LLOYDS BANKING GROUP PLC – Q1 2019 INTERIM MANAGEMENT STATEMENT – TRANSCRIPT
(amended in places to improve readability only)

Thursday 2 May 2019 – 9.30am

LBG PRESENTER:
George Culmer, Chief Financial Officer

George Culmer
Morning everybody and welcome to the call. I will give a short presentation and then we'll open it up to Q&A.

In Q1 we have made good strategic progress and delivered another strong set of results, with statutory profit and EPS up 2 per cent.

Starting with strategic progress on the first slide. Last February we set out an ambitious plan that built on the progress of recent years to transform the Group for success in a digital world. We have made a strong start, our transformation is accelerating and we have already invested around £1.2 billion out of our target of more than £3 billion over the 3 years of the plan.

In terms of key deliverables, it has only been 10 weeks since our 2018 Results, but since then the migration of our prime MBNA credit card portfolio has been completed, one quarter ahead of the original timetable, and with expected superior financial returns.

We are also on track to stand up our joint venture with Schroder's in the second quarter, subject to the usual regulatory approvals

New customer propositions include the launch of self-serve business banking loans, a new digitised SME lending tool and the digitisation of our insurance claims process with over 50 per cent of claims already being managed digitally.

We are continuing to roll out Open Banking, and we now have around 60,000 users and continue to benefit from our unique banking and insurance Single Customer View.

Customer satisfaction also continues to improve. And our Net Promoter Score has increased by 2 points to 64, driven by improvements in both the Branch and Digital channels.

And finally, we also continue to make progress on simplifying our systems and driving further cost efficiencies in the back office. These include introducing a new HR system and removing 60 legacy systems, and we have also extended our use of e-auctions to include professional services with the cost of contract renewals down 10 per cent.

So a busy start and much has been done, but as ever there is more to do.

Turning now to slide 2 and the performance update. In Q1 the Group has again made strong progress and delivered increased profits and market leading returns. As mentioned, statutory profit after tax was £1.2 billion and up 2 per cent with returns remaining strong at 12.5 per cent.

These results were driven by an 8 per cent increase in underlying profit, with a 2 per cent increase in net income, lower costs – with the cost:income ratio lower at 44.7 per cent, and the expected higher net AQR of 25 basis points.

Capital also remains strong, with the build in the quarter of 31 basis points and, as you will have seen yesterday, we have reduced our capital requirements.

Looking at income on slide 3, NII at £3.1 billion is down 3 per cent on prior year due to slightly lower average interest earning assets while the margin remains robust and is in line with guidance at 291 basis points.

Other income increased by 7 per cent driven by a strong result from Insurance and Wealth, including a £136 million benefit from the planned change in investment management provider. We have also seen a 13 per cent reduction in operating lease depreciation mainly due to robust car prices and lower fleet volumes. And we have also recognised a £50 million performance-related earn out from the Vocalink disposal.

On costs, total costs are 4 per cent lower year on year, with operating expenses down 3 per cent as a result of continued cost reduction, and a significant decrease in remediation charges. And Jaws for the quarter are a positive 6 per cent.

Turning to slide 4 and credit, asset quality remains strong, with the gross AQR of 30 basis points in line with Q4 and the net of 25 basis points up due to the expected lower releases and write backs.

Despite the Brexit uncertainty, we continue to see no deterioration in the portfolio and new to arrears remain low across key products such as mortgages and credit cards, while our diversified high quality Commercial portfolio also continues to see very low impairments.

Looking below the line on slide 5, restructuring costs of £126 million include redundancy and MBNA integration costs and are 9 per cent lower than prior year. These are offset by the increase in volatility and other items, which includes an estimated charge for exiting the Standard Life Aberdeen investment management agreement. We have also taken a further £100 million for PPI, reflecting the operational costs of dealing with higher gross complaints and information requests, while net complaints are in line with our assumption of around 13,000 per week.
Our effective tax rate is also marginally better at 25 per cent, compared with 27 per cent a year ago, due to the increased proportion of Insurance profits, and is in line with our longer-term guidance.

Turning briefly then to the balance sheet on slide 6. Given the current external uncertainties, we continue to adopt a prudent stance with pricing and underwriting discipline, targeted growth and business mix optimisation.

Total loans and advances at £441 billion are down 1 per cent on both year end and Q1 2018.This mostly reflects a reduction in the open mortgage book of £2.5 billion in the first quarter, largely due to disciplined pricing and expected increased outflows, and we are still targeting the open book being flat at the year end against 2018.

Elsewhere we continue to target SME and Asset Finance growth. SME balances are up £0.7 billion in the last year and Motor Finance is up £1.5 billion, both growing ahead of the market and supporting the margin.

On liabilities, we continue to target growth in current accounts, which are up £6.7 billion on prior year with increases in both Retail and Commercial.

And finally, RWAs at £208 billion are up £2 billion on year end despite the lower loans and advances, with the RWA reduction from the low-density mortgage book more than offset by a £1.5 billion increase from the implementation of IFRS 16 as well as some small model changes. And given our ongoing optimisation we would expect a slightly lower level of RWAs at year end.

Finally on slide 7, we have set out our usual capital walk. Our build for the quarter of 31 basis points is after the expected one-off 11 basis points for IFRS 16, as well as the PPI and Standard Life charges, and is in line with our ongoing target of 170 to 200.

And as you will have seen yesterday, the Group has also now received confirmation from the PRA of the Systemic Risk Buffer, which will be 200 basis points for the Ring Fenced Bank, and 170 at the Group level. This is less than the 210 basis points we had previously included in capital guidance, following action to manage the size of the Ring Fenced Bank. This also follows the net 30 basis point reduction in the Group's Pillar 2A that we announced in July last year.

