LLOYDS BANKING GROUP PLC – Q3 2018 ANALYST BRIEFING – TRANSCRIPT

(amended in places to improve readability only)

Tuesday 30 October 2018

LBG HOSTS:

George Culmer, Chief Financial Officer
Antonio Lorenzo, Chief Executive of Scottish Widows and Group Director of Insurance & Wealth
Carla Antunes da Silva, Group Strategy, Corporate Ventures & Investor Relations Director
Toby Rougier, Group Corporate Treasurer
Douglas Radcliffe, Group Investor Relations Director

George Culmer

Welcome to Lloyds. This briefing gives us some time together to cover things we didn't have time to go through on the phone or anything else. This side of the table, you know Douglas and Carla. I have asked Toby Rougier along who I am sure is known to a large number of you, the Group Treasurer and also Antonio Lorenzo along who obviously is the CEO of Insurance & Wealth so any questions you have got around the announcement regarding Schroders, please fire away. As I said, thanks for coming and there is no format, this is just really sort of over to you and we will do it on a Q&A basis – there is no presentation, so just ask away and we will try and answer as best we can!

Question 1 – Raul Sinha, JP Morgan

Toby, can we talk a little bit about the structural hedge? I guess the question is, in the past you have talked about the fully hedged position and the gross balances have fully grown. Could you help us understand what is driving your view on where the fully hedged position of the Group is because it seems to be changing? And how that impacts the P&L as you see it?

Answer – Toby Rougier

So the underlying balances that we hedge are very similar to others. We hedge our equity, we hedge most of our current account base and we hedge a proportion of the variable rate savings book. So it is not dissimilar to others and so as a proportion of the total I think we are just under 40 per cent and others would be at a similar level. And the growth in the hedge mainly reflects the growth in the underlying balances. We have been very successful in the current account space and our current account balances have grown and that growth in the underlying balances is mainly what is reflected quarter on quarter in the growth in the external hedge.

The only choices you have on hedging, are the nominal volume and the duration. So the only other choice is around duration and our duration is around 4 years. We have changed that in the past. So immediately post the Brexit Referendum we actively chose to come a little bit shorter than that. And then when we started to reinvest we kept the duration a little bit shorter because the yield curve was very flat. More recently we have seen a little bit of steepening in the yield curve and we have gone back to what we would call a more natural position. So what we describe as a natural position is the broadly fully hedged on nominal to a sort of natural duration of around 4 years.

Answer – George Culmer

And I know we have talked about this a lot of times in the past. As Toby said, we don't just automatically roll and reinvest. We think we are sort of paid to take a view, we absolutely don't trade, but Toby and I will meet every month in terms of what balance evolution, what is our view on markets evolutions, what the curve looks like, how we manage it. And in terms of what should our approach be. But the natural position is to be fully hedged, but in exceptional times, if we think it is right to stand off, we will. But the natural position is to be fully hedged, and I know it is hard to convey this and we say this all the time, but one of the great advantages of Lloyds is running that great centralised process, and we run the Bank out of here and the structural hedge is £175 billion, we can work out how we want to deploy it. We manage the balance sheet centrally. And being UK bound, you know we can deploy within obvious restrictions and consents as we wish. So I am not adding a balance sheet up, I am running a single balance sheet.

Further question

But there is a view that taking a view is not really standard or not what the regulator wants to see so obviously I am not sure you can comment on what the regulator has said to you, but can you say, have you ever had a regulatory add on for what you have done on the hedge?

Answer – George Culmer

I think where the regulator is today around the whole concept of structural hedging is a different place to where they were about 4 years ago. There has been a massive advance in their sort of knowledge and understanding of what goes on with regards to this. And we have had discussions with them around term, around demonstrating substance and at various times the regulator will have a view as to what it thinks for example is optimal duration, and if you stray from that they will reflect that in some form of capital loading that they will put on you. And at various different times we have been in slightly different places and we have taken a capital loading. And it is a trade-off, do I think, you know here gives you optimal capitalisation, so if I go there I pick up a charge, but do I think that covers the cost etc. So the thing has evolved and the way you face it has evolved. We are not talking massive movements, but I do think the whole regulatory stance on structural hedging is significantly more advanced than it was 4–5 years ago.

Answer – Toby Rougier

And you effectively have a capital add-on whether or not you have hedged to be honest, because if you have a hedge you would assess the add-on as part of your Pillar 2A assessment. And if you don't have a hedge then your earnings are much more volatile and you get it through the Pillar 2B.

Further question

So what you are trying to do is optimise the regulatory add-on versus the view that you take?

Answer – Toby

Yes I think we are trying to do what we think is the right thing for the business with an eye to the regulatory impacts as well.

Answer – George

And to your bit about is it right to roll or is it right to take a view. As I say, in certain exceptional times we will take a view. There is a big delta that we worked out in terms of going back to the sort of Brexit time, in terms of the value that we have added through going short and then going back into the market versus if you had just done a programmed, and in terms of the market value of the hedge, you know you get up to about a billion pounds in terms of the delta. So as I say this is not trading, but it is just at exceptional times taking a view, if yield curve is very flat. If I don't think I am being rewarded then why lock up monies?

