LLOYDS BANKING GROUP PLC – 2019 Q1 IMS – SELLSIDE ROUNDTABLE
(amended in places to improve readability only)

Tuesday 7 May 2019 – 4.30pm

LBG HOSTS:
George Culmer, Chief Financial Officer
Carla Antunes da Silva, Group Strategy, Corporate Ventures & Investor Relations Director
Jon Burgess, Group Financial Controller
Toby Rougier, Group Corporate Treasurer
Mike Harris, Insurance and Wealth Finance Director
Douglas Radcliffe, Group Investor Relations Director

George Culmer
Hello everybody, thank you for coming, this will be my last one. As of last time this is a chance to ask things that weren't asked or for clarification. So from our side obviously we've got Jon here, Jon Burgess, Group Financial Controller, we have got Carla and we have got Toby, Treasurer. We don't have Mike and we don't have Douglas just yet, but we have got Ed and Angela. Anyway are people alright to go straight to Q&A, so if someone wants to kick off?

Question 1 – Fahad Changazi, Mediobanca
Yes can I ask about Other Income, and especially related to Commercial clients. If we could get some idea on what the trend of other income and loan growth is in Commercial?

George Culmer
We don't give quarterly splits in terms of Commercial. It is marginally down and you have got lower levels of activity, thinner margins etc. Markets business is tough and I think OOI is probably down about 4–5 per cent to where it was at Q1. And see what RBS said about it, the Commercial business. It is just low levels of activity and thinner margins. Toughness in markets, yes.

Question 2 – Raul Sinha, JP Morgan
A couple of questions, mainly on capital. Can you maybe talk a little bit about the Systemic Risk Buffer and how much the absolute size limits in terms of where you are standing. Are there constraints for the business at all, if you see them as a constraint actually?

And then maybe the second one on capital, I don't know if you had a chance to look at the CRR2 buffer intangibles technology spend. I don't know if you have any thoughts on that and clearly there's a lot of unknowns, but any kind of thoughts around that would be interesting?

George Culmer
I haven't had the detailed brief on that at all, but I have various high level comments in terms of deployment of intangibles etc. Without having read the fine details, if someone has read the fine details shout out, but instinctively the way spend is going, you have to have a rethink in terms of how you classify this. Every bank is doing the same in terms of investment in intangibles and growth in intangibles on the balance sheet. So you do have to have a rethink about it.

On the Systemic Risk Buffer, as you know it is for the Ring Fenced bank and assets of £610 billion is where you flip from 2 per cent to 2.5 per cent and our Ring Fenced bank closed 2018 at £593 billion and part of that is simply just a consequence of what has been going on with volumes, part of that was having a good look at the balance sheet and asset size. And sort of to your point, levels of things like derivative activity and running a hard lens over that. So if I'd taken a business cost to be able to reach that, absolutely not, it is just around challenging more in terms of levels of business done and returns etc. So there's no big P&L negative. And on the go forward, I would be expecting to stay below the £610 billion, as the last marginal bit of business that took me over would have to be some bit of business. And I don't see it as a sort of business imperative. There are also things you can do. In the same way as people are going to learn to live with IFRS9, there is learning to live with non Ring Fenced banks as well. And in terms of how you can move assets between LBCM which is our Non-Ring Fenced bank and the Ring Fenced bank gives you things that you would want to look at as well. So that gives you some opportunity to bring that number lower or put it the other way, give you some capacity to be able to grow it without picking up that punitive capital charge as well.

So when we built LBCM we were very clear that we only want to put stuff in the non Ring Fence bank that has to be there. As you learn to live with it you just take a different view on asset classes and asset categories as well. So there is some latitude to be able to do things there as well. But there has been no business costs getting there in terms of the £593 billion and we do see ourselves staying within that limit and potentially create some additional capacity as well.

Further question

And one other question on something we don't normally talk about which is LDC. I think that sits in the Head Office?

George Culmer

It's run by two very competent people. Toby and me.

Further question

So obviously that business has done pretty well. We don't see the numbers, but reading about it, it seems to be making quite a meaningful contribution to the Head Office and it is quite a lumpy item I would have thought?