And, given these decreases, the Group will now target a CET 1 ratio of around 12.5 per cent, rather than the previous 13, whilst continuing to hold a management buffer of around 1 per cent.

So to conclude, we have continued to deliver on our ambitious strategic plan to transform the Group for success in a digital world. While Brexit uncertainty persists and continued uncertainty could further impact the economy, given the strong current performance, we are reaffirming all of our financial targets.

This includes NIM remaining resilient around 290 basis points, operating costs below £8 billion in 2019 and a net asset quality ratio below 30 basis points.

We also continue to seek targeted loan growth and customer deposit balances.

Finally, we continue to expect a return on tangible equity of 14 to 15 per cent in 2019 and capital build of 170 to 200 basis points.

That's all I was going to say up front and we can now go to Q&A.

Question 1 – Raul Sinha, JP Morgan
Morning George. A couple of questions if I may. But firstly on the underlying NII trends. Can you unpick a little bit in terms of how much of the weak performance this quarter is really going to stay with you as you move through the year and try to grow this open mortgage book back to flat? And obviously I'm looking at consensus which is broadly flat, slightly down on NII for the year. Given where you started the year obviously it looks like running below that run rate so if you could give us some thoughts on what should we think about at the full year?

And maybe similar question, but from the other side on other income. Obviously headline has got the insurance benefit and the Vocalink earn out, but if you take those two out you know you have got a softish sort of run rate there and perhaps you get some back through bulk annuities deals or higher gilt gains. But if you could talk through the underlying run rate that would be really helpful, thank you.

George Culmer
Hi Raul. Okay first up, dealing with the mortgages. I mean our overall strategy has not changed and we continue to adopt a prudent and a discipline as I said in the presentation as you have heard many times before. In Q1 what we have seen and as I have said in the presentation, expected larger levels of maturities. So in Q1 2018 we had maturities of around about c.£10 billion and that is up a couple of billion in Q1 2019 through an expected larger maturity. So that is sort of when I look at Q1 versus Q1 immediately I saw seasonal type effect. As I said in the presentation though, we remain committed to an expectant of getting mortgages back on track in terms of closing the year in line with where we've opened it. So basically making up that ground. And we will do that through a combination of continuation of focus on retention and referral.

Also what I am seeing is in terms of campaigns with our 'great rates' campaigns and in terms of things like application pipelines which we are actually seeing is about 10 per cent up at the end of March and about 15 per cent up at the end of April. So it is our fulsome expectation that we will move through the sort of seasonality and phasing of the Q1 and will get mortgage balances back in line with where they were at the start of the year and we will do that at the same time as not stepping off NIM because we can do it in a disciplined way and we are staying as we would see in our guidance, reaffirming that guidance around 290. So we are fully expectant of being able to get back in terms of mortgages, the open book, back to where we started the year.

Now if you take that big mortgage movement and alongside with that, and again you have heard this many times before, but those areas that you have seen grow at Q1 things like SME, Asset finance, again I would sort of expect to see them grow as we move through the year. So I would certainly expect. I mean I think that Loans and Advances were down at the sort of 440 level having come in at 444 or something like that. I would certainly expect to see us moving back to that opening year position as we move through the rest of the year. So from a, you know, from an asset strategy, the overall strategy isn't changed, I think you will see the low point at Q1 and our expectation is that we will build that back as we move through the second half of the year. But what I would stress as well within that, that we are sticking with our margin guidance as well around the 290 and that is not about buying growth, that is about staying disciplined on price and underwriting. But leveraging our multi-distribution, multi-brand approach etc. etc. that you know. So that is where we sit on the asset strategy.

On OOI, look we are very clear and transparent and called out what is driving OOI. I think I said at the year end a few weeks ago or 10 weeks ago, whenever it was, that other income would remain challenging, but we would continue to aim for around about £6 billion of other income for the year end and I will repeat that now. That remains our position, that remains our aspiration for this year. In terms of what is driving, yes it does remain challenging, but it has been a standout performance for Insurance and perhaps we are to blame in calling out the 136, but we call it a one-off, but the reality is that comes from good business management. The way the Insurance business works, if I take out, if I reduce my expenses, I prove my persistency; I have got things like longevity improvements coming through as well this year which you might have read about across the insurance sector. You will get those benefits, you know, they are helped and they are slightly accelerated by insurance accounting. But we said a few years ago that we were putting effort and time in building that Insurance business and improving its performance and you are seeing that coming through. Costs are coming down and the investment management agreement is a key part of that. Persistency is improving, we have some tailwinds from longevity that will come through as well. And they may appear to people as one offs, but what these represent is an improvement in business performance. And we have seen the benefit of that in Q1 and perhaps it is slightly distorted because it is just Q1 but you will continue to see Insurance continue to perform.

So when I look across the piece I have got a strong Insurance result. Yes it will stay tough in Retail for reasons we have talked about previously. You've got lower levels in things like consumer card fees, I have got some mortgage related business down as well. I have got some default fees which are running at a slightly lower level, so I have a combination of things.

Commercial, it is a tough market, slightly lower volumes and some thinner margins. We talked about £100m of gains. We know there is going to be less gains this year than last and we have seen most of those in Q1. So that has come through. But we will continue to see a strong performance from the likes of LDC. It is also worth looking at things like, particularly going back to Retail where some of that is down to lower fees from Lex that you can offset in things like operating lease depreciation. But as I said, this has been rather a lengthy answer, but as I said at the year end, I said it will be challenging, there is no point hiding away from that, but our aspiration was to be in line with round about the £6 billion. And that very much remains the case and without boring you on the 136, what you are seeing is the financial consequences of an improved and performing Insurance and Wealth business coming through into our results.