Question 2 – Robert Sage, Macquarie

A question possibly for Antonio. It is really looking at Schroders and the Schroders brand. I am trying to ponder what is the opportunity you see in terms of scale within the Lloyds client base? I think you are putting £13 billion or so into the financial planning joint venture. Do you sort of sense that there is a large benefit for Lloyds Bank customers currently with you? And I guess the same question for the high net worth one as well where you are taking a stake in Cazenove Capital and where you put in £400 million or something like that. Again, is there a large mass there that could be got at?

And a second very short question, outside the Lloyds customer base, might you be looking at external opportunities and third party clients as well?

Answer – Antonio Lorenzo

Certainly, there are many opportunities, there are different ways we can see that. But one of those is - we know we have more than one million customers with more than £100,000 in cash with us at this point in time in the Retail network. And obviously you can infer that obviously there are people that have money away in not dissimilar amounts in investable assets that they have in other shops. And I think this is an opportunity that we are not driving at this point in time and when we were analysing why, there were several reasons. One is, our brand is a good brand, banking in the high street, much more considered as a free bank or the bank that you want to make your transactions and hold your cash but probably not the place where you want to have your investments.

And the other reason is we don't have a proposition in accordance with the other competitors although obviously we have been investing in the platform for investments, as we said in GSR3. So in doing this transaction I think we can have a brand that is much more in the investment arena and more appealing in that sense. Secondly, they are bringing a platform that can help us to develop the business and bring forward some of the dates.

And last, but not least, obviously I think that now that we are working through the GSR3 and as we discussed in February about segmentation I am trying to see what is the segment that can bring more value to us and we are working as we speak through this data. I think that we are better equipped through this partnership to deliver growth. We have discussed our ambition is to be in the top three and obviously you have the numbers, now the number three has around £25 billion of assets. We have £13 billion and obviously all that is north to that figure would put us in that position. So there are opportunities and we can grab this opportunity through this partnership. It will take time obviously, we need to build this platform, we need to create the JV and we have said that we will have the JV in place at the end of first half of 2019. And during 2019 and 2020 we will bring this up and running. Therefore we said 5 years because in essence in the first 3 years we need to build this up.

And the second question was about third parties. The other issue we have is how we can attract people to our proposition, engage intermediaries and get engagement from more advisors. And this is bringing in new advisors when we are bringing in other parts of the business, not only our customers in Retail, but also customers from other latitudes. So I think we see it could be a combination of organic growth and in time, if the right opportunity comes at the right time, inorganic as well.

Question 3 – Claire Kane, Credit Suisse
Just a follow-up on that. So I think you have your own £25 billion of wealth assets and £13 billion are going to the JV. So what kind of brand are the residual assets that are left?

Answer – Antonio Lorenzo
We have £13 billion. It is the competitors that have £25 billion.

Further question
Maybe it was something different, you classified Wealth?

Answer – Antonio Lorenzo
We have in Wealth £13 billion of investments and we have £12–13 billion in deposits, and that is the £25 billion. This is cash.

Further question
And those deposits, what brand are they under, under Lloyds?

Answer – Antonio Lorenzo
Under Lloyds.

Answer – George Culmer
And the banking will stay.

Answer – Antonio Lorenzo
The deposits will stay with us.

Question 4 – Fahed Kunwar, Redburn
Can I ask one, just to go back to the hedge for one second, sorry, and on the size of the hedge. Should we infer that the income from the hedge is going to increase, that means you expect current account penetration to keep increasing?

And then on the duration, I assume the hedge is in place to match the behavioural duration of the things you are hedging. But when you say you take a view on the duration you are not saying you think the behavioural duration of the underlying product is changing, just that Lloyds are taking a view? Because as far as I am aware no other bank in Europe really does that. So unless they think their behavioural maturity of the current accounts is changing as rates are going up and down, just so I understand that. How do you think about divorcing those two things as I thought they were intrinsically linked?

Answer – George Culmer

The view has evolved over the last 4 years, but the duration is the duration. You look at the composition of that and we have ongoing discussions with the PRA on our own views in terms of the terms, so the duration now is pretty constant around that 4 years. So it is not a view so much on duration, it is a view on quantum that says in terms of how much should I actually be deploying. So that is where we can take a view on.

But the 4 and a bit years, it will move around depending on the mix between current accounts, capital, non interest bearing. But each of those is now kind of prescribed. But that has evolved over the last 4 years. You are taking different views of behavioural life. We are always looking internally at behavioural lives and feeding more information into machines in terms of you know, do digital deposits have the same behaviours as branch based, all those sorts of things. You are always sort of evolving as those sort of mixes change, so there is that bit.

And in terms of evolution, I think we are somewhere like 175 at Q3, we were 171 or whatever at the half year, so you are seeing a sort of an increase here. And again, I think I said before, don't look and try and read off the balance sheet and say ergo it's gone up therefore the hedge will go up. Because we take time to filter these through the systems and the process. But do I expect to see a bit of continued growth going forward? I would do. And in terms of contribution, I think we said at the half, I forget the phrase we actually used. But we had a little chart which I think deliberately you couldn't read what the numbers were, but I think it was at least stable and sort of inferring, it was at least stable.