George Culmer

Yes last year was, because of the NEC. In a normal year LDC would have investible assets just shy of about £2 billion. We would be generating income of £300 million plus in a normal year. Last year with the NEC, it was about £100 million higher than that.

Further question

And that's all Other Income isn't it?

George Culmer

And that is all in Other Income. It's a key part of the offering, a key part of the portfolio. It has been remarkably resilient over the period just in terms of return that it has generated. And even through things like crisis years, LDC is a regional based business so it doesn't tend to slug it out in London so much. It is more in the industrial estate up in Derby or up in the North East or North West and it is businesses of £10–20 million investments. And the NEC was just a tremendous deal in any sense, was its biggest deal and its biggest return. But now because of the NEC it is probably now at £1.6 or £1.7 billion of assets, that is the size now. But its profitability has been remarkably consistent over the period.

Further question

Is that going to be a headwind for this year then?

George Culmer

Obviously it will make less this year than it did last because, and we saw that in Q1. So £60 million plays £80 million or something like that, £60 million plays £85 million in types of numbers. But it is good business.

Question 3 – Tom Rayner, Numis

How long can you carry on just maintaining a flat core mortgage books, or even shrinking it with franchise implications of not growing the core business at some point?

George Culmer

It is a good question and there still isn't a precise mathematical answer. When we look at market share of new business, we were probably about 15–16 per cent in Q1 of this year. And you are right, in terms of keeping channels open, they sell what they can sell, and you have got to retain a presence and all those sorts of things. Within that we look to flex not just in terms of product type, but in terms for example, we want to grow market share of branch base. So in line with using branches for more complex sales we want to grow and we have grown it by about a couple of per cent in terms of branch base sales as opposed to intermediary sales.

But you are right, the 16 per cent back book is whatever it is, 21 per cent in terms of the open book. As I said on the call, we were down in mortgages in Q1 start of the year. We make up some of that ground at the half year and close that by the full year time. But when I look out over a plan, which you don't have, our presumption is the market stays tough and we would still be in a market that was growing 2–3 per cent net over that period, we would still be inside of that by a per cent, per cent and a half, something of that order.

So to your question, there is a need to keep franchise present and stuff like that. So dropping much below 16 per cent new business, probably not. But whilst market is relatively muted in terms of growth and composition, our assumption is that we will continue to be sub-market for a while.

Question 4 – James Invine, Soc Gen

To put the question another way around. So we've heard from other banks they have been improving their intermediary channels but you are still taking more share from the intermediaries than anyone else despite the fact your pricing is never really best in class. So what is it that you do to impress the intermediaries so much? Is it you get higher fees, is it service levels, is it something else?

George Culmer

I don't know about higher fees, but I think we have got brand recognition, you have got continuity, as you say. Intermediaries tend to sell what they know how to sell and they tend to deal with people with whom they have strong relationships. They like to be able to key in things they know will work but don't embarrass them in front of clients. And with whom they are acquainted in terms of application procedures.

Now that all sounds complacent and you can't be, because if it does fall over and you embarrass them, you have got to move with the times, but they do tend to deal with what they know. And as long as you keep in the frame then that is where they will.

Mike Harris

The same with the insurance market. Make it as easy as possible for them to deal with you and they will continue to deal with you even if you are not best cost.

George Culmer

Yes, that is how it has been over the years.

Question 5 – Rohith Chandra-Rajan, BAML

On the same topic, I think you said that redemptions are around £12 billion in the quarter, is that right?

George Culmer

Yes

Further question

£12 billion and then the new lending then would be about £8.7 billion to get to your net number in the quarter. And the redemptions number, does that include the outflows from the closed book or is that just the open book?

George Culmer

I think the outflows from the closed book I said, I might just check that one, but I think that is outflows from closed book. But your maths without getting into the decimal points is correct. It's in that order yes.

Further question

And then in terms of your pricing position your step back from last year, are you happy with the way you have priced through or is there any change in that?

George Culmer

No I can't call out any material shifts in pricing. I would like it to be higher. What's happened is everyone has chased each other round so we moved down some maturities in that space and people are playing the LTVs and the higher risks. There is nothing I would call out in terms of pricing at this point.