Further question
Okay. If I could just follow-up on the NII point, what have you done with the structural hedge in the quarter if I may ask because if I look at the 5 year swap rate obviously it is down through the quarter. It has recovered a little bit since in Q2, but have you been rolling the balances or expanding them in Q1?

George Culmer
Hi Raul. No on structural hedge I think you can say at year end given that we don't adopt an automated approach to this. We will do what we think is right and in the best interest of shareholders on this. And at certain times if we don't see value and we don't see any merit in basically hedging our non interest bearing balances we won't do so. Now our natural position is to be fully hedged and we have capacity up to about £185 billion and we have a duration there of around about 4 years. But given where rates are and as you say and as you know, we stood off that at the sort of yearend point and we are still basically more out of the market than in. And the equivalent would be now that I think we are invested balances around about the 172 and we have got a duration of about 3.5 years. So at the moment we have un-invested capacity that is sitting there and which we are able to deploy both from a volume, sort of notional amount, and from a weighted average life. So that's the position we are at, at the moment, and that is what we think is the right thing to do in terms of current economics and how we deploy shareholder money. So that is where we are.

Raul Sinha
Thank you.

Question 2 – Joseph Dickerson, Jefferies
Hi how are you? Most of my questions have actually been answered.

George Culmer
He asked everybody's questions!

Joseph Dickerson
Exactly we can hang up now! So if I look at card loans, they were down about 2 per cent year-on-year. That is an area where you have been growing in the past. If there is any colour you could provide there particularly as regards to trajectory of that book over the course of the year that would be useful because presumably one of the drivers of your margin strength has been the unsecured products. So any colour there would be helpful?

Then in terms of thinking about the capital, you know the lower capital threshold that you announced yesterday, can we tack on that 50 basis points into whatever buybacks we have pencilled in for this year or is it something you hold back as you think about things like Basel IV in the future? How to think about deployment of that or uses of that benefit would be also helpful? Thanks.

George Culmer
Right, okay if I deal with the second one first. And stating the obvious we are obviously delighted at the news and being able to communicate that and it wasn't something that happened unexpectedly. The combination of both what happened in Pillar 2A last year and the reduction in the Systemic Risk Buffer from what we had previously included guidance reflected deliberate management actions in terms of managing the ring-fenced bank.

And I think it's important unto itself because you know the only route for capital changes have been ever upwards and so it is important unto itself as an amount but also the symbolism that says actually if you manage your business you can invert that direction. So it is good unto itself and I think just good terms of bucking that trend and demonstrating the art of the possible.

In terms of utilisation, as you say, 50 basis points is the best part of a billion. But look the Group is not going to change its approach to either sort of dividends or distribution strategy and by that I mean you know that from the dividends we have a sustainable and progressive and I think it is quite clear in terms of the sort of growth rates the market should be looking to for that. But in terms of distribution of any capital above our requirement which is now essentially the 13.5, the 12.5 plus around the 1, 13.5. that will be a decision for the Board that they will take at the end of the year. And so all I will say is that you know that decision will fall as part of the normal decision making process as to how we run the business. So what we do with surplus capital above our requirements, above our target will be a determination as I say for the Board at the end of the year and we will deal with that then and you know we will make that decision at that point. But there is certainly no change in our distribution policy and how we apply that.

So that is the second bit. On the card loans, we are slightly down and I would expect us to be slightly higher come the end of the year. The overall strategy, having been looking to grow market share etc, essentially achieved that with the acquisition of MBNA and perhaps will be slightly more choice in terms of where we charge in growth and you particularly see that in things like balance transfers where you will see in terms of some of the months that offering has come back quite severely and we are part and parcel of that. So a slightly different strategy in terms of acquisition versus overall book management and slightly down at Q1. But I would expect to see a slight growth in terms of by the time we move back in the full year.

Joseph Dickerson
Okay, thank you.

Question 3 – Fahed Kunwar, Redburn
Hi morning George, thanks for taking the questions. Sorry I was going to come back to NII if you don't mind. On the structural hedge point you made, I appreciate the NIM guidance is the same and hopefully volumes grow, they will grow according to guidance from here. But you didn't invest the structural hedge this quarter because of the lower swap rates it sounds like. So if the Bank of England stays pretty dovish and the swap curve just stays pretty low, would you invest that structural hedge capacity to meet NIM guidance or would you say look we don't think it's economic, we won't do it, we are happy to miss the NIM guidance? We won't reinvest that hedge. I just want to understand because obviously other banks are very mechanical with their hedge, but you guys do it a bit differently. So how do you think about using that capacity on the hedge and if there is more deposit growth in the current account space given if the swap curve stays low? That would be very helpful.

And the second question I had on NII as well. Your back book/front book. Your front book is still obviously below your back book, your SVR book is kind of moving down at the same kind of pace but it is moving down. So what kind of mechanisms do you have right now to offset that back book pressure on a kind of 2-3 year view, you obviously use the unsecured market. A lot of the banks have gone towards 5 year. But it looks like a lot of those things are, you know at the capacity to keep on doing that is slowing down. If the rates don't rise how do you offset that kind of back book pressure that doesn't seem to be going away?

And the third question which is a very easy one is, the RoTE target is 14-15 but obviously if you pay that down to 13.5 per cent Core Tier 1 ratio should we then expect a higher RoTE because you don't need to hold as much capital as you did when you kind of set those targets? Thank you.