Further question

Since the two base rate rises, your funding rates have been coming down, other peoples have been going up. And I think that is because your current account penetration is very low. I know you don't look at other banks but other banks in the UK, current accounts as a share of their entire deposit base is 50, 60, 70 per cent – you guys are at 30 per cent. Why is that historically? What is the reason? Is there some kind of structural reason that you have less deposits than your other big UK peers? Is it because your L/D ratio was very high before and you have had to bid up the deposits? I am just wondering, in terms of looking forward, is your deposit rate coming down as you get more current accounts coming in? What the historic reason is for that differential?

Answer – Toby Rougier

It will be a function of the merger. Lloyds is a very big current account bank which didn't have quite such a big savings portfolio. Clearly HBOS had a very big savings portfolio, but very little current accounts. So it is just a function of the start point relative to other clearing banks.

Answer – George Culmer

But again as I think I said this before, mixing the Commercial with Retail is going from like 65 to 109 something like that. I am not saying we will do that again, but that is to your point. Structurally where we came in gave the opportunity to be able to grow.

Question 5 – Ed Firth, KBW

Can I ask a question about the broader environment? I guess we all seem to be fighting a sort of phoney war at the moment of everybody, whether it is going to be a big US crash or UK house price crash or Brexit or anything else. And yet the messages I am getting from all the banks are yeah we are all super worried about the outlook, but we see nothing in our early warning indicators or anything to support that. I would be interested in your thoughts about where your thinking is on that? Is this a sort of phoney crash that we are actually going to see one day? Are you actually seeing anything? Does it influence your lending policy and how might it influence your lending policies?

Answer – George Culmer

Okay, there are some facts before we go into surmising about the outlooks and stuff. We are not seeing anything. There is nothing that we are doing today in terms of a sort of knee jerk that because I am here I should be doing that. But that is not to say that over the last 12 months, 24 months, nothing has changed. It is an ongoing process of how we try to reposition the book within the UK. And that covers stuff we have sort of bored you with before around exposures to London and the South-East, through to, and this isn't related to the economy, but in terms of managing down single large name exposures you know in the Commercial book. And it has been massively successful in terms of reducing RWA. They can be quite attractive positions, but big exposures and we will continue to do that. So the example would be in something like the retail sector you know where we deliberately managed down and I think our exposure now is, I want to say, about a couple of billion in terms of drawn with a strong bias towards the food sector. And that is not sort of Brexit related, that is just general sort of, when I look out the window and look at sort of behavioural trends and I look at the economy etc. I will try and sort of position.

So I have not been knee jerking in the last 6 months, but there has been a sort of continuation of things we have done in the unsecured book in terms of amending underwriting criteria and there is just a continuation of things that we do. So you know as you would expect, we sort of internally do this. Internally we go to boards, we go to risk committees who ask us similar sorts of questions. So as I look out the window and is there stuff that we should be doing? And we sort of conclude to say, no there is nothing dramatic that I should be doing now. And perhaps, because we have done an awful lot and continue to do an awful lot in terms of how we have repositioned this business.

So when you are the size of Lloyds as well, the ability to turn macro things off and all those sorts, is actually pretty limited. You are not about to lurch this way or that way.

Further question
Is there a danger though that it becomes a bit of a self-fulfilling prophecy because I guess if you look at provisions across the sector, you could argue that the banks haven't lent as much as they should because provisions are virtually absent and I guess that does have an impact in terms of economic growth. You have 20 per cent of the market so how you lend into that, is going to be a big determinant of how the market performs?

Answer – George Culmer
It is a sort of simple statement with a lot of complicated answers. In terms of again boring you, we are underweight in a number of areas and want to grow the SME story and mid-markets. In mortgages we haven't grown, but you know all know the reasons for that, we stood off that. So there is a myriad of reasons as to why we have operated as we have done, different reasons in different parts of the business.

But you know going back to where you started. We think we've done all that we should do in terms of preservations, where from a balance sheet perspective at the moment we are slightly long on liquidity. If we can get ahead on stuff, we are getting ahead on stuff so you saw that in the AT1 issuance. As I say when you see our numbers, I have probably got more cash than I would normally expect to have at this point. And that is just so if there is short term market turmoil, I am in a decent position. So as a bank I will naturally hedge interest rate, currency type exposures. You get some, you can't close off every door. You get some bizarre sort of consequences if we just run these scenarios. If there are things like no deal and credit spreads spike, well my net assets shoot up because of what happens on my pension scheme. So we run all those sorts of scenarios and look at the earnings and CET1 impact, and as I say we tend to run a matched balance business, a balanced book. And I don't know about self-fulfilling, I don't know if it all works in the positive, I think it probably works in the negative if we came out and said it is all doom and gloom and all that sort of stuff. But you know we genuinely don't see at the moment…

Further question
But I wonder to what extent there is capacity for you to manage that view in terms of lending a bit more and taking a little bit more provisions as a result of that and how you think about that in terms of whether, what is the growth / provision trade off?

Answer – George Culmer
No it is the debate we have around the top line quite a lot in terms of where you go to, you know, as previously discussed we work on absolute risk appetite so percentage of CRE, percentage of balance transfers, absolute amounts of RVs, exposures, all those sorts of things. And we ask ourselves the question actually. Am I foregoing in the current climate? Am I foregoing some income? Which, post the credit, would still leave me in the money? So we think we are operating in the right space and we do go through those exercises internally to say, am I being overly cautious? Should I be letting more in, taking the credit, but we think we have judged that we are at the right space. But we do carry out the very exercise that you talk about.

