LLOYDS BANKING GROUP PLC – 2019 FY RESULTS – SELLSIDE ROUNDTABLE
(amended in places to improve readability only)

Monday 24 February – 5.00pm

LBG HOSTS:
William Chalmers, Chief Financial Officer
Vim Maru, Group Director, Retail Bank
Carla Antunes da Silva, Group Strategy, Corporate Ventures & Investor Relations Director
Jon Burgess, Group Financial Controller
Douglas Radcliffe, Group Investor Relations Director
Toby Rougier, Group Corporate Treasurer
James Hillman, Finance Director Insurance & Wealth
Israel Santos, Finance Director Retail Banking

William Chalmers
Welcome, thanks very much for coming. We deliberately have a team that can hopefully deal with most of your questions this afternoon. Happy to discuss any issues or topics that may have come up since Thursday's results.

Question 1 – Joe Dickerson, Jefferies
On the mortgage pricing, you mentioned at the time that the churn in the book was turning favourable in terms of the margins. Could you discuss the mechanics behind that? Is it that the funding costs are coming down, is that the primary thing? Or are you actually seeing a bit of pricing change?

Vim Maru
I think clearly we have seen in the second half that swaps have dropped and that has created better margins. We have also had the Tesco acquisition that allowed us to re-optimise our activity in Q4 and they together have created a better trajectory in terms of new business margins versus maturing margins. That is really what I was calling out last Thursday.

William Chalmers
The key difference being if you look at this time last year versus now, you have got a more favourable discrepancy for what is coming off the book in terms of the re-pricing of what is going on the book. Previously that would be negative, now it is a positive trade-off. It will last as long as the present conditions stay the way they are, but loans are at least a bit more favourable.

Vim Maru
The key trends, as I called out on Thursday, that matter in terms of how you think about what happens to the mortgage side of the business: what happens to attrition which was stable in the second half, what happens to retention of customers which was stable year on year. And then what happens to new business margins versus maturing margins and that is obviously, as William said, better than we have seen over the course of the last few quarters in terms of trends. So that is the outlook that we see.

Question 2 – Jonathan Pierce, Numis
On the RoTE guidance, I am not asking you to give us the full shape of the P&L, but triangulating the various moving parts, we know equity, we know your impairment guidance and cost guidance. We have a sense I guess on where income is going. But if you could give us a bit more flavour on some of the below the line items. You said restructuring is going up. So maybe if you could give us an idea of the scale of that?

And is there anything baked within your plan with regards to asset sales or market volatility that we need to think about?

William Chalmers
I think I said restructuring would be slightly higher this year versus last. We had a period from 2018 to 2019 which came off partly because of MBNA, partly because of ring-fencing. And that lends us a tailwind into 2019. As we look into 2020 we see it coming back up again a little bit and that is a function of some of the regulatory programmes, IBOR being a good example. Some have restructuring measures that incur severance costs as a second example. And to a degree, a reshuffling of the property portfolio which we are looking at over the course of 2020. There are a number of other topics or issues within that overall bundle of restructuring costs, but those are some of the main ones that we would call out. So that is one piece.

The second piece on below the line items is the volatility picture, which we don't really make a call on because volatility is a function of the markets and we are no better at calling the markets than anybody else in that respect. The one point that I would mention is that we have seen a period of interest rate contraction or suppression during the course of 2019. That has lent us some benefit in terms of the Insurance business. It may be that, in our outlook, there is a touch of interest moving in the other direction and that causes a counter-balance in the volatility line. Again I don't want to call out volatility because a lot of it is down to markets and who knows better than anyone else. If you think about the nature of our plan, there is probably a little bit of improvement in interest rates which in turn will play into the volatility environment that impact insurance.

Question 3 – Raul Sinha, JP Morgan
Can I ask about the structural hedge? Could you remind us of the maturities in 2020 in terms of the shape and profile of the hedge, is there are anything material? I think last year you didn't have a lot of maturities and had a lot of flexibility to reinvest towards the end of the year. Is it the same picture this year in terms of the maturities?

And maybe a little bit about what happens if you think about the curve remaining quite flat where we are today, have you thought about contingency planning?

William Chalmers
As you saw we improved the position of the structural hedge between Q3 of last year versus Q4 of last year and that was off the back of some deliberate, and I think consistent with our overall strategy and policy, de-risking of the structural hedge in the context of rates backing up at that time. They obviously have come off since then, but that was an environment to take advantage of. As we look forward into the coming year, the pattern of the structural hedge roll-off is relatively stable overall.

Toby Rougier
So on the hedge, yes you are right in terms of 2019. Historically, we did a lot of investing in 2018. We came into 2018 slightly underinvested, a lot of investing in 2018. So we left 2018 fully invested both in terms of nominal and in terms of duration. Which meant that we could effectively sit on the side lines for most of 2019 when term rates weren't attractive and we didn't have NII volatility considerations. Looking out into 2020, I think we have got about £30 billion of maturities in 2020. So again we did a little bit of investment in the last quarter of 2019 both on the swap and on a forward basis and so we have got about £30 billion of maturities in 2020.

Raul Sinha
Can I ask is the duration consistent with the average duration?

Toby Rougier
Our weighted average life is three years. We don't give a profile, but we have a number of risk appetite metrics around that, one of which means that we have to bucket the hedge such that we don't have any cliff events in the hedge profile.