George Culmer
Right Fahed. In terms of the reverse order. I mean as I said to the previous question, any action on distribution vis-á-vis the 13.5 will be taken at the year end and by the Board consistent with our policy etc. etc. But what I would also say though is that 14-15 is quite a broad range in terms of returns and in terms of pounds that sit behind that. So there is quite a spread of financial outcomes that would fall within the 14 and 15. So I am not sure in my answer I am suggesting that you formulaically run things through. I am sort of saying there is a quite a spread between the 14 and 15. And anyway any decision on what we do will only be taken at the year end.

The mortgage bit, good question. I mean as we said to you numerous times and when we plan and when we talk about our long-term guidance, we don't plan on the presumption that the asset pricing, you know, will rise like the 7th cavalry and come back to save everybody by suddenly getting a whole lot less competitive. We assume the market stays competitive and within that without publically airing all our strategies and tactics moving through the durations in terms of being able to refinance, in terms of targeted campaigns within the mortgage book. And then everything we talked about previously in terms of off-setting it with growth in some of the higher margin areas, being the unsecured, the SMEs, the Mid-Markets. The ongoing management of the liability side of the balance sheet and shaving the deposits. I mean you know the quid pro quo of the competitiveness of the asset side is that it isn't as competitive on the liability side of things and still being able to take action there. And that is despite new entrants, Marcus', etc. as, all those would have come to pass there's still ability.

And then going back to your structural hedge type question, you have seen today we have continued to grow our current account balances, they are up quite meaningfully on a year ago. Retail is up on where we were at Q4. Commercial is slightly down but that is partly a phase and partly a tax payment timing issue that has come through that as well, and we continue to target that as well. So you know your question, if you go out long enough we are all dead type stuff. But you know I think we have proven over the last few years our ability to manage the spread. And again in that, and I know we have talked about this before, this obsession with managing the bank at a totality and making sure we are managing the spread and making sure we are doing it on a weekly basis is critical to all this as well.

So I am not going to, through the course of this call, say we have a secret silver bullet that we haven't spoken about before, it is the ongoing close attentive detail you know; utilising the distribution channels, utilising the differential brands that we have got. Utilising the skills and expertise in terms of product development, in terms of retention strategies, etc.

And then to your first question, look, it's going to sound slightly tried, but I think you know we will always do what is right for the business. And it is our current view that the structural hedge essentially exists to protect us from volatility and particularly downside risk in terms of where rates might go. And I do that by locking up money. Now if I don't see that there is actually significant downside risk and I am not really being rewarded for locking up that money then I am staying out of that market and I don't think that is right to manage that on just an autonomous and automated basis. We have a natural position which will be to be fully hedged, to deploy the 185 so that is always our sort of, our natural tendency to move to that position. But I absolutely, do not manage it for the very, very short term bit. It is around what we think is right for the business and that is how we go about it.

Further question
That is very helpful. Could I just ask for one quick follow-up?

George Culmer
This will make 4!

Fahed Kunwar
Which will make 4, I apologise. You mentioned the current accounts. Obviously that has been one of the reasons that overall deposit costs have been falling. Q on Q what has happened to the overall deposit cost? Has it decreased?

George Culmer
No it is pretty flat. When I look at the slide in Q1'18 and Q1'19 where we had 12 basis points lost on assets and then clawed back through liabilities and funding. If I had shown you the Q4 on Q1, Q4'18 to Q1'19 it would be a pretty dull slide. I think it is just one basis point off. The cost of the savings for example is around the sort of low mid-40s and it stays around about that level Q1 versus Q4.

Fahed Kunwar
Okay, perfect thank you very much George, sorry for all the questions. Cheers.

Question 4 – Chris Manners, Barclays Capital
Good morning George, how are you doing?

George Culmer
Fine thank you, are you well?

Chris Manners
Yes good, good. So just sort of two linked questions if I may. The first one is just on Basel III impact and the mortgage before it gets to 1 Jan 2022 we have got the 50 per cent output floor coming in. Look through your risk weight density on mortgages is sort of roughly 10 per cent from your latest Pillar 3. How much RWA inflation are you expecting on that mortgage book?

And then the sort of linked question on that is how do you think having higher risk weight density is going to impact front book mortgage pricing? Are you actually starting to price those higher risk weights? I mean if you write a 5 year fix it is going to be held on your book until 2024. So are you think about that in pricing? And if you are, do you think your competitors are thinking about that in their pricing? I'm just trying to link in that RWA inflation and what that might mean for price reaction on the mortgage market. Thanks.

George Culmer

Hi Chris. Look in terms of RWA inflation, if I answer the question you didn't ask first. Before we get to Basel III and all that type of stuff, in terms of the broader bit. We have got the sort of foothills of, well actually the first thing was the IFRS16 which you have seen today and you saw the 11 basis points in terms of capital. And then ahead of me I've got more of a sort of PRA, EBA inspired one. So I've got the Definition of Default I think in 2020. I've got the hybrid PD calculation 2020 and I think I've got the EBA repair programme which is 2020/2021. I've got securitisation I think which is a sort of 2020. And those could add anywhere between about £6-10 billion or something like that in terms of RWA.

And when we talk about our, as you've heard lots of times before, in terms of our capital guidance, that is why whilst I grow stat profits etc, I'm funding a number of things like that RWA inflation which keeps that capital guidance pretty static over that period as I seek to do that. I mean the Basel III which is the sort of 2020, yes it comes in during 2022, but a lot of it is backend in the outer years of that. So 2025/26/27. So you know in terms of pricing, when we price products we'll look at current RWA requirements, we are cognisant of stress capital requirement, we are cognisant of leverage ratio requirements. You don't explicitly put in the new floors as yet. But I don't feel that is derelict in that given the other things we look at and given the timings that will come in.