Further question

Do you think pricing is relatively stable you mentioned on the call that swap rates have moved down a bit but it's not currently following that trend?

George Culmer

Yes, that is correct so things have eased slightly, but as I said on the call, no one is going to say that this is some great turning point or anything like that. But things have eased very slightly and, again, as I think I said on the call, there is no particular call out on an individual name. I am not going to say there is an HSBC or a Nationwide, it tends to be kind of across the piece at the moment.

Jon Burgess
And the numbers were on the total book

George Culmer
Yes.

Question 6 – Fahad Changazi, Mediobanca
I have a question on Other Income this time, Insurance. Have you disclosed the bulk volumes?

Mike Harris
No.

Further question
Is it fair to say that Q1 is normally seen as the quieter quarter?

Mike Harris
It varies, we had an okay quarter.

George Culmer
There was about £40 million of income in Q1 from bulks. But the bulk market, we will play and we will take money. I have talked about this before. If we like the bulk, we deliver more income. If we don't like the bulk then we have got more capital there etc. And because we are just one step removed as the numbers come through into our numbers, we are not sitting there having to say 'I have to hit this budget' and all that kind of stuff. On a deal by deal basis, and the sign offs in terms of returns and where we play and where we don't play, there is some very strict governance around. And if we don't think we can get the returns then we won't put the money there.

Mike Harris
And I know we step away from a lot more than we participate in.

George Culmer
You might think that sounds very virtuous, and you would say that wouldn't you. But there is a different dynamic in terms of how they fit into our earnings profile and our dependency upon them. Yes we would like to write our budget allocation but if we don't write our budget allocation because people have outbid us then so be it.

Further question
Has the competition intensified?

Mike Harris
It is more the market has grown, there is more availability and more people are coming to market than twelve months ago. In terms of volumes of deals, there could be one or two knocking around that float out as they did last year. The market is as big if not bigger than it was 12 months, 24 months ago.

Further question
So do you agree with Legal & General's comment about £30 billion per annum market now?

Mike Harris
Yes that kind of order.

Question 7 – Raul Sinha, JP Morgan
There is very strong growth in UK Motor Finance in the first quarter.

George Culmer
About a billion and a half.

Further question

11 per cent up year-on-year. I mean I guess these are small numbers in the context of your balance sheet, but it is a market where the Bank of England have obviously set themselves in the past. I just wondered if you could cover off if you are seeing anything specific in Motor Finance and also broadly in consumer credit in the UK in terms of demand, changes to that demand, your risk appetite?

George Culmer

The answer is not especially. On the asset finance side, the growth rates will come back and I would expect it to be more in line with market so the low single digit type percentages in terms of growth. Things like residual values have stayed pretty robust, a bit of softness most recently in things like SUV prices which have been coming through. Cards we would be in a sort of 3 per cent market growth and I would expect us to be there or thereabouts as well in terms of our business.

In Cards, I think you see a different stance in terms of balance transfers. Obviously the months have come back quite seriously in the last 12–18 months or so ago in terms of the longest balance on offer out there. I haven't seen of late splits between mainstream bank and non mainstream bank so I haven't seen whether the NewDays and what their growth rates are and whether they come back, so I can't speak to that detail. But our expectation would be, as I said, markets have low single digits and we would be low single digits for the full year.

Further question

Credit cards went backwards, is that seasonal?

George Culmer

Part of that would be seasonal and part of that is coming back on BTs, different BTs.

Question 8 – Rohith Chandra-Rajan, BAML

On Mid-Markets that has gone backwards in the quarter, I guess that can be a bit lumpy?

George Culmer

Yes Mid-Markets is lumpy. SMEs is up, Mid-Markets I wouldn't read too much into what happens in one quarter in terms of that. You get redemptions and stuff like that, so it does move around a bit so I would not read anything into that.

Further question

What sort of full year growth would you be looking at?

George Culmer

Have we got that for Mid-Markets?

Jon Burgess

There is for SME and Mid-Markets.

George Culmer

SME and Mid-Markets together we are looking for what?

Jon Burgess

About £2 billion.