Question 6 – David Wong, Credit Suisse
Just two questions on mortgages. Number one, I was just curious and forgive me if you have disclosed this before. You talk a lot about mortgages, but in terms of the £18 billion of top line, if you were to break up your £18 billion of top line a year by product, what actually, the £18 billion of revenues you make a year, if you break that down by product, mortgages, card etc etc what percentage of the top line actually comes from mortgages?

Answer – George
I don't know if I have been asked that question before. I don't have that number to hand.

Further question
My guess is a third, but that is my guess. Second question is, I think you have been happy to lend slightly lower LTVs on new lending, slightly lower LTVs than the peer group. Can I confirm you are generally happy to play in that space and you won't be chasing higher LTV new business?

Answer – George Culmer
Within our new business we tend to favour things like first time buyers which suits the position we hold in the economy. We actually think from a return perspective it actually makes better returns for us as well. You are right, our LTV across the book is probably about 43, I think in new business it is about 62, something like that, of that order. To the earlier question, going back to the help to buy and participating in the high LTVs, we were happy with that being underwritten. I don't see us any time soon changing that materially at all.

Question 7 – Ian Gordon, Investec
If I could go back to Schroders again. It's a deal I guess you are very excited about. My perception, correct me where I am wrong, is the numbers are underplayed, the market shrugged a bit. And I know I am not comparing eggs with eggs here, but if I go back to 1999 when you acquired Widows, your predecessors were very excited. The rating agencies were very excited and upgraded you. Now I know this is more niche. I know Widows was a grotesque deal at the wrong price. I know execution was poor, but what comfort can you give us that all those things are going to be ticked this time?

Answer – George Culmer
That was a different time and a different age and obviously none of us were here. And without dwelling on that too long, I think you are right. But what the Bank knew about the insurance was limited and what the insurance knew about the Bank was limited and I think that persisted for some while.

And I actually think bancassurance should work and I think should work in terms of technology, it should work in terms of regulation. It is just working by proximity doesn't work. And you have to run the Bank in a very deliberate way to get the best out of those two bits.

Here, in terms of this deal. Look first up, we are excited about this and I will obviously let Antonio speak. Clearly it's an entirely different scale and all that sort of stuff. But we have a Wealth business, we know what this business is about. It is genuinely bringing the best of both parties. I would say that I would like to think that over the last few years we have shown that we know what we are doing in terms of acquiring businesses. We know what we are doing in terms of integrating businesses. We know what we are doing in terms of bashing businesses together. That is the HBOS Lloyds or the MBNA stuff which is going incredibly well. We know what we are doing in the basics of putting businesses together and actually making them work. And you know it has to be taken on a promise because you ain't going to see the results of this for some time here. But I do genuinely think this is the right thing for us. In terms of, you know banks and wealth businesses they kind of circle but never quite crack the code. And I genuinely think this gives us a sort of breakout opportunity in terms of the platform, in terms of the plan, in terms of what the two parties will bring to this. But we know what we are doing and I can say this with as much conviction as I can, we know what we are doing in this space and this is completely worlds away from the bank that was. I mean I remember I was working for Zurich then I think when Lloyds, it was kind of at the high water mark of the whole insurance industry, people buying new business multiples and things like that.

Further answer – Antonio Lorenzo
I think I mentioned this before. The future will tell if we have executed this deal well, but obviously there are some weaknesses that we try to address. And we discuss around the different boards, the insurance board and the main board, and there are people with experience. People that say they have seen high street banks trying to do the same and with the what you call, stupidity, try to do the same all the time and you receive the same, nothing. So therefore it is not possible to build a proposition in wealth only attached to the high street.

So we are trying a different way. I think we think there are opportunities there. And obviously we can see the wealth of the customers. We have done a good job, with the people that we have because we have previously been north of 300 advisors. We have £13 billion of assets. We compare with St James' Place they have more than 4,000 advisers and they have £90 billion. So we have to do more of the things we can do, obviously we need a new way of working, a new model and really new brand proposition and assistance. But it is possible because the money is there.

Question 8 – Rahul Sinha, JP Morgan
Can I just ask maybe the insurance side then, because as a banks analyst I spend remarkably less amount of time on what actually happens inside the Lloyds insurance business. To me it is not quite clear apart from that annual insurance dividend that you get, as to what the benefit…

Interrupt – George Culmer
Twice a year actually!

Continue question
I am not quite sure, I am a Scottish Widows customer, I have got a mortgage with Scottish Widows but I don't have my current account with Lloyds. It doesn't seem to me from the outside that there is actually any integration. So can you talk to us about you know, does bancassurance really work from a customer or a product perspective at all in the UK?