We haven't actually given an explicit estimate in terms of whatBasel III, your estimation of sort of 10 per cent is pretty correct. By the time you get to Basel III coming in, you will have been through the foothills of the, you know, the Definition of Defaults, of the hybrid PV coming through as well. So I would imagine by the time you come into Basel III type stuff, the 10 per cent could be anywhere up to you know 10, up to 12-13 per cent something like that. So I am already starting to tune into that. But those are sort of the numbers. And then as you say, as things go to 72.5 over that period then you can do some simple maths to work that out. But this is going to sound complacent in all those sorts of things and I definitely won't be here, but you know the actions that one takes and how one responds to that, there is plenty of time to give absolute thought to in terms of what the overall approach to the business. And as you know Chris, it throws up a whole load of interesting dilemmas in terms of how you approach such a relatively crude yardstick. Anyway, so partially answering your question.

Further question

So I guess the thought was as the risk weight density goes up that will mean it is much harder for mortgages to hurdle, the intense competition you've been seeing from your competitors, may then abate to a degree. And so maybe just if you could, is that a fair thesis? And also it would be interesting just how you've seen maybe over the last sort of 2 or 3 months mortgage pricing evolve?

George Culmer

No sorry I missed your punch line then. I mean these are very fair and very rational thesis in terms of risk weightings, you know we would also say that in terms of deployment of things like leverage ratios against ring-fenced bank would become very relevant in terms of how people should be, if you are looking to make economic returns on these products and not just deploying excess liquidity for example, it should be very pertinent in asset pricing as well. So there is a very rational case as to why asset prices should move and not necessarily wait for Basel III as well, but just in terms of some of the PRA moves. As we say, the imposition of ring-fencing, the imposition of leverage ratios as they come through, as people re-finance, some of the challenges in particular, some of the Bank of England sponsored funding to market originated funding and given some of the travails, some of them are probably going through at the moment, all of those costs of liabilities should feed through into a higher cost on the asset side. I agree with that, with you entirely.

And in terms of recent observations, the market remains tough you are right. There has been a slight easing, so prices have you know still come off a bit. People, you know, the market is in the sort of 2 and 5 year type, I think that is about where 90 per cent of the action is at the moment. But swap rates haven't moved and swap rates haven't all been priced through which is good. So there has been some alleviation in the sort of 10-15 basis point range. So you know we talked about previously sort of new business margins of about a per cent or something so it is slightly ahead of that. So there has been some easing, however much as I'd love to, I am not going to stand here and say I am calling a turn in the market. But there has been some recent easing there is no doubt.

Chris Manners
Thanks George.

George Culmer

Cheers Chris.

Question 5 – Andrew Coombs, Citi
Good morning, two clarification points and the first is, can you just remind us please what you have assumed in terms of base rate hikes for your guidance for the full year?

And second question which is looking at your return on tangible equity target, the 14-15 per cent. You have obviously printed 12.5 per cent for Q1. It would be 17 on an underlying basis. So the delta in terms of whether you can get there or not seems to all be down to the below the line items. So if you could just give us an idea particularly on the volatility and other items line, the split that first between SLA and other? And then where you think that goes going forward?

And then also thoughts on restructuring? Thank you.

George Culmer
Hi Andrew. Okay if I deal with your second question first. Yes you are right. You know the underlying shows the consistently strong, the 12.5 vis-á-vis 14. We annualise, so essentially we take the below the line in Q1 and it gets annualised up. The extent to which one suffers a poor Q1, that hurts you in terms of the methodology of the calculation. I don't expect to be taking SLA in Quarters 2, 3 and 4 as we go through this. So you are right, it is the below the line items. As I called out in the presentation, we have got about 120 or so from restructuring of which about 40 was from redundancy. I had about 40 or so from the last parts of MBNA which is essentially done, as I said in the presentation. So that should drop away.

Within the banking volatility I'm afraid I'm going to be somewhat opaque and that is all due to as you will know, within there we have included the estimated charge for exiting the Aberdeen Standard Life investment contract and that we will not be disclosing to the market in terms of the amount that is included in that. The other bits of volatility that sit within those just to clarify is, we have insurance volatility and as you know, both insurance and banking you essentially look to hedge the capital position which sometimes you get disconnects between capital positions and P&Ls. And what I can say is that having suffered a large negative delta for insurance in Q4 of last year and that was equity market lead as well as credit spreads, credit tightening, equity market recovery. We have got a better performance for Insurance and we are going the other way, we have a banking volatility where we essentially hedge out our our foreign currencies, RWA exposure and we also pick up our cross-currency basis and that has gone negative in Q1 as well.

But in terms of precise components and precise elements of the mass, you know in disclosing you know a part of it and revealing the other part I'm afraid I'm going to have to frustrate you. So those are the themes. But in there I've got the estimated charge for exiting Aberdeen Standard Life, I have a positive from insurance and I have a negative for my banking for those reasons. And those are the components that sit within that. So that is the elements of that.

And then in terms of rate hikes, yes we assumed one per year over the course of the plan, so this year it was the backend of the year, I can't remember whether it was November time or August, I can't remember which one we assumed in. As you have seen from our previous disclosures I think it is about £86 million per 25 basis points. And I think I we may have said this before, but you know so it does not have a material impact on, if there is no rate increase, on 2019. And thereafter if we stay flat, we will hunker down and we will go back. And if I'm looking at revising income I will look at what else I can do across my business in terms of mix, in terms of pricing, in terms of expense actions to see what I can do to make sure I hit my returns target. And I know you have heard this many a time, but you know the business models that we operate and the management processes and structures that we operate give us early line of sight on that stuff and give us a better chance than most of being able to deliver that.