Raul Sinha
Can I just ask a follow-up on what William mentioned on the call? I think you mentioned that if rates were to get cut and obviously that has some impact on the way your hedge rolls in terms of the pay leg of the hedge. Is that something that mitigates the downside risk for you on the rate significantly or is that not a big driver? I am just trying to think about the magnitude of that impact on its own. If rates were to get cut how does that impact the structural hedge net contribution?

Toby Rougier
In the Annual Report and Accounts there is a rate sensitivity which is I think £150 million for a 25 basis point rate down movement. But that ends up being a combination of two things. That is a twelve month income look forward. That ends up being lower reinvestment on the hedge and some customer balance sheet impact as well in terms of timing of moves of announcements to customers and changing the rates and that sort of stuff. But it is of that magnitude.

Question 4 – Robin Down, HSBC
Can I just follow-up with a request? Could we get more granularity on the structural hedge, because at the moment you round things to one decimal point. Optically, it looks like the second half structural hedge gross contribution is higher than the first half. And we are trying to play around to work out what the exact movements are here and we can't.

William Chalmers
I think Robin we are already victim to giving sometimes too much guidance rather than too little. So I am not sure we will do much about it.

Robin Down
Second request in terms of disclosure, slide 24 that shows the profile of how the front book and back book are moving, you have included the Tesco mortgage book in the second half there. Is there any chance you could split how that £3.5 billion is split between effectively back book and front book, because obviously it does have an effect on the percentage movements we are seeing there.

Vim Maru
I think it's virtually all front book, is the way I think about it. It has been generally recently originated and there's not much SVR in that book.

Robin Down
And my final question is on the consumer credit side, if you could talk about what you are seeing in terms of interest-bearing balances within the credit card book? We are seeing across the industry that the percentage of interest bearing seems to be going down, given the market share that you have you are probably seeing similar trends.

And likewise, overdraft balances seem to be falling across the industry, I am just wondering if you have got any colour in terms of the drivers of that? Are consumers getting more sophisticated?

Vim Maru
Let me do overdrafts very quickly. So you are right, I think from the industry perspective, you have definitely seen some change in the last few quarters. As we said on Thursday, we made the large part of the changes from a customer perspective eliminating unarranged overdrafts and returned item fees in 2017. So the wash through of changes in customer behaviour we generally saw happen in 2018. So that is not a trend per se for us. And then obviously we will see if there is any change in behaviour after we have all made the pricing changes in March/April this year. But you are right to say there are some changes and some industry trends. But that has not been us driving that in 2019.

On the interest bearing balances, there are a couple of things to call out. It is reasonably stable for us on interest bearing balances. We had the MBNA migration during the course of the first quarter last year which meant that there were some balances where we simplified our proposition. There was an Affinity business that we removed and migrated. So that had a little bit of impact, but we thought that was value accretive for us in terms of what we did.

Then I think the other thing that is obviously happening industry wide is the changes from an FCA perspective on persistent debt. And again we have tried to get ahead of that. We have been doing work with customers for about 18 months or longer actually in terms of engaging with customers to get them onto different payment behaviours and plans. And therefore we probably front run some of that, but we think that is a good thing to help us as we look into 2020 and beyond.

William Chalmers
Just to add one point to that which is around the overdrafts specifically. There is a strategic emphasis where we see an overdraft customer who is consistently using the overdraft, to try to migrate them onto a better – from their perspective – payment process through a personal loan that will replace the overdraft. I can't really comment on whether others are doing that or not, but as far as our overdraft strategy is concerned that is the future of it.

Robin Down
That should be inevitable when you charge headline 40 to 50 per cent?

William Chalmers
Yes for sure and I think it is good practice.

Robin Down
So could I just come back with credit cards? So the revolving thing at the moment, I think the industry is around 51/52 per cent and that has dropped from about 75 per cent four or five years ago. Is that right?

Vim Maru
Those two numbers do not ring a bell with me, so as I say we have seen, bar the changes that we have made proactively in terms of supporting customers through persistent debt, migrating customers from credit cards onto personal loans, to William's point as well. It has not been as dramatic a trend for us.

Question 5 – Ed Firth, KBW

I have a few questions on the NIM. Just to be clear, I think you said last year that if the yield curve stays where it was, there would be a £250 million headwind in NII this year. So your 275 to 280 guidance, that doesn't assume the yield curve stays where it is or it does? Because you are suggesting a long end of 85 where it is 57 at the moment or something like that.

William Chalmers

The guidance that we have given was based on an in-year average five year swap rate of 75 basis points. That encompasses the 275 to 280 range.

Ed Firth

But the yield curve is not at 75 now. So if it was where it is now, what would be your guidance then?

William Chalmers

The comments that I was making on Thursday were that I think the curve then was about 10 basis points lower than 75. So at that point if you had had a more market aligned scenario, including the possibility of the absence of a base rate increase, that we would see therefore at the back end of the year. A combination of those two is a couple of basis points on the interest margin. That in turn would bring us down to the lower end of our guidance at 275 to 280, so a couple of basis points off our base case.

Ed Firth

So ten basis points of swap rate is broadly two basis points of margin, is that the way we should think about that?

William Chalmers

Broadly, yes. Everything in this business is more or less brought back to the 5 year swap. Insurance is a little different in terms of the term, but that is the rate you would pay most attention to.

Ed Firth

Can I ask a question on Basel IV and I know you are not going to give us the number for Basel IV. If we take whatever number we have got for Basel IV, could you help me out in terms of the phasing as to how you expect that to come through? We are getting different guidance from different banks on phasing, some are telling me it is going to be 20 per cent, 20 per cent, 20 per cent over a five year period starting from 2022. Others are telling me it is going to be back end loaded, others are saying it is going to be front end loaded. We can all have our number, but can you help me a little bit about how you are expecting that to come through in terms of the phasing?

