can do with it to say, how would it scale? What's our functional fit? It is quite a different type of product, so it is not an out of the box package as many more traditional banking providers are. There is a lot more work we have to do with them to work out how would you do this to adapt it to an end-to-end solution? So still early days, lots of promise and really one of a number of guys we are talking to, it's one we think has perhaps strategic possibilities. We have all the range of other fintechs we talk to as part of, not particularly to invest it but part of all the overall GSR3 just to say how do we accelerate our digital transformation?

Further question

So you are looking for kind of legacy and fairly un-integrated IF-type set-ups that might be?

Zak Mian

We are looking for low risk. Clearly we'd want to go and work out whether this is going work in a Lloyds environment and try it out first before we make any more, because you know what this is. We may get to it and conclude it is many years away from being ready. You know we might conclude it has got great potential, but it is something we do first things first is prove that it can scale and understand where its best use is.

Further question

I presume it is a case of building a bank within a bank and then see how successful and scalable that is and it's only then you start tracking it over. Because RBS is doing a very similar initiative?

Zak Mian

At this stage we are trying not to kind of get too worried about what '20 might look like before we work out what we do. Clearly there is a lot of technology and what we are finding is technology is changing pretty quickly. So we have just got to keep active and look at what our opportunities are across the market, work with some of these firms and then work out what we can use in the short term, medium term and long-term.

George Culmer

You know plan A remains from our existing estate and our current technology to add layers; to improve functionality, but the plan is okay perhaps there is something over here that supersedes and negates that part of the journey somehow. But it is option value and it is a kind of we get out there and we talk to people and the story was slightly ahead of itself. But it is, that is what you are looking at.

Question 15 – Andrew Coombs, Citi

Open banking, you touched on it. It gets more interesting over the course of the next year, with start adding savings and credit cards and naturally you might start seeing a few more people get on it, but particularly in respect to savings is probably where we could see the most adoption. Do you think is the likes of yourselves to win in that environment or is it likes of say the active savings markets like Hargreaves Lansdown where they are more happy to push the money around on your behalf and becomes the winner in our environment?

Zak Mian

I think in the short to medium term definitely not long-term, it is difficult to put who else will come on board but in the short to medium term we feel that the players with the high connecting transacting accounts are the ones that at one level are the places that people will naturally want to aggregate from because if I look at my internet banking to my current account I probably want to put my savings account, if I have got it somewhere else, there, because I am already looking at something. So I think that is why it is getting to a well-integrated API based aggregation capabilities that provide a great frame. And I think long-term remains uncertain so we have got to rely on the fact that we have great franchise, great brands, people do trust banks, it is how from a security point of view how do I make sure my data is safe? And this App you know it is not from some provider I have never heard of or what may go wrong here. Whereas for all intents and purposes people continue to transact heavily with us and that transact, that PCA relationship we really see as a foundation for much of the stuff. And equally the pressure to make sure we continue to deliver great customer experience because I think if we don't deliver that people will go elsewhere.

Further question

It is the bear case isn't it if you have savings and small banks are paying, Hargreaves 25bps I think, and then it becomes a race to the pricing, that is the bear case. I guess the flip side if you look at wealth providers. They have been aggregating for quite some time and it has not been really an issue. But mass market retail is probably more at the automated end I guess?

Zak Mian

Yes and I think it is probably going to be a couple of years journey and we will see how those things emerge. But in the short term we feel around next year we will see gradual take up and creating great customer experiences and that reason for keep coming back which customers are already doing is a key defence.

Toby Rougier

On the bear case, we talked about increasing velocity of money and all that sort of stuff. The bit that is sometimes forgotten there is if your deposit base is more volatile than it is worth less to you so you have to reflect that through pricing terms as well which is sort of what we do when we distinguish between relationship deposits or relationship accounts and when it is a tactical business. And those two things have different pricing strategies reflecting the velocity, the stable nature of the money.

Question 16 – Guy Stebbings, Exane

Can I just ask on operating lease depreciation. I think run rate in Q3 and Q4 was down quite a bit in the first half of the year. I believe some changes in derivative value assumptions might have played a slight part and if I could check on that? And any sort of guidance you can give and any sort of framework as there was also quite a sharp drop?