Andrew Coombs
Very useful. Thank you.

Question 7 – Jonathan Pierce, Numis
Hello, morning George. Three number ones and they're quite quick. The first one is TNAV. When you went to about 0.4p in the Quarter and I think the dividend went ex in April, the earnings about 1.5p and there wasn't much in the way of buy-backs which should be broadly neutral anyway. Was there something going on that we can't see because there is no sort of full balance sheet here?

George Culmer
Pensions I think you have seen, because the tightening of credit spreads, I've lost about half a billion on the pension valuation in the quarter, that is probably a piece that you are missing there.

Further question

Okay that's helpful, thank you. The second one on the share count. I think there is about £170 million of buy-backs in the first Quarter in terms of millions of shares. The share count went up 10-20 million. So I guess the awards were something in the order of £200 million in the first Quarter. Can you give us a sense as to where you think that award number will end the year? Sort of similar levels to last year at £700-800 million?

George Culmer

Do you have 2 questions or?

Further question

Okay, the third one is the POCI book the credit impaired HBOS. We are seeing quite a lot, as we have historically, quite a lot of reduction year on year in that book as you would expect. I guess that is where that book is sat is in the closed mortgage book. What sort of margin are you generating on that book if I can ask?

George Culmer

You can ask, whether I can give you a straight answer, we may have to come back to you on that one in terms of the margin. It is coming down, I forget how much we have got left in there. I can't remember the number. But in terms of spreads on that, I do not have that to hand. So we will come back to you on that. On the award bit, my expectation would be, I think last year we issued something like 700 or something and I would imagine if you assumed there would be a consistent amount was added this year. And then obviously my buyback, depends on price and all those sorts of things, but somewhere shy of 3 billion or so shares I would have thought over the course of the year 2.7-2.8 something of that order. So you are probably looking at sort of net 2, 2.1 type reduction over the period would be my expectation.

Jonathan Pierce

Okay brilliant, thank you for that.

Question 8 – Guy Stebbings, Exane BNP

Morning, thanks for taking the question. Firstly I had a couple of very brief clarifications on RWA. I think you said earlier on the call that you thought RWAs were going to fall from the Q1 position this year. So I was just trying to understand what is driving that?

And then also just to check the £6-10 billion guidance, does that capture the 90 day Definition of Default; net of the PRA mortgage rate changes, securitisation changes and EBA repair programme? So all those three.

George Culmer

Yes it did. Yes they are sort of the ones up to the launch pad of Basel III that I have got all those sort of things. And that is slightly a large range because you know these things are yet to be fully flushed out, we have still to get final papers on this, who knows whether EBA repair programme will come in as one hit or be staggered and all those sort of transitional reliefs. So there is an element obviously of variability around this. So that is just an indication.

And then yeah you are right, in terms of RWAs, we are whatever we are, about 208 at the end of Q1, I think I said we expect to probably be slightly lower than that come the end of the year. So I would expect to see, it sounds slightly counter intuitive, you have got sort of Loans and Advances moving forward and RWAs going back. But part of that is composition I would expect mortgages to go forward, obviously those are at a low risk weight density. So we don't get much RWA inflation off the back of that. And at the same time as you know we have got a continuation of our optimisation programme particularly among all the high density type RWA users particularly within the Commercial business where I would expect to see some benefits from further on-going optimisation which will take me down. So I would look to be growing Loans and Advances, but the RWAs shaving slightly as basically I've got growth in low density and I will look to optimise and take out some high density elements of the Portfolio.

Further question

Okay perfect. And also can I just check on the new capital guidance that you have given in terms of how permanent you view that. Presumably on a 2-3 year view there is a possibility of moving back through the threshold to the 2.5 per cent for the SRB given the limited gap currently. Is that fair? And if so are you assuming that you will see offsets elsewhere like Pillar 2A through lower pension risk and Op risk that means you do things, 13.5 per cent is kind of long-term go to, even if the SRB was to go back up?

George Culmer
Look yes there are a number of moving parts and if I start with a sort of negative you know counter cyclical or whatever in terms of where that might move to. But something like Pillar 2A, the flip side for example of, I'll be making some substantive pension deficit contributions over the next few years and the way the Pillar 2A is calculated the starting point is the position of your accounting surplus of your pension scheme. So as I put money into the pension scheme for example I will lose that from a capital perspective, but if I am improving my Pillar 2A starting point for pensions I should be getting 55 per cent or 57 per cent of that back theoretically all other things being equal on the Pillar 2A.

On the Systemic Risk, we are, you know it's a very simple calculation, it is calibrated to the size of assets and the 250 down to 200, the magic number is 610. You know we closed last year well below that, below the 600 level. And you know deliberately so. We know entirely what we are doing. And as we plan out we see ourselves staying below that level. And if you think about it, I'm not quite sure what a business, what piece of business you can write me that ticks me over from, you know, 609.99 to 610 and still makes a decent return on capital. So you know the marginal costs of that last piece. So you know I would expect to stay below is what I would say to you.

Guy Stebbings
Okay perfect, thanks a lot.

<u>Question 9 – Edward Firth, KBW</u>
Morning. Apologies, it's probably just two points of clarification, I think you have probably told us both directly. Just on the Basel III you were saying you think that is a 10 per cent incremental after you have had the 2020 changes, is that right?

George Culmer
No I didn't necessarily say that, no all I am saying was we are currently at around 10 per cent. You have to try and look at, you have got then the PRA changes, Definition of Default and I imagine will be sort of 12-13 per cent or something like that. But by the time you come to the start of the Basel III implementation. And then the Basel III implementation 2022-2027. I mean, the main thing is they kick in at the back end of that. So let's see where that gets us.