Answer – Antonio Lorenzo
Well when I joined the insurance proposition, one thing that some board members asked me was what are the things you have on your wish list. The first one, I think, is to build something that we have called a single customer view. And we are working on it. And it is when you can see everything in one place. Obviously open banking will bring for the people the opportunity to have all the bank accounts they have in different banks in one app. But we are building into having in one app all the positions that people have in our bank and obviously they have in other banks through an API, but also the positions, the holdings they have in insurance. And we are running now, we have our corporate pensions business where we have, with Zurich a couple of million customers that have their pension with us, customers from Zurich, currently Scottish Widows and previously Scottish Widows. We have a digital platform where people as employees can check how much they have in their pension and now we are starting a rollout with the people who have a bank account with us and within their app of Lloyds, Bank of Scotland and Halifax. At this point in time we have 300,000 customers who have their pension in Scottish Widows and have a bank account or product in Lloyds, Bank of Scotland and Halifax. Only 300,000. Previously, 50,000 customers per month in corporate pensions had a look at their pension, even though we have as I say almost a million. Now with this 300,000 it is now 38,000 customers per day who have a look at their pension because they are looking at their bank account, but at the same time they see the pension. And so when we have the roll-out that we are starting to have at the end of the year, I think we will have 100,000 or more, I think that this will be exponential, the opportunity we have. We have said that our customers, digitally active customers have 15 interactions per month, Aviva customers they have one interaction every six weeks. My Aviva is quite good, they've delivered a good job, but obviously you add Aviva with Lloyds and it is more powerful because you have the full core. Can it work? Obviously I believe we have the opportunity to engage with the customer.

Question 9 – Chris Cant, Autonomous
Can I come back on what we have discussed a lot I am afraid, structural hedge. You talk about current accounts. If I think about the system, the system is currently about high teens of deposits in the UK system or current account at the minute, but that used to be 4-5 per cent when rates were higher. So to talk about getting the benefit of rising rates in the structural hedge, won't you see some attrition in the level of that in current accounts? And how do you factor that in?

Similarly on the variable rates savings book, I guess part of the reason you view that in some way as rate insensitive is because you have higher rates there on certain pockets of those deposits, compared to some of your peers, which is why you are able to price lower your deposits as rates are going up because presumably you are just not keeping some of those products. But it comes back round to something you used to disclose about HBOS versus Lloyds. We all used to talk about the average deposit cost to Halifax, average deposit cost to Lloyds, you stopped disclosing it a couple of years back, it used to be really useful disclosure.

Comment – George Culmer
I can't remember us disclosing that!

Question continued

You definitely used to give us that. I was wondering if you could give an update on where that sits because you used to talk about that not closing. You said Halifax customers are structurally different in kind, different profile customers to Lloyds. But I guess part of the reason you have been able to extract these significant liability repricing benefits over the last few years is that gap has closed. I am just curious as to where that stands today?

And then on Schroders. What you are doing in terms of the accounting, I am not really sure why you are not consolidating with 50.1 per cent ownership. That the impact of what you are doing will be a slight positive to your cost:income ratio of sort of 0.2–0.3 per cent and you are wanting to double or more than double the size of the business presumably. How much do you think that will benefit your cost:income ratio over your plan period out to 2020? Could that 0.3 be a percentage point on your cost:income ratio by the back end?

Answer – George Culmer

Dealing with the second bit. I mean what you say is broadly correct in terms of the accounting for it. I don't think you will get to about a percent, it will be a point or two, unless you are going to tell me differently. From memory whether it is 0.3 or something like that, it is of that order type. The accounting is around control. So you have to be able to demonstrate control to consolidate. So it is not just lead by percentage ownership. And by definition with the JV in terms of reserved powers that the minority has in terms of setting budgets, appointments, strategic direction and all those sorts of things. By definition, irrespective of shareholding, when you look at matters that are reserved to the shareholders, you can't, you don't have that control that will permit you to be able to consolidate. So that is where that comes from.

And then look, it still would be the Halifax are more price sensitive and when we showed charts of cost to funds, you are right, both were coming right down, from left to right and the spread between the Halifax and Lloyds. And we didn't deliberately stop disclosing that. I can't remember us disclosing it, but we will go back and look at what the delta is between the spread.

But to your other question, we want rising rates and when we look at structural hedge and when you look at current accounts versus savings and tipping point in terms of people moving out of current accounts and is it 2 per cent or whatever the number is. We still want rising rates and the give in terms of loss of volumes I will more than make up in terms of forward swap rates etc. So I will still come out ahead. And what we do do in terms of going back to risk appetites and modelling and all those sorts of things is that we model and we have defined risk appetites in terms of what are shock factors just making sure that if rates were to spike tomorrow and I was to see a portion of the hedge march with its feet or flip out of current accounts etc, we have prescribed limits on that to protect us, to make sure we are not in an unhedged position and I have got too much exposure. So I am definitely preferential to rising rates.

The bit around rate insensitivity in terms of the variable accounts and due to deltas in pricing. That is not a factor that comes into it. We will model this stuff and take it through frequent ALCOs.

Further answer – Toby Rougier

We do a lot of segmentation at customer level to determine different cohorts of customers and all that sort of stuff which is all built into the hedge profile effectively which is why there is an amortisation structure in the hedge profile.

Further question

I am just trying to understand why you talk about hedging your variable rate deposits when most peers just talk about equity and current accounts?

Answer – George Culmer

No the others do variable rates as well, they do. If you look at RBS, Santander, they do variable rates.

Question 10 – David Lock, Deutsche Bank

I have got a couple. First of all following up on the structural hedge again! Interest rate risk in the banking book – there are new rules coming in next year. My understanding is they are going to start doing an outlier test by the bank. And obviously you do, as I think a lot of people in this room, you are perceived to do it differently to others. So how should we think about that coming in next year? Does that mean any changes in disclosure or the way you manage this?