William Chalmers

I'll tell you, and others on this can obviously comment, but I think the reason why you are getting different guidance is because nobody knows the answer. There are different fundamental equations you are getting, because we still have the EBA to take a view on what happens, we still have the PRA to take a view on the interpretation of the EBA. We still have any other offsets that are maybe applicable to other aspects of the risk-weighting regime. And off the back of that, you will get very different views on quantum, on phasing and so any guidance I give you is going to be hostage to all of that. Which means for us at least we are not inclined to give any guidance simply because it is just too much up in the air. The one thing with that point not withstanding is that when we look at it, we are focused on the back end of the overall phasing and implementation timetable which is when, to the extent output floors are agreed, and that is the most significant impact on our risk weighting. Not surprisingly that is when we look to their impact. And that is sort of 2025 through to 2027 that type of time frame.

Ed Firth

So the output floors are the biggest bit and that should be at the back end?

William Chalmers

The truth is that we don't know. What we are trying to do is to avoid giving guidance that would be updated by virtually any piece of news flow in what is a highly uncertain environment. So when we look at it, we look at the output floors and we look at the later end of the overall timetable.

Ed Firth

So the operational risk side is not going to be as material?

William Chalmers

Well again I think the reality is that there will be uncertainties as to how these elements come in. When we look forward over the course of the coming year, over the course of this year we have securitisation changes to risk-weighted assets that have come in already as of January and we have one or two Retail headwinds which refer to modelling techniques that we might apply: point in time versus hybrid versus through the cycle for example. The HPI index that is being brought in to those respective models. And that is this year. And then next year we see potential derivatives increase in risk weighting, it is not huge but it is there and we anticipate that. And then we don't necessarily see a whole lot beyond that in the near term until, as you say, we get into this question around output floors and Basel IV.

Toby Rougier

The reason you are probably getting different answers is because the package of measures impacts different banks in different ways. And as William said, given the makeup of our book it is likely to be the output floor that has the main impact on us and even if others are in a similar position, when the floor becomes an impact will differ for different players in terms of the makeup of their books. And it will also differ given the assumptions that they are making in terms of whether you assume that the floor operates at a Group level, operates at a legal entity level, operates at a portfolio level. None of this is clear yet and so that is why we have been hesitant about giving anything other than the broadest of guidance about what the implications are.

William Chalmers

Just to add to the layers of complexity, the other changes in the Retail risk model we expect to come through during the course of this year, which again is contained within that RWA guidance that I gave. So 90 days versus 180 days that is a changing metric which again has risk weighting complexity and that is within the Retail portfolio.

Question 6 – Claire Kane, Credit Suisse

Hi, I've got two questions please. First on slide 24 you show the margins of the different books. I was just wondering how should we think about the Global Corporate margin versus front-book mortgage margin, is loan growth from there going to be replaced with new mortgage lending? I think you have got 2 per cent back-book versus 1.7 per cent for overall mortgages so I was just thinking if we are going to be cutting that book and growing new mortgages, how should we think about the margin differential?

William Chalmers

A couple of points there and Vim may wish to add in terms of the pricing. The overall margin that is shown on the Commercial Banking business as a whole, you will see quite a different margin picture within each of those elements. Typically as you would expect that would tend to be lower margins for the Global Corporates part of the business and higher margins as you work your way down to the SME. The commentary as to that particular margin and its comparison to the mortgage margin will depend on which particular segment we are looking at within that, which depends on the relationship you are looking at. That is one point.

I think as we look to replace business, there are a couple of things to keep our eye on. One is talking about margin metrics, the other is obviously to a degree cost to serve and the other is capital that is required to back particular business. So when we look at the Commercial optimisation programme that I described on Thursday, that is about ensuring that the returns that have come into the Commercial business as a whole are improved over the course of 2019 and 2020 and looking forward and that is what it is about. The margin is a component piece of that analysis, but it is only one piece.

Claire Kane

I guess that is all factored into the guidance. And then I have a second question. So the PRA updates that you get on Pillar 2A, typically in August and they were discussed last week. Given you already know the improvement that you got from the contributions you were making to the pension fund, how much of the 30 basis points improvement that you need in Pillar 2A do you expect to receive this August and how much is backend loaded? Would you need to potentially revisit your 13.5 per cent target if you don't get a Pillar 2A reduction in August?

William Chalmers

The guidance that we were giving on Thursday was related to Pillar 2A developments over time. We don't necessarily expect a wholesale shift down as of this year. We were talking about the end 2021 period and thereafter. Now what we expect is to see that Pillar 2A respond to the pension contributions that we make over time, again all else being equal, we would expect that to start to build into the capital ratios in a way that allows us to manage capital close to target during the course of the latter half of 2020 and 2021. We will see what we get at the end of this year, we are going to have a number of countervailing factors. There is the fact that we have made continuing pension contributions, the fact that we have developed a longevity hedge. There is also the fact that spreads have come down and our pension surplus has come down off the end of 2019. So there are a number of different factors that will be in play during the course of this year. But our guidance on Thursday was relating to not just 2020, but going into 2021 and the period thereafter.

Claire Kane
But I guess it is quite unique in setting a capital target which is dependent on getting an offset in a buffer a couple of years down the line? Essentially it is a 13.8 per cent for now and hopefully it comes down?