Further question
Okay so as at this stage we don't really have any guidance on Basel III, in terms of total?

George Culmer
We have said what we've said.

Further question
No that's fine. And then the other question was could you explain why gilt gains in Q1 both this year and last year and the equivalent period last year and do you have any visibility on what you would expect us to be putting in for this year as a whole?

George Culmer
So this year it was round about 100, it was slightly less than that '18/'19 last year. I think as we guided for the full year we expect to be about £100 million or so less than last year so I would have thought going forward for gilt gains it would be slightly the same as we have seen before in Q1 if not a bit less than that in terms of the rest of the year. So less gilt gains and most of them have been taken in Q1. So that would be my estimate there.

Further question
Okay. So basically that is it for the year, the £100 million you have got in Q1 we should expect that to be zero for the rest of the year?

George Culmer
No sorry, I was not completely clear. What I was saying is probably just less than about the same again through the next two quarters.

Edward Firth
Okay thanks.

Question 10 – Robert Noble, RBC

Morning. Just a general question on the sort of economic outlook from what is happening with your books and things like that. Have you seen any slowdown, you report your Mid-Market corporate growth came down, you said that was due to tax, but is there any sign of pulling back on investment in the corporate book? Obviously you point to strong underlying credit quality, but the presentation does show a pickup in Credit Card arrears, is there anything going on there at all or is it just normal volatility?

George Culmer

No, if you look at that slide you see a little pick up don't you in terms of cards. No that is not underlying deterioration in trends, that is sort of operational factors. So that for example, things like as we moved over the MBNA book, migrated that onto the Lloyds book we were basically, and customers were unable to pay off for a period of time. And there has also been various operational reasons in terms of a drop down in outbound calls etc. So we see that as operational factors. So that little tick up at the end of that is operational and that is not the beginning of the turn that we are just seeing the start of there.

Elsewhere as you say, look I mean I think we showed a slide in the Results in terms of business investments and you know in Q4 last year and have continued into this year, you are seeing a step off in terms of levels of business investment, that is undoubted. At the same time you know we are not seeing any deterioration trends, new to arrears etc that we have just been speaking about and you know the consumer stays relatively robust and resilient. And you see that in most recent data around record levels of employment, there is something like 400,000 new jobs created already this year. You will see wage growth now moving measurably ahead of inflation coming through as well.

What we do look at though and this is where when we talk about our outlook we are reaffirming our full year metric. What we are looking at are things like HPI and stuff like that where again you will have seen the various stuff from RICS and whether we should be tempering that. That is something that we are thoughtful about if the Brexit uncertainty persists. So that is something that we are thinking through.

So you are seeing slightly different things. Businesses standing off, still resilience amongst the consumer and obviously we are predominantly a consumer led bank. But things like HPI etc., we are thoughtful about where that is going and what the latest data is showing. And also what is the geographical dispersion of that as well vis-á-vis. London for example where we are underweight and ex-London where we are slightly overweight. So those are things that we are mindful of and we are looking carefully at.

Further question

Just a follow-up, on house prices, what is the sensitivity of your models to change in house prices if they were to fall I don't know across the country by 5 per cent what does it do to you?

George Culmer

Well we used to talk about, oh I can't remember now, 10 per cent was £1 billion of RWAs, that was what we used to talk about. And I think that is still relevant. So 10 per cent RWAs. Now how that plays through into, I forget whether, because that is the sort of RWA type sensitivity and I think that is true, we talk about a 10 per cent gives you about a billion, billion and a half of additional RWAs. As I pay through into the wonderful world of IFRS9 and if I am dropping my HPI and my economic scenarios and how that plays through into my book as well. So that is something that is worth considering.

Robert Noble

Thank you very much.

Question 11 – Martin Leitgeb, Goldman Sachs

Good morning. Could I have one quick number question and two follow-ups on earlier comments. And the number question is just whether you could comment on what level of attrition you have seen within either the SVR or your broader back book? Some of the competitors have flagged that attrition has gone up somewhat in the quarter.

And just in terms of the earlier comment with regards to mortgages and mortgages strategy going forward, I was just wondering what do you see currently in the market? Do you see a couple of players being overly aggressive or in a way not sensible that they are writing business which is potentially below their cost of equity? Or they think the market is generally at such a level that it is getting closer to cost of equity that you know the upcoming changes in terms of risk weights, capital density and so forth are likely to be supportive for pricing going forward? Are there one or two out there which might destroy the broader pricing.

And the final question just on scope for liability optimisation so I was just wondering if you could comment on whether you see scope, is it mostly on the deposit side or still some other instruments potentially out there which could be helpful? Thank you.

George Culmer
Hi Martin. On attrition, it is still around 13 per cent and it has been, I was about to say remarkably constant, it has probably been about 13 for the last 18 months, something like that of that order. But the in quarter, attrition is still around about the 13 per cent. So you know that is the size of the book that we are seeing. And the Halifax book that people talk about, I want to say it is now about I think it is about £35 billion of that order I think size I think. And it is round about the 13 per cent attrition is what we have seen. And it is about £35 billion is the Halifax book.

The mortgage stuff. Do you know what it is, there is no one lender leading the market. So and this is not just being polite or stand-off or anything. At previous times we have seen lenders and whether it has been Nationwide or HSBC but at the moment there you know all major lenders competing strongly. Our response is, and this sort of touches on some of the tactics on how we play things, we use Halifax as a competitive brand in sort of house purchase and we use Lloyds for example in the remortgage and we take different brands in different spaces. In terms of tenure, I think as I mentioned to an earlier question, it is a 2 and 5 year gain between the two of them. You know you have almost 95 per cent if not a bit more of the market going through with those elements.