George Culmer

The answer is yes and part of that was actually in the use of car prices going up and so that was captured in that. And so that caused a slowdown. There was also I am not sure whether this was last year when we had that. Did we have the last Commercial write down last year?

Jon Burgess

Last year.

George Culmer
That was all last year was it. So most of it would have been in terms of just factoring in in terms of what was happening on prices. So going forward there is an element that is volume. Slightly careful because there is a volume dependency and a pricing dependency. I am not expecting any material change in that number for 2019 versus 2018. Versus the full year 2018.

Further question
And just a point of clarification. When you talk about tactical Retail deposits and relationships or should I say one of your more competitive relationship accounts, sort of precisely what is the difference between the two? What would be the cut-off between one and the other?

George Culmer
Branding. It is just the branding. So yeah, Birmingham Midshires, Saga, they're the tactical ones.

Further question
You would never have one of your most competitive Halifax products that would dip into?

George Culmer
No. The relationships, it's all branded so the Halifax, Lloyds, Bank of Scotland are all relationship stuff. It is the other branded products that are the tactical. So no they don't flip between the two.

Anything else anyone?

Question 17 – Fahad Changazi, Mediobanca
I don't want to re-tread any grounds but in terms of how you structured the pension contributions, sort of back end loaded. Are you hoping for better mortality in markets? I'm just curious how you went about structuring?

George Culmer
You know the pension deficit funding is a long-term agreement that you re-negotiate every 3 years. And the current schedule of payment pays off over whatever it is, 6 years or something like that. But we get no benefits from that thing ever being in surplus and so don't want to overfund the thing. And the last valuation was done, in inverted commas, the worst of times and so basically you know when it comes to the next valuation, let's see what the deficit is and then let's see what the negotiation is at that point in terms of those contributions. So you know it is not an atypical type of structure in terms of that.

Further question
Looks very clever from the outside.

George Culmer
I don't know but that is how it was. It is a long-term arrangement you re-negotiate every 3 years type of deal.

Question 20 – Chris Cant, Autonomous
On the structural hedging which I think we spend pretty much the entirety of the last one of these sessions on. On the call António referenced I think £5 billion or something of current accounts which he said you haven't yet deployed into the structural hedge. What is the threshold at which you deploy that? I mean in the past you talked about gilt rates minus 1 per cent was the cut-off when you had this dynamic previously. I am just trying to think about at what point do we see those getting deployed or not and how does that feed into your NIM guidance actually for 2019? Because presumably if rates remain very subdued and you stick to your guns and don't renew any of the maturing hedge, the hedge contribution will just decline mechanically into 2019?

George Culmer
Well first off I think we did £180 billion wasn't it and we talked about it and there is another £5 billion which will move into that number because of the current accounts I have acquired. So that will come through in terms of 2019. I think we said whether we were investing at the moment didn't we on the call, did we not say?

Comment
I thought you said maybe you weren't.

George Culmer
No that is what we did say you are right. So we are currently not investing because we don't see value in the delta. And to your point, it is a bit like you know if that persists and gets tougher and I have got to go and look at other levers in terms of how I am going to make the NIM but at the moment the thing is shortening and I am not investing at the moment because the pickup you know between the LIBOR and the fixed received isn't worth tying up shareholders money for that period of time. So we are out of the market at the moment.

Further question
And then your sense on at what level you see that pick-up being worthwhile?

Toby Rougier
It all depends I think is the answer. It depends what is happening in the outside world as well. But we don't see the value today.

Further question
If I think about what happened the last time you did this, I seem to recall your Pillar 2a going up the year that you stopped investing in your hedge and I guess there is potentially interest rate risk on the banking book implications of not passively hedging which is what most of your peers do. So should we expect if the curve stays as it is and you continue to not invest, that Pillar 2a may creep up again?