William Chalmers
No it is a 13.5 per cent target, we have to see how this Pillar 2A develops over the course of this year and next. All we can do is call our expected capital standards as we see them and we see it coming down towards our 13.5 per cent target during the course of 2021.

Question 7 – Chris Cant, Autonomous
Could I just follow up on that point? So in May of last year, you cut your target 50 basis points in response to a 70 basis point reduction in MDA. Your MDA is going to go up by more than 60 basis points, but when it goes up more than 60 basis points there is no change. That is the bit I struggle to understand, there was a direct proportionate response to a 70 basis point reduction in your MDA, but now it is going back the other way and there isn't a change. Could you just explain a little bit more? Something else in your thinking has obviously changed there since last May when a reduction in MDA drove a reduction in your capital target.

William Chalmers
I don't think it has really, because we had a reduction in Pillar 2A in the autumn of last year, we didn't reduce our capital target.

Chris Cant
In May you cited the lower Systemic Risk Buffer and a reduction in Pillar 2A you got prior in the year as the reason. I say you, your predecessor, cited that. But it was specifically linked to the reduction in Pillar 2A in 2018 and the lower Systemic Risk Buffer that you got in 2019.

William Chalmers
We typically don't try to vary our capital standards every time there is a change in Pillar 2A. That wasn't done as I said in the autumn of last year. When we look at our capital targets this year, we thought a lot about our capital target in the context of the Countercyclical buffer and the partial mitigation off the back of the Pillar 2A that we expect to see over the half year. In that context, we also looked ahead and rather than reactively change our capital targets every six months or ever twelve months, we took a view as to what we expect to evolve during the course of 2021. And we set out our capital targets accordingly. I think if your point is what is our buffer to the MDA and how concerned are we about that, I think we look towards the static buffer to MDAs. As you know that has fluctuated from time to time. There has been plenty of times, two that I can think of, when the management of Lloyds has chosen to reduce inside of the stated capital target at the period of the year end to see the capital build then to take off over the course of the year.

The second point is that the expected or average capital that we hold over the course of the year is clearly in excess of targets which only then get re-based at the period end. And then as we say, we look towards what we expect to happen during the course of 2021 in the context of what is a very capital generative business this year and next year and beyond. And therefore we think about our MDA buffer in the context of all of those things. How do we see it over the course of any given year? How do we see the capital generation of the business? What is the management buffer that we see appropriate? What are our expected Pillar 2A changes? Have we responded to the last Pillar 2A changes? There are a lot of different moving pieces Chris and that is the way in which we set our capital targets.

Chris Cant
On the pension, if I could just follow up on that point as well. One of your peers has had two very discrete contributions in recent years to its pension and if I look at sort of bang for buck, it looks like you get about 45 pence back on the pound in terms of contributions reducing Pillar 2A. Is that the sort of number we should be thinking about versus your £800 million this year and £1.3 billion scheduled for next year?

William Chalmers
I don't know if we can give you as precise an answer on that as you would like. If your point is do we get a partial CET1 offset for pension contributions because the nature of the 56/44 per cent Pillar 2A offset, the answer to that has to be yes because those are the regulatory rules.

Chris Cant
Is there any reason to suppose that you would be treated wildly differently by the regulator on that?

William Chalmers
In so far as what? The ability to offset CET1 against Pillar 2A requirements? No.

Question 8 – Jenny Cook, Exane
Can I ask about the Schroders joint venture, because I understand it as being equity accounted for through other income? Then when I look through the accounts it looks like you could imply in terms of your net cost reduction, anything between £100 to £200 million, depending on when it was in operation. Could you clarify anything around that and how much that will actually reduce your net costs? That would be quite useful. And then in terms of the profitability profile of the joint venture. At the moment I think it only delivered around £7 million or so profit in Q4. What can we expect in terms of a ramp-up profile from that?

William Chalmers
I will give a partial answer to that. I don't think that we are going to disclose again quite as much as you might necessarily want around that. The accounting treatment has moved from consolidated to equity accounting, effectively. And so that has an immediate impact on the overall profile of Schroders Personal Wealth in the accounts. I don't think we have ever disclosed the component costs.

Jon Burgess
I think the costs impacting Q4 was about £20 million.

Jenny Cook
If you look at note 22 you can see all the contributions from your joint venture. And stepped up from pretty much zero during 2018 to around £60 million in 2019, the majority of that is going to be Schroders which looks like quite a bit.

Jon Burgess
I can go through the notes in detail offline if you want. In terms of what you see in our underlying income/costs numbers that is the sort of delta impact there was in Q4.

Question 9 – Ed Firth, KBW
Two more questions. Gilt gains. Can you just update us where we are there in terms of the book of outstanding and how you think that might pan out over the next year or two years?

And I guess a similar question on the experience variances. I think you signalled the longevity changes was £100 million of that. In theory it should come to zero at one point, but it always seems to be positive so I don't know if you are just structurally prudent and therefore always writing back £100 million a year or something. Can you give us some idea of how we should be thinking about that?

William Chalmers
The gilt gains came off in the course of 2018 to 2019 and we expect them to come off again in the course of 2019 to 2020. I gave some numbers on the 2018 to 2019 profile in that which suggested about £100 million or so less. I didn't give an exact number for gains on 2019 to 2020, but it will be less than we experienced in 2019.

Ed Firth
It was £180 million I think this year, so it could be between zero and £180 million I guess.

William Chalmers
I don't want to be too specific, it just depends on all the leading variables.

Ed Firth
On the back book, in the past we used to get a mark to market on the back book of the gilts so we knew roughly how much was in the pot.