And then I have a second question which is on bulk annuities. You have obviously been doing a lot of bulk annuities over the last few years, you have got excess value in force so that makes sense to do it. But with the accounting changes of IFRS 17, the way that that revenue is going to be booked, is obviously no longer up front. So does that change the economics of it for you?

Answer – George Culmer

On bulk annuities, we are a win/win at the moment because if I write them it is income, if I don't write them then it is better capital and part of the dividend that flows back in. In all the pricing of the deals and all those sorts of things, it is done on a sort of cash return type basis. So that is how we look at it. You are right, I mean IFRS 17 is meant to be coming in 2021 and people are looking to delay it. From our basis you have got a number of our products where you'll upfront profitability, but now you have got to turn it and you have got to look at profit from inception and spread it over the future life of that product. And you are right for something like bulk annuity which at the moment is heavily sort of front end loaded. You have to go back and think again and spread that over the term. The thing is it will bring earnings down in terms of across the board for insurers. To me one of the tensions is that IFRS 17 will probably bring insurance earnings down but capital will still be determined on Solvency 2 basis. And so has no impact upon capital and capital distribution. So I think it will end up in some strange place where you are going to see a slight disconnect between reported earnings and profitability. Because the capital will still be determined on Solvency 2, which is more of an embedded value type basis.

But to your question. We look at bulks, you are right, they are kind of like instant fixes at the moment and I kind of like where we are, which is we can walk away and going back to it is income versus capital. It is a tougher place to be, I think, if you are out to the market and this is your primary product, it is hard to step off.

We are in a better position which we can step off. So last year we did hardly any bulk annuities and we paid up a larger dividend because of this. This year I think we've have done about a billion five or something which I think is almost double last year. The profitability is I think like 80 plays 50 or something like that. But that hasn't changed our approach to them and I don't see it changing our approach to them.

Further answer – Toby Rougier

It is also a core component of the ICAAP submission today. And so that feeds into Pillar 2A. And the methodology has changed a bit over the years. But in the last couple of years it has been relatively consistent. It does contain an outlier test as of today, which I think you are referring to and I think EBA has got some views as to how the outlier test might change. And so if the methodology, if the PRA's methodology for looking at that changes then we will structure that through our modelling as well. But we have an outlier test included today in our ICAAP submission.

Further question

Who are you compared with? Are you compared with European banks or just UK?

Answer – Toby Rougier

It is a methodology that we have reached agreement on and we have run on our own book. It is how we look at look at our own book.

Further answer – George Culmer

When you say outlier, going back to where we started. At various times I will go short on the amount I invest to which, as Toby says, you kind of can't win because you are already taking an interest rate in the banking book charge in your Pillar 2A so when you see your Pillar 2A, when it came down from three to the new one, that includes my capital charge for my structural hedge within that. I could decide to go smaller in my hedge and perhaps I could pick up a smaller charge, but as Toby said, all that will happen when I run our stress test my earnings will zoom all over the place and I would pick up Pillar 2B. So the fundamentals of the methodology are that I invest the capital, the current accounts and the variable rates will be the same as everybody else. The duration that we apply as Toby says, we have worked with the PRA over the years over what we think is the right behavioural duration, what they think is the right behaviour duration and we are in place of agreement. So I don't see that we are, this sort of massive outliner in scale or quantum. If we become an outlier now because at certain times we just won't programmatically follow then so be it. But I still contend that is the right place to be.

Question 11 – David Wong, Credit Suisse

I have a question on your commercial bank deposits. Because from memory you had quite a big ambition to win things like more cash management mandates, I think from 1 in 8 to 1 in 3, in your strategy update. So I wonder how have these transactional banking deposits in your commercial bank developed?

Answer – George Culmer

If you go back to the liability mix over the years, there was a sort of pricing advantage when commercial rates used to charge 50 basis points or something, we would deliberately grow in the commercial deposit base. And there were a lot of things factored into that. Our rating upgrades, rehabilitation of Lloyds as a bank and place to go, a counterparty for corporates and all those sorts of things. So I think from memory you know I think commercial deposits have gone up from less than £100 to about £120 billion or something of that order. So we were deliberately growing, utilising rating advantages, utilising the cost advantages. A lot of that, it is less stark now than it used to be in terms of the pricing differential. You are right though in terms of the sort of core Lloyds offering, global transaction banking, which should be Lloyds' staple product, its company relationships, cash management, trade finance, letters of credit, you know invoice discounts and all those sorts of things. We are underweight, we are still underweight when you look at the market shares and we've spent an awful lot of time over the last few years, because we didn't have the kit or the capability of buying the kit or buying the capability. And when you look at the Commercial Bank numbers and the progress, we can still do more in terms of our global transaction banking and we would look for that business to be growing from a profitability perspective by, it will still be single digit, but will be high single digit. And what that is offsetting, you won't see all of that in the numbers because it is offsetting tougher times in other parts of the business such as financial markets and things like that. But the global transaction banking, we are still underweight in terms of market share. Stuff we should be doing, basic relationships with companies, cash management as I said, those sorts of things.

Further question

Of the £150 billion of deposits you have got in Commercial business how much of that is related to global transaction banking actually?

Answer – George Culmer

I will check the number. Would you say a number?

Answer – Toby Rougier

I would say about two-thirds.

Further question

It is a big number as you win more cash management mandates, that number should grow by quite a lot I would have thought?