George Culmer
No. Well one never entirely knows what happens to your capital buffers, but I certainly wouldn't expect. You know you are right. You know the PRA's concerns tend to be more that one is over-hedged rather than under-hedged. So I would certainly, it is not cause and effect in terms of I step off and therefore I get a bigger Pillar 2a charge. You are right in terms of the more it plays out actually would be in things like 2B buffer and stress test precisely to Toby's point in terms of latent volatility to low rates environment. So more would be picked up in stress tests from that respect. Okay last one then.

Question 21 – Chris Manners, Barclays
It is just about the buyback capacity if you think about that. You say, if you can do 200 basis points of capital generation at the top end, that gets you to £4.1 billion. You pay a dividend progressive if I am getting that right would mean £3.3-3.4 billion. Then that mean you really have to hit the really right the top end of your guidance on capital generation to be able to repeat the £1.75 billion buyback, is it as simple as that where you just take capital generation minus dividend and that is what comes back?

George Culmer
The right answer to that, you know the Board will decide and all those sorts of things, but that is what we have done for the last two years and that is sort of the go-in assumption. Now we give a range so we can you know talk down my own book type of stuff. We give a range 170 to 200, you are right and I think the assumption around the ordinary and that what is left is what is left and the default is pay that back. Other bits that can move the external environment, capital requirements, but that's a good proxy.

Further question
If I could ask one last follow-up. You are not going to start your buyback until after Brexit?

George Culmer
We start in March.

Further question
So start before Brexit, okay cool. And say it is going to be a numerator deduction in Q1?

George Culmer
Slight one, yeah.

Further question
I just thought Brexit might get delayed, buybacks might get delayed, you talk about uncertainty, starting in March?

George Culmer
We start in March. Okay. Thank you ever so much everyone.
End

FORWARD LOOKING STATEMENTS

This document contains certain forward looking statements with respect to the business, strategy, plans and/or results of the Group and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about the Group's or its directors' and/or management's beliefs and expectations, are forward looking statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will or may occur in the future. Factors that could cause actual business, strategy, plans and/or results (including but not limited to the payment of dividends) to differ materially from forward looking statements made by the Group or on its behalf include, but are not limited to: general economic and business conditions in the UK and internationally; market related trends and developments; fluctuations in interest rates, inflation, exchange rates, stock markets and currencies; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the Group's credit ratings; the ability to derive cost savings and other benefits including, but without limitation as a result of any acquisitions, disposals and other strategic transactions; changing customer behaviour including consumer spending, saving and borrowing habits; changes to borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability, instability as a result of the exit by the UK from the European Union (EU) and the potential for other countries to exit the EU or the Eurozone and the impact of any sovereign credit rating downgrade or other sovereign financial issues; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; natural, pandemic and other disasters, adverse weather and similar contingencies outside the Group's control; inadequate or failed internal or external processes or systems; acts of war, other acts of hostility, terrorist acts and responses to those acts, geopolitical, pandemic or other such events; changes in laws, regulations, practices and accounting standards or taxation, including as a result of the exit by the UK from the EU, or a further possible referendum on Scottish independence; changes to regulatory capital or liquidity requirements and similar contingencies outside the Group's control; the policies, decisions and actions of governmental or regulatory authorities or courts in the UK, the EU, the US or elsewhere including the implementation and interpretation of key legislation and regulation together with any resulting impact on the future structure of the Group; the ability to attract and retain senior management and other employees and meet its diversity objectives; actions or omissions by the Group's directors, management or employees including industrial action; changes to the Group's post-retirement defined benefit scheme obligations; the extent of any future impairment charges or write-downs caused by, but not limited to, depressed asset valuations, market disruptions and illiquid markets; the value and effectiveness of any credit protection purchased by the Group; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors, including non-bank financial services, lending companies and digital innovators and disruptive technologies; and exposure to regulatory or competition scrutiny, legal, regulatory or competition proceedings, investigations or complaints. Please refer to the latest Annual Report on Form 20-F filed with the US Securities and Exchange Commission for a discussion of certain factors and risks together with examples of forward looking statements. 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 to reflect any change in the Group's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. The information, statements and opinions contained in this document do not constitute a public offer under any applicable law or an offer to sell any securities or financial instruments or any advice or recommendation with respect to such securities or financial instruments.