William Chalmers
If you did, I'm not going to give it to you right now.

Toby Rougier
I think George mentioned a number previously.

Ed Firth
He did, he used to update it.

Toby Rougier
It was just over £100 million so about the same.

William Chalmers
And on longevity James Hillman is at the back of the room who I will hand over to in a second. But longevity produced gains in the course of 2019 which were booked in the first half. There may be gains in the course of 2020. The truth is we don't really know yet because it will depend on how we compare to the CNA tables and what that means for our business. Even if it does, I would expect them to be less than we saw in 2019 and that is partly for the reasons that you are inferring in your comments is that logically the rate of progress, if you could call people dying earlier progress, should slow down. And so we will see how we fair against CNA tables. But I would expect it to be less if there is anything in 2020 than in 2019. I would also expect it to be in the second half rather than the first half.

James Hillman
We have had a period of 5 to 6 years of improvements occurring at a slower rate. And just the way in which we set our assumptions, they will average over a period of time. So when you have that coming down it will take a little bit of time to catch up, but you will have seen we have had positive longevity assumption changes for the last 4 to 5 years reflecting that.

Ed Firth
Is the bulk of the experience variance longevity, like 80 to 90 per cent of it?

James Hillman
Well it has been recently. Longevity has been the big bulk of that.

Question 10 – Jonathan Pierce, Numis
In the movement in the capital resources table there was another big positive right at the bottom; sort of £250 million last year and that takes the costs of the AT1, so gross of that, another £600/£700 million of capital coming from somewhere. Now I think the special dividend out of the Insurance company was in there because it came out of a banking entity. There is still £500 million of capital which I can't really account for. Can you give us some colour, I think there may have been some tax activity in the Insurance company last year as well to help that, I don't know?

Jon Burgess
I think tax was part of it, in relation to the back end of last year and into the first half of this year. Some of it is complexities in terms of the way the Insurance business is consolidated. There is nothing particularly to call out. I mean there are just a lot of moving parts in that particular line item.

Jonathan Pierce
And is that going to be an ongoing benefit to capital build on top of the dividends that are coming out of Insurance, on top of the dividends that are explicitly disclosed?

William Chalmers
I think because it is a whole load of moving pieces, it isn't one that will be particularly predictable.

Question 11 – Ben Toms, RBC
It looks like JP Morgan might be moving into a UK retail banking space. Is this something that worries management? If a big company comes into the space, would it worry you more from an asset perspective or a liability perspective?

William Chalmers
Yes it is a good question. Today wasn't the first time that we have contemplated that type of move from the likes of JP Morgan. I think the first point I would make is that JP Morgan is one of a number of potential digital or otherwise players that appear on the landscape. You have obviously got the new entrants in terms of the challengers, the Monzos and the like. To a degree, and I suspect we will see it emerge over the coming years, you have deep pockets of the big tech players. And now you have got the likes of JP Morgan, and Goldman Sachs might fit into a similar sort of bucket. I think the way we see it is it manifests itself in an

increasingly competitive environment. We see that a little bit on the savings side. We see that a little bit on the mortgages side. We see that a little bit on the current account side. I think it is just part of the landscape now. I don't think JP Morgan worries us any much more than all of the other competitors that we see out there. And from our perspective at least it is really about ensuring that the customer proposition we have remains relevant. That the approach to customers, through whatever distribution channel they find relevant is effective and that we are able to offer value. So I don't want to dismiss it at all, but on the other hand I don't think we distinguish JP Morgan above and beyond any of the other competitors we are seeing in the field.

Vim Maru

We will see what JP Morgan do, but I think our approach has always been to welcome competition. It is good, it helps us to think more about our business, what our customers want and need and how we develop our proposition and if you look at the history over the last few years with Marcus coming, neo-banks coming etc. We looked very deeply at what our customers want, what certain segments of our customers want. How we use our multi-channel and multi-brand strategy to make sure that we appeal to those customers and make sure that we remain the main bank for them. I said it the other day, the vast majority of our customers actually like and prefer a multi-channel experience. That is something that we think gives us a competitive advantage and we think that will also help us to make sure we deepen and grow the relationships we have with our customers. There will be a segment of the market that allows digital and digital only propositions, but I don't think, if I take the loan market for example and JP Morgan coming into unsecured lending, is going to change the nature of the competition in that market. We already see people as low as 2.9 per cent in unsecured loans at the moment. That hasn't changed the profile of our business. And you saw last year we grew 6 per cent in personal lending for example. So we are sort of welcoming a lot of the innovation and changes there, it helps us to learn. It helps us to step up our game and continue to be relevant and serve our customers well.

Further question – Ed Firth, KBW

Do you ever look at doing the reverse because it seems you are sitting there and everybody is taking pot shots at you, you don't seem to be shooting back at all and I wonder why are you not looking at America and setting up? You are good retail bankers, I assume you could serve as efficiently as anybody else. Why are you not setting up a digital bank in America or trying to actually take other people's pie?

William Chalmers

I think it is a good question and every now and then we think if that makes sense or not. I think one comment on that and again Vim should add. None of the businesses that have done this so far have a particularly profitable business model. So when we look at what some of these players that Vim has just been outlining do in this market. Goldman Sachs may have their own reasons for doing what they are doing, but whether it is the Monzos of this world or other direct players, so far they haven't been able to make a particularly successful outcome of what they have done. Not to say they haven't gained market share, but they just haven't made any money out of it. And we see ourselves as potentially allocating capital a little differently in terms of what we are doing. Plus within the UK we think there is a lot more we could do. A lot more outside of our traditional areas in the areas that we are trying to build in, whether that is aspects of the commercial SME space or aspects of the wealth space, whether it is those parts of the Insurance business where we could deploy capital on a much more attractive basis where we feel like we have got the right to compete and the right to exist rather than gaining in some of the other non UK markets. That is how far our thinking has got so far.