Answer – George Culmer

Yes it depends where you want to grow it at and depends what deposits we need.

Further question

Why would they choose Lloyds instead of HSBC I guess?

Answer – George Culmer

We have come a long way. As a partner I think we have come a long way and Andrew has gone now, but I think Andrew Bester did a great job in terms of getting that bank into shape, stopping some of the peripheral activities and making sure it was part of the Lloyds franchise. And I think as I say as a credible counterparty I don't think it probably was back in 2012 but it absolutely is now.

Question 12 – Guy Stebbings. Exane

Can I ask about liquidity? Sam Woods said a few days back, about a bit of a warning to the market in terms of holding a bit more liquidity. And I seem to remember at the half year your LCR was towards the lower end of peer group spectrum, but I think you said a few moments back, you are running with excess liquidity. So how do you view that position in the light of what the regulators said there and could it be a headwind to NIM if you thought you need to hold a bit more liquidity?

Answer – Toby Rougier

So we are currently about 130 per cent on LCR so our liquid assets portfolio would be just over £130 billion. We clearly run a bunch of regulatory stress tests and internal stress tests with different outflow factors and all that sort of stuff to determine what we think is the right level. That is what we would call the primary liquidity. In addition to that we have access to very large amounts of secondary liquidity which is effectively collateral that we would pre-place at the Bank of England. And it is not quite the same size portfolio, but it is a very substantial portfolio. And I genuinely don't know where others are. But our liquidity position is very robust. Our liquid asset portfolio is larger than the entirety of our wholesale funding base. So our liquid asset portfolio is very robust. We have been running slightly higher levels of cash in the liquid asset portfolio because we have been selling down some of the gilts. We have been running slightly higher levels of cash versus securities, which costs a little bit, and that is a conscious decision. But it is a very robust position.

Further answer – George Culmer

And I don't see it as a headwind to NIM. We haven't had a NIM question yet, so let me give a NIM answer. When we look to manage NIM and manage all the stuff that we bore you about. Building MREL, holding a bit of excess liquidity, it costs, but in the scheme of things that is not a big swing factor in managing the margin.

Further question

Does liquidity actually impact your NIM though? The way you define it, the denominator is just a subset of your loan book, whereas others would include the entire loan book plus cash plus investment securities. Presumably in your case, if you hold liquidity, you're not actually seeing that in your definition of interest earning assets at all.

Answer – George Culmer

No it's a cost and I have got a funding cost.

Further question

Could you not strip that out as part of your non banking NII?

Answer – George Culmer

You are going to tell me about how I do non banking NII then?

Further question

Your definition is very unusual in the UK so when you say NIMs stable and RBS comes out the next day and says we are down a lot due to liquidity and everyone freaks out. I am genuinely curious as to the extent to which your NIM is impervious to fluctuations in liquidity. If you doubled your liquidity position tomorrow would that actually alter your definition of NIM materially?

Answer – Toby Rougier

I mean one way of thinking about it, not the way we do, but one way of thinking about it, we have a wholesale funding portfolio of 120 billion quid and I have a liquid asset portfolio of 130 billion quid. So they are broadly equivalent. Now the cost of the wholesale funding, all of that flows through NII and one doesn't quite fund the other because it is one balance sheet so all the funding is fungible. But if I didn't have to hold the liquidity I wouldn't be holding £120 billion of wholesale funding.

Question 13 – Chris Manners, Barclays

Could I ask a couple of questions? The first one was on the cyclical buffer being raised to 1 per cent, Financial Policy Committee may eventually raise it if they think risks are elevated or they try to be counter cyclical. So if we have a good cycle maybe they will raise it. When I look at your capital stack to see the 30bps benefit on the Pillar 2A, that Pillar 2A number seems to bounce around. I remember them jacking it up and bringing it back down. How, conviction level, are you on your 13? And if the counter cyclical buffer goes up, Pillar 2A goes up, do you change your 13 to run with a bit more? Just trying to understand that.

And then the second one was just in terms of the narrative, one of the things everyone is concerned about is getting some top line growth, balances aren't growing very much, NII not growing very much. The Schroders deal which could be interesting. There are puts and takes on the margin, I think that is a big play whether it goes up or down. Balances aren't growing that much, How do try to reinvigorate the top line? Is that something you are thinking about?

Answer – George Culmer

OOI has been tough and will stay tough and to stand here and tell you that fee-based offers are the way forward, would be misleading. It is different things in different places, but they tend to come out as making a pretty tough space. Now things like the insurance new business is fantastic within that in terms of driving us forward, but some of the structural things, everything you have heard before, interchange. Financial markets etc. are pretty tough. Within the NII, we have talked about the resilient margin, we have talked about where the asset base goes to. And you know being stable or slightly up in the mortgage market enables me to move the thing forward. But again assets aren't going to move forward at a dramatic rate. But I would reassure you that in terms of growth opportunities, be it doing the things like we are doing in terms of Schroders, doing things internally around new propositions etc is paramount. But we are not going to do anything stupid that causes the back book to collapse or takes me to spaces I don't want to be going, around the earlier conversations on risk appetite and our absolute exposures. We think where we are positioned now is the right place to be in terms of top line growth where the economy is now and some of the uncertainties, and we are quite comfortable with what we are doing and why we are doing it.