So it is still tough out there. As I said to the earlier question, we have seen a slight alleviation and you know the ending of TFS, the leverage ratio etc, pricing. They are all you know rational factors as to why you should get some underpin I think in terms of the mortgage market. But the presumption is it stays tough.

And to your cost of equity, I am sure each bank will sit in front of you and justify and explain etc. All I would say is we struggle to see how some make a cost of equity and whether it is people simply earning more than cash, whether it’s people are not putting in the full cost of funds and what their market rates really is as opposed to simple margin and banking margins. We are slightly suspicious of but we struggle to see with some of the rates out there what you might assume about rollover and continuation and tenure and all those sorts of things. But we struggle to see how current rates make a decent cost of equity.

Further question
And on the liability side in terms of optimisation?

George Culmer
Oh sorry, apologies. Yes liability side of things, yes as I said to an earlier question. We are fully sort of stable going, I think there is still a bit of room around the fixed book, where I have still got sort of some £20 billion or so in my fixed book which I think I will be able to price down. Still being able to pair elements off some are variable branch rates etc and things like that. I think there are still opportunities to do that. So both cost of fix and variable, I still see opportunities to be able to price down to offset some of that margin pressure.

Martin Leitgeb
Okay, thank you very much.

Question 12 – James Invine, Soc Gen
Hi good morning George. I just wanted to ask about PPI, where the claim volumes, the net claims you would be in line with your provisions, but of course we are all expecting a bit of a surge. Are you just taking the view that it will be what it is and then you will take a provision in the second half to clean it up? Or are you just not that worried this time around, you think the CMCs are just generating spurious claims rather than real ones?

George Culmer
Hi James. Look PPI, the £100 million that we have taken basically reflects what we are seeing as you said net complaints are pretty much where we had expected them to be. So we allowed for 13,000, I think the precise average for Q1 was 12,800. What we have though seen is a vast increase in gross complaints in PIRs, so which are basically information requests and those are up by about 30-40 per cent you know as we approach the time bar. And the issue is that each of them has to be dealt with. You know a nil return requires effort to in the sense of searching databases, searching records etc. So we were expecting at this moment in time to potentially be running down for example the workforce, the colleagues that we have working on PPI, but we currently have something like 6,000 people and that is simply because that gross level that are coming in is requiring work and effort in terms of validating or determine that there is no case to answer so to speak. So it is that surge in increase, and the £100 million is not a pay as you go, that is basically us assuming, it is a bit beyond the sort of August time because if something

comes in before you have got to sort of deal with it. So that is just assuming that we keep those elevated levels of colleagues deployed dealing with that surge in gross complaints.

Further question
Okay, lovely. When do you think we will finally have the actual total number? Does that come with the Q3 numbers or do we have to wait for the Q4s?

George Culmer
I think it will probably be Q3 so you might have to ask William that.

James Invine
Lovely, alright, will do. Thank you.

Question 13 – Chris Cant, Autonomous
Hello there, thanks for taking my question. If I could just come back on the RoTE target questions and your remark at 14-15 per cent is a broad range. Just mechanically the shift down to 13.5 from 14 might add something like 50 bps to whatever you thought you were going to be within that range. But as we discussed at full year 2018, your definition excludes intangibles amortisation and if I look at what that was adding in the quarter, that is adding about 95 basis points now versus at least what I would consider to be a more typical definition that your peers are using. You indicated that you might revisit that definition now that that intangibles impact is getting quite large. So are you perhaps simply going to offset those two factors in terms of the return i.e. lower capital positive but actually including the intangible amortisation as an offsetting negative? That would be one question, just trying to understand what is happening with guidance?

And on capital generation you said you are sticking to the 170 to 200 per year and you view the first quarter performance as consistent with that. How much capacity in terms of basis points of capital do you still have to come through over the next year or two from further optimisation of the Scottish Widows capital position, how much do you have in your back pocket there and how much of that might be deployed this year please? Thank you.

George Culmer
Okay, two good questions. The second one, on Scottish Widows. I am not going to give you a precise number but there is some more we can do. There is an ongoing piece of work in terms of de-risking that business. So I would still expect there to be supplements to the normal dividend streams that come through us de-risking the Scottish Widows business and be able to upstream capital. So I am sorry I am going to frustrate you, I am not going to give you a number, but the principle is right and they are doing a great piece of work in that business in terms of they are growing it and making it more capital efficient and we see some more opportunities there and being able to de-risk that.

And then to your first question, I hadn't thought of that actually. But look on the RoTE calculation yes I agree with, when you asked and what we said last time, I think we will relook at it For the purposes of the go forward I think it is simpler for everyone if we stick with what we have got because you, know it's clear and it's transparent in what we do and we can take a subsequent look as to the right way of actually calculating that. But I don't think we are going to do anything for this year because you pointed out somewhere the diverges from our peers and we are looking at that. But at least everyone knows what it is and I think we are not going to change it for this particular year. We will stick with it and we will work out you know if and should we move in terms of 2020 onwards. But at least it's clear, we know how it's calculated and we are transparent about it.

But again going back to the sort of first part of it, you know we are very pleased with that revised capital requirement and you know how we deal with it the Board will decide as part of its normal process at the end of the year. So that is where we are.

Chris Cant
Okay, thank you.

George Culmer
Thank you everybody for taking part. I think that is the end I am being motioned to move. So many thanks for that and thanks for all the questions. Cheers everybody.

FORWARD LOOKING STATEMENTS

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