Vim Maru

Just building on one point from William. I think as some of these new entrants have to at some point start turning profits or returns back to some of their investors, you start to see some of the growing pains emerge. And as they try and scale as well, you see some of the challenges for them. So we have been watching that quite closely to see the impact which is returning customers etc as well. And that is going to be a real challenge I think. You can lose money for a period of time, but at some point people will ask for a return and that will then change their business model and there will be some challenges there.

And then I think the other thing we are definitely seeing and it's an interesting trend and one we need to reflect on a bit more, is when you look at some of the customer bases, the sort of digital only businesses, they are starting to look a bit similar more globally, if you look at various markets in Asia, Australia, the US and parts of Europe too. That is something I think we need to give a bit deeper thought to. But there is definitely a cadre of customers that start to look similar across the globe.

Ed Firth

The incremental cost to you must be next to nothing doing a dollar current account as opposed to a sterling one and getting that out and seeing what happens?

William Chalmers
Well I think we are moving into a technology environment that lends itself to that type of activity and I think that is partly why we have seen some of these players come in and set up over here. So I do agree with you, there are some pretty low marginal costs and low fixed cost models that are lending themselves to that type of activity. Again, having said that, we want to take advantage of our defendant position in our home market first and foremost which is the position we take. And for the time being at least, I think that is what we will stick with.

There is one other point that I would add to Vim's commentary around what we see from the other UK digital players which is, not only do we learn a lot from them in terms of things to do, but we also learn a fair bit from them in terms of things that we don't want to do. So there will be products that are launched by some of these players that we see as being not necessarily within our risk appetite. It might attract a certain customer base, but it is not necessarily one for us. For example advancing monies to people before their pay day necessarily arise, to us that is not obviously a great product from a risk management point of view. And so we are happy to see these things go on and indeed we can learn stuff that we don't want to do as well as learn stuff that we do want to do.

Further question – Joe Dickerson, Jefferies
When you talk about the customer base being similar across the market, was that in terms of demographic or in terms of products? What is the similarity?

Vim Maru
I think if you look at the bases in the UK where people are mobile first, and the demographic of that population as well as what their needs are. And as we have started to segment our base carefully you see similar profiles when I look in different markets. And actually there is some interesting learnings to be had from different markets that we can bring here. To William's point there are some things that have been happening globally that we don't like very much and we can discard those. But there is some interesting learnings as we develop our digital proposition that helps us to think, how do we make sure we learn from some of that global experience or similar groups of customers who are in effect mobile natives and what their underlying needs are which are slightly simpler than other groups of customers. And in that digital first model they are looking for frictionless experiences and so on, and that is what we try to develop in our digital business, but with a more multi-brand and multi-channel approach. But it gives us good skills to keep learning. As William has also said, priority number one is how do we look at adjacent markets, opportunities within our own base, so you know consumer lending that we have talked about, Schroders, the Insurance business. There are lots of things in markets, certainly for my customers I would love to talk to them about where the marginal costs are very low as well for us to develop propositions for them and that whole Single Customer View is the key anchor for us which has helped us to evolve our thinking beyond Open Banking. Because obviously Open Banking is that big, Single Customer View is much bigger and a bigger opportunity for us.

Question 12 – Fahed Kunwar, Redburn
Other Income came down like £350 million in 2019 versus 2018 [note: Other income reduction was £278 million in 2019 versus 2018], and £100 million of that was the gilt gains and we can take off that. Of the remaining £250 million, I think you said the overdraft changes was all in NIM. So is there anything else structural that you see or is that all cyclical related so if things get better during the course of this year you can expect a bounce back?

And on the tax rate, your medium term 25 per cent guidance you talked about a benefit from revaluation DTAs. How big is that benefit and what are you looking out for in the budget in terms of the implications to your tax rate this year and going forward? Thanks.

William Chalmers
On the first of those two questions, structural issues. I think if you look at 2019 to 2020, then you have the investment management change in the first half and you have the longevity piece that we were just talking about a second ago, also in the first half. I think taking the first of those two, I would see as structural in the sense it is not going to recur. And the second of those two may recur but at a slower pace, as we discussed. If you look at that same business then on the Q3/Q4 basis, what is structural there? I think the bits that I would point out are for example in the workplace pensions area where a lot of the growth during 2019 was fired up by the contribution rates. That was not apparent in Q4, i.e. those contribution rates were less versus the first three quarters. In Q4 that piece of the business came off a little bit and you would expect to see that continue to come off in the course of 2020. And I suppose that is structural as well. We would expect to see that come back i.e. the contribution rates increase but not in the near term. I think that is probably a couple of years hence. So I think that is the case for that piece.

Fahed Kunwar
Could you quantify that piece?

William Chalmers
No I don't really want to just because it gets too much into the individual business lines. But the way in which I will quantify it is to tell you that you could see the effect in the first three quarters and you could see it dropping out a little bit in the fourth quarter.

On the Retail side there is as you say High Cost of Credit or the overdraft fees, in the interest income line. But at the same time there was a little bit of ongoing fee pressure in the retail space, which I don't know whether that counts as structural or regulatory driven, but it is there.