Question 9 – Martin Leitgeb, Goldmans Sachs

Can you give an indication of how profitable the front book mortgage for a banks like yours? I'm just trying to understand is there further room in the market for pricing to come down or pricing for the efficient large players whether getting closer to that cost of capital everywhere and maybe a couple of players are pricing aggressively at this point in time?

George Culmer

Yes is the answer in the sense that you are getting pretty close to your cost of capital in terms of where new rates are. We try to look at actual prices from others, to work out what returns they are making and there is a question as to whether they have got the full cost of funding in there or whether they are just putting in Internal transfer pricing and not actually pricing in cost of raising money over and above that. Whether people are assuming conversions into other products etc. So we just struggle to see how some of the prices out there would give you returns above cost of capital.

Further question - Rohith Chandra-Rajan, JP Morgan
It is not just the small banks?

George Culmer
No.

Further question - Rohith Chandra-Rajan, JP Morgan
Number 3, number 4, they are saying that pricing is attractive enough to make very high returns. But they say the funding costs are lower, they clearly have got opportunity costs perhaps from liquidity trapped?

George Culmer
Well the last point is a separate point. If you are HSBC you might say I have got a lower cost of funds etc. and you can't bleed that in, but you still struggle with some simple maths in terms of how you make money economically on that. I mean, if you are deploying trapped liquidity and you are making more than cash, you think that is a good use of funds then that is the wrong answer to the problems that you have got. But this isn't small boys stuff, there are some big players out there so we struggle to understand.

Further question – Martin Leitgeb, Goldmans Sachs
The overall blend of new business, is it just particular products like the 60 loan to value or 2 year fixed or more?

George Culmer
It is more widespread than picking on a particular product. It's much more widespread than just that they've got a smart product which is in the high take-up rate and that is some kind of loss leader. But no, it is more across the range. So we struggle to see how rationally some people pay at the moment and we certainly struggle to see how things could go lower.

Question 10 – Chris Cant, Autonomous
When you make that kind of comment, what cost allocation are you thinking about, when you are thinking about your own internal points of margin and RoE, what cost allocation are you putting against that? Some of your peers, RBS for example would say they still think mortgages on the front book are generating 15 per cent returns, which is above their 12 per cent targets. So presumably they are quite happy to see pricing if then they will keep writing it. But from what you are saying we see a 20 per cent reduction price that presumably you would allow the mortgage book to continue to contract?

George Culmer
I don't know, but then you come into the earlier question I've got franchise protection and there is more than that. So I can't sit here and shut up shop and say I don't like the market – and you have got to keep going back to why do IFAs like you, they like the familiarity and all those sorts of things. So we are being defensive, we are taking what actions we think are necessary, I can't stay out of the market, I have to stay as a participant, I have to stay with people knowing how to deal with me. I have to keep a presence out there.

Further question
Where are the differences to say RBS, what type of cost:income are you looking to apply when you define your returns?

George Culmer
I will give you the trite answer, which is we look at the appropriate allocation of costs. We also look at gross margins as well and seeing what the gross margin people are making before any allocation of costs. So we come up with comparisons that we will bring to GEC, say this is where we are pricing, this is where we see the gross margin and this is where others are, pre-cost of funds and we just don't get, because in terms of the vagaries of cost:incomes and all those sorts of stuff. Although I would say I would have thought in any cost:income battle we would do alright in terms of that customer comparison. But we look at gross margins.

Further question – Alistair Ryan, BAML
We are all seeing in real time those competitors you are talking about, let's assume that as of this morning HSBC are not going to reprice because it has realised it is wrong, how do you make your market share go up? I take you point like they might be doing something wrong from your point of view, but let's say they are going to do it again as did Royal Bank of Scotland who are prioritising market share over and above margin in Q2 that is what they said, how do you make your market share go up now?

George Culmer
Targeted campaigns, by being smart. I am not going to sit here and say that here are the 20 things I am going to do. You have got to be incredibly selective over what you play and making sure that you are targeting growth in areas that aren't going to be attritional and aren't going to just cause the back book to walk out the door and where you think there is room in the market. So all these are bland answers, but I am not going to say here is the secret sauce. We manage the hell out of this.