Further answer – Toby Rougier

The guidance is around 13 per cent plus the management buffer of around 1 per cent. We have confidence in that. It does factor in what we know and what we anticipate. You are right in that the Pillar 2A number has moved around a little. So I think it went up 50 basis points and this year it has gone down 40 basis points and will go up to 2.7 at the beginning of next year. But that sort of reflects the journey that we have been on in terms of understanding and getting agreement on the methodologies that we use to calculate what we think we need to hold in addition to Pillar 1 and getting alignment with the regulators' methodologies.

I don't know the history of HSBC, but it feels like they have been on a sort of similar journey as well. So I think we now have a reasonable alignment. In terms of how we see that going forward, you know a big component of that is whilst we can't break down the details of that, a big component of that is the pensions charge that we run. And as we make deficit contributions you would expect that to reduce, all other things being equal.

The other thing we don't yet know is what the Systemic Risk Buffer will be. So our guidance makes an assumption on that. And clearly for the stress tests that are coming up, the PRA has indicated that they will use a 2.5 per cent number for our ring-fenced bank. It obviously gets diluted down at Group level. But we don't know that number yet and will find out early next year. So that is a missing piece.

Answer – George Culmer

And that pensions point is a good point. We are slightly concerned what we say about the 2A, but you have seen the disclosed pension contributions and the 4-6-8 as it sort of builds and you saw it in the capital production in Q3 and you will see in Q4. But it should be that for the pounds you put in you get pounds back. Now we will see.

Further question

If you contribute 4-6-8 that is 90 basis points?

Answer – George Culmer

You don't get pound for pound unfortunately. You only have to take the equity portion, but you should get an element. You should get 50/70 per cent of that back in terms of reduced 2A. Now this is all in the gift of the regulator etc. But that is how it should work.

Further question

And the counter cyclical buffer it seems like they are taking it to 1 per cent if things go well, if they are trying to be counter cyclical they should build it and mend the roof when the sun shines and release it if something goes wrong. Do you think they are just going to stick at 1 per cent for the foreseeable and how do you factor that into your capital planning? They have actually got quite a lot of leeway to push that up. When we chat to the FPC guys they are thinking about it.

Answer – George Culmer

Well we haven't heard anything. Not to say they might not and all those sorts of things. Look I will give you a very vague answer. If it comes up I will deal with it as it comes. Because in terms of other offsets and things like where we think 2A should go to and the extent to which that gives you capacity to be able to absorb other moving pieces, you know that is all I'll say.

Further question

You can earn into it so quickly?

Answer – George Culmer

That is true. Yes if you had to hold an extra amount, you'd hold an extra amount, but I certainly don't foresee having to hold an extra amount as we stand.

Question 14 – Claire Kane, Credit Suisse

On stress tests. So yourselves and other UK banks have had pretty confident capital messages this quarter and obviously Barclays got approval...

George Culmer

Yes, we thought that was very interesting.

Continue question

I think I guess it would imply the regulator is obviously quite happy going into stress tests and that you are quite comfortable about the stress test outcome. I am just thinking, I know you mentioned IFRS 9 will be quite ugly, we could have a situation on the day a bit like last year where your implied requirement is 15 and everyone then suddenly saying, they are blindsided. What do you think the outcome will be there? We will just wait to hear, no it is not a pro-forma add-on, we will wait for the PRA to say it is all okay and then we have to wait until February to see what the buyback is?

Answer – George Culmer

Those are very valid observations. And first to your point, around last year and this is where you know, we have to live within the process that we live in, but it is not a perfect one. And the information coming out in bits and bobs and last year we got hammered because of this sort of consumer finance overlay and then whilst we are not allowed to talk about our Pillar 2B, you can just do some simple maths to see that actually whilst you might have thought the end of the stress test would have led to an increase in Pillar 2B, it absolutely did not. So there is complete disconnect. And I say that because it is very relevant, last year, for what I would expect to happen this year in terms of there is not an automatic cause and effect in terms of what happens in stress tests flows straight through into buffer.

Further question

Your requirement went up by 1 per cent, you upped your own requirement, your own target.

Answer – George Culmer

No the Pillar 2B which was the key one, that was the one that is related to the stress test. So our requirement went up because our Pillar 2A went up which was earlier in the year, but the Pillar 2B which was linked to the stress test, if you do the maths, you can calculate that the Pillar 2B moved in completely the other direction.

Further question

We are still at 13 plus 1 and we used to be at 12 plus 1?

Answer – George Culmer

I know we did, but that is around things like the Pillar 2A and if you followed where you thought the Pillar 2B would be an even bigger number. So for this year, to your question, yes there have been some encouraging signs. We are going to have EBA whatever it is on Friday and then the PRA. I think what matters in all this, I know Sam and the team will drag you all in. We are very hopeful that what they say is very clear in terms of how they see the stress test and how they see the interaction of IFRS 9 and how they are going to propose methodologies to be able to preserve the capital position and not infect that with the volatility of the accounting. Now they have said good words, you know we have the transitional and the statements around IFRS 9 shouldn't increase the capital. The way in which they intend to affect that, whether it is through amending the pass marks and the hurdle rates etc, I am hopeful that they are very clear in terms of how people should see the PRA stress test.

We have reached the end of the time. So thank you very much for coming.

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