And in Commercial I think to be fair a lot of Commercial was cyclical in its nature and as I said if you look at that on a 2018 to 2019 basis it definitely looks weaker on a 2019 basis. And if you look at it on Q3 to Q4 it continues to be weak. And if you look at it on 2019 to 2020 to be honest with you, I am not seeing a revitalisation in markets in January or February, it continues to be relatively slow paced. But there is a view on the back of the clarity in the Government's policy that may be delivered off the back of a fiscal package that may be expansionary, then you will start to see some activity coming off the back of that.

On the tax piece I think I said about £300 million benefit from the DTA revaluation in the course of 2020. That is based on the expectation that the Government keeps taxes at the 19 per cent level rather than reduce them to 17 per cent. We don't know that for sure obviously but that is certainly the expectation right now. And that will take our effective tax rate down from an expected 25 per cent to a couple of percentage points below that.

Question 13 – Robin Down, HSBC
I am not a natural optimist, but I am slightly worried that we are in for a multi-year period of revenue decline. I know you would disagree with that, but it feels that is the real risk here. And on the cost side, maybe you could give me some reassurance but when I look at the 2019 cost base, we did see a reduction coming through there, but that in part seems to be driven by lower performance bonuses for the staff. There was a reduction in the service cost on the pensions, I don't know if that was linked to a discount rate move. And it feels like there isn't much of an underlying cost reduction coming through there. And then we can see in 2020 it sounds like the Schroders accounting change may partly explain some of the cost reductions in 2020. My question is really, what is the scope here for real genuine sustainable underlying cost reductions to come through over the next two or three years to kind of mitigate some of that revenue hit?

William Chalmers
Well I think on the revenue picture Robin, obviously you must take your view which is fair enough. I think the view as to revenue as we see it depends upon the success of our various initiatives across the three businesses i.e. Insurance, Commercial, and Retail banking. It clearly depends in part on your macro outlook. So I wouldn't subscribe to your view on revenues, but that must be your view. On the cost side, one of the things that I have been most impressed by in this organisation is the ongoing continued focus on costs. And it is a culture of efficiency. In terms of where we get cost savings out of, a couple of examples that we are looking at over the course of this year, which I think will go against your points of bonuses and other more transitory measures. We are looking at a significant organisational redesign going on over the course of this year. I am not going to name a particular division or area. But it effectively brings together functions that were previously apart. That in turn allows us to achieve real efficiencies, i.e. doing the same job with one person that was previously done by two.

So that is an example of organisation redesign. There are other micro examples of that through the organisation that we are also running. So combining certain functions in ways that allow us to achieve certain efficiencies. That is one, I think the second one is you see the outside systems and technology world just as I do. We are seeing very material changes in the way in which systems are provided to the banking sector as a whole but also to industry as a whole. And that obviously goes in favour of the private and public cloud point I mentioned on Thursday. That gives you the ability to access a sustainably lower and more variable cost environment. Now it will take a little bit of time to get there. You will also have to invest in a bit of decommissioning to yield the benefits of that. But there is no doubt that is a structural change in the way in which businesses are being run. So to see it as a function of bonuses and HR policy is in my view incorrect. Another example, look at our property portfolio. Now as we look into 2020 there is reason to think about our property portfolio. And we will see some benefits coming out of that over the course of 2020/21/22 simply because we will be consolidating what we do now in a more rational way. That is not about customer branches as Vim said in his presentation, that is pretty minor part of the picture. But it is about doing things in a more rational, more coherent way. But again it is structural in its nature.

So there's three examples there. That is underpinned by what I would see as a culture of efficiency. Every two weeks this side of the room here and a whole number of others, sit around this room and go through every item of expenditure that this bank makes. And that isn't about bonuses, that is about what contracts we have with the external world that serves us, how can we get them better and they are sustainably improved year on year. Simply because the other institutions not in banking but around us are in the same environment as we are and we impress the same tactics upon them as our customers impress on us.

So you must obviously make your own judgements, but what I see is structural changes that lead to a different cost base over time.

Robin Down

And is that something that at some point you will be able to give us some numbers in terms of head count reduction, in terms of what it does?

William Chalmers

Well we do already. We have given cost guidance this year of less than £7.7 billion in total with detailed guidance last year.

Robin Down

I am really thinking on a three year time horizon?

William Chalmers

Well GSR4. I mean I don't know what we are going to say in GSR4. I am certainly not making any pledges today, but what guidance we'll give over the next two or three years, that is a GSR4 matter.

Question 14 – Fahed Kunwar, Redburn

One of your UK listed peers for the same cost savings had a restructuring cost which was a heck of a lot higher. And you talk about technology changes. I always thought of Lloyds as a bit worse than one for one in terms of restructuring costs versus annual cost saving. Is that ratio deteriorating because you are getting into the harder and harder bits of cost saving now, the big system changes and that? Should we be thinking about restructuring costs going to get more and more for you to get these cost savings that Robin is talking about?

Vim Maru

I was just going to add a couple of things. When I look across the Retail business, two things, one we continue to see opportunities where they are what I think of as "win, wins." Good for customers, good for efficiency. A small example is some of the additional migrations we are seeing so in the last year we have developed the capability to deposit your cheque on your mobile. You take a couple of pictures and it is deposited. 100,000 customers are doing that every week. So that is one example. I talked about the Google maps example the other day, 40 per cent reduction in call demand as a result of being able to show people what they want to see digitally. Then I think when I look across the business we still have a huge amount of paper and I think of those as win, win, wins because there is good for sustainability, good for customers and good for us and you have still got opportunity to talk to customers about how they would like to get served and how we will reduce the amount of paper that we consume in our processes. So when I look at the business in the next couple of years I still see lots of opportunities, partly also because new capabilities have emerged in the last couple of years, things like robotics as well as the machine learning and advanced analytics that will help us to take advantage of those opportunities to serve customers better but also become more efficient. So I'm certainly feeling like it is more actually a management capability, which is how do we get at all of the things that we see in front of us, rather than, actually this is the end of the road.