Further question
You have been doing that very effectively for a number of years but as it stands today those people have been pricing at a level you are uncomfortable with and your market share is at the bottom end of the level that is acceptable.

George Culmer
But they have been in that position for the last year or so. They've been aggressive on pricing for the last 6 months or so.

Further question
And your mortgage book has been shrinking and the others have been growing them.

George Culmer
So say we are going to get back to where we were, we are going to grow from where we were at the end of Q1 and be close to where we were at the start of the year. And we will do that. We have got things like the targeted campaign out there at the moment. Applications are actually up, which we talked about on the call as well. Just because there is competitive pricing out there doesn't mean that you can't find your niche and you can't find a way of improving retention, which is a massive part of this, and stopping those maturities, getting people to convert internally as opposed to going out to the market. That is a huge part of growing that book. Retention is key.

Question 11 – Raul Sinha, JP Morgan
At the end of the day your RoE at the Group level is higher than some of the other banks so that does mean that you are going to, as long as the mortgage products RoEs are between 10–15 per cent let's say, it is going to be more attractive for everybody else to write this business than you, given where your starting point is and hurdle is? So is it a reality then that growth at Lloyds is going to be non mortgage related then, is that the best way to think about it?

George Culmer
Well it depends how long you think the tough market is going to persist, how long you think other people out there can generate lower RoEs, before they have to basically re-price or the extent to which they can keep their funding costs down etc. But as I say, our planning assumption is, and I will just repeat stuff that you know, is that it stays tough out there. I will continue to do as much as I can, I have got to play in the game, to keep my growth as close to market, but knowing I will be inside of that.

But at the same time we have got a commitment, we will deliver these returns that we expect to make at the bottom line as well. But there is no point getting away from, it is a tough market, our assumption is it will stay tough. And we are the biggest player, I think the strategy that we are adopting is the right one to take. If you think there is a better strategy out there you can tell me. But I don't see there is a better strategy to be adopted.

Question 12 – Chris Manners, Barclays
How much of it comes down to capital allocation? I guess because of the Bank of England stress test your mortgage book plays a lot more than the other banks. So if they are looking at how much stress capital they need, they can actually have a smaller stack than you even if you were to normalise at the same risk rate? And is it that £10 billion stress impairment loss in your stress test that makes any difference?

George Culmer
There is a simple answer, no. There are a number of things there. Do you think other people do this in terms of a stress capital basis in terms of stress capital allocation on this?

Further question
They will say, my credit card book is very stressed. My mortgage book is not. Therefore when I look at how I allocate my capital, maybe I am going to allocate more to RWA to my credit card than my mortgages.

George Culmer
Stress capital and consequence thereof, and uses of thereof, I don't think features very highly.

Further question
You are bound by stress tests or you are bound by something else?

George Culmer
And that is a fair point as well when you look at our capital stack and you look at things like the PRA buffer and you can work out what isn't there, and you can see that actually that stress isn't weighing down on capital. But there is no particular prize there, if you like. If I was to deal with this you wouldn't see a fundamental shift in overall Group capital requirements. So I don't see the stress tests are massively relevant in terms of pricing and what people are allocating.

I know it is all a bit silly isn't it, but we are not allowed to say what it is. You can see all the bits you can see – you know what the Pillar 2A, management buffer is, etc.

Question 13 – Martin Leitgeb, Goldman Sachs
How much of a help will there be from the Term Funding maturities which are start in a year's time roughly into mortgage pricing and what impact will it have on your funding costs? Will your funding costs materially change as a consequence?

George Culmer
No, I don't see it

Toby Rougier
We have about £5 billion maturing next year and the remainder the year after. And that is fully baked into our funding plans. This year we have been paying, repaying FLS, which is a pre-curser to TFS and that activity hasn't materially affected the funding costs.

George Culmer
I mean for us it is just a margin in terms of the overall funding. For others, you have got the challengers, obviously they have got bigger proportions and see how that flows through.

Further question – Tom Rayner, Numis
Won't that affect the marginal costs for you as well though when they are having to pay up to replace the TFS that they have maturing, so they will be competing with you for the marginal deposit