And I think to the restructuring point, when you get into things like property reconfiguration or massive IT change. Yes those might have different configurations, but the ones that I am looking at have very good paybacks both from a customer and from an efficiency perspective.

William Chalmers

That paper based example that Vim was just referring to, it doesn't sound like huge numbers but of course they all add up, potentially saving of circa £10 million or so. Some of the movements in Cloud that we are seeing over the course of this year, potentially savings of £50 million or so. Now there is no individual number that is going to make a massive difference but the idea is that you add them up and that is what contributes.

Further question – Robin Down, HSBC

I think the problem we have on the sell side is that, we probably find it easier to forecast revenues, and revenues are fine because we can extrapolate the structural hedge movements etc. It is far harder for us to see in absolute terms where your cost base might be three years out. And everyone talks about digitisation etc, but we have not really seen across the industry massive cost take out?

William Chalmers

No I don't think it has arrived yet really, I think that is probably fair. I think what you have seen in the spirit that Vim was just commenting on and I was adding to were two things really. One is incremental benefits that digitalisation has in part arrived and the paper free example that Vim just gave is one of them. What you have also seen is just a kind of cost re-engineering process that is going on, on a pretty manual basis. That table gathering that I mentioned that we have once every couple of weeks here, is the top twenty suppliers are responsible for circa 50 per cent of the non-FTE cost base. Those suppliers are on average contract tenures of three years. So once every three years we are taking a crack at those suppliers in the context of what can they offer from a service point of view and a price point of view. And the non-FTE cost base turns over on that basis. That gives us a reasonable ability to try to manage the costs on an ongoing basis. It is pretty manual and it is hard labour, but it is ultimately what keeps the costs under control.

I think the bigger picture point and again others may wish to add around the "what are you going to see out of the private and public cloud?" I think that plays itself out over the course of the coming two, three years, something like that. Simply because institutions are getting to the point where they need to think about how they manage the systems within their institution. The offerings from the cloud providers are getting steadily more compelling and more competitive. The regulator is starting to understand that they need to allow the sector to gradually move into the space. That is not risk free, but nonetheless the regulatory discussion is progressing. And so I think you will see these things start to develop. The other piece that it implies and to your point, it also implies a degree of decommissioning investment. These things are not going to come free. The only way which you will get benefit from them is a little bit of decommissioning along the way. Which is an area that we are already engaged in and to your question, see pretty good payback for that. I am not going to quote precise numbers on this, but generally speaking we invest one pound and get one pound of pay back in the year. And that one pound of payback is obviously recurring whilst the investment is a one-off. It is around that order of magnitude for types of decommissioning. But Robin to your point, the big system changes, as you said they are still ahead of us.

Question 15 – Ed Firth, KBW

To what extent do you worry internally or do you test yourself internally as to whether you are being radical enough? It seems to me that the attraction of the market for people like JP Morgan is they can see that they can provide a similar product to a bulk of your customers at orders of magnitude lower cost. We are not talking like with one-off or one branch less, like orders of magnitude lower. And I just wonder whether if you look in other industries which face that disruption, it's not that the management didn't see it coming, they all saw it coming, but they were never radical enough, they never changed their business enough to actually get into the new world. By the time it happened it was always too late. And I just wondered, I mean when we see, not just you, but from the whole sector, when we hear cost savings like a couple of hundred million off here, we put a few things on the cloud. I am sure it is all hard work and I am not trying to rubbish you, but maybe your costs should be half of what they are?

William Chalmers

I think your point is absolutely right, we will have to be radical on both.

Ed Firth

But have you got enough time? Because it seems to me that this is an issue that has been going on now, you know the Monzos arrived 3 or 4 years ago now and now we have got JP Morgan arriving. If you are still thinking about it, at what point do we think it is just too late and actually this is a run-off business with a load of old branches, a load of old customers that over the next ten years is going to dissipate down to 3 or 4 per cent return?

Vim Maru

Two things because I won't repeat many of the other things that I have said. Firstly on a marginal basis, if I took on a digital only customer, the marginal costs are as competitive if not better than many of the players you just talked about. So we have done a lot to re-engineer the way that we on board and we work with customers. So I need to keep doing that, need to keep reinventing. But I don't fear competitors from that perspective. And then I think the other massive advantage which I probably haven't spoken enough about which matters a lot to customers is brand and trust. And as much as people would like to say it will go, it will disappear, quarter in, quarter out when you look at the information and you look at how customers view us, how they view the Black Horse, how they view Halifax, how they view Bank of Scotland and Scottish Widows. Masses of trust with those brands. We would like to do our main business with these brands, it would be useful to use some of these to try out and do some other things. But from a revenue perspective those aren't that material. We can't be complacent and therefore we are continuing to work hard to make sure we remain that primary bank of choice. But that combination of brand, multi-channel as appropriate, slick processes, low marginal costs, low funding costs with our low risk approach. All of those things come together to help us compete every day. I certainly talk to the teams every week about various things that are going on. There is no complacency in the way we approach things here.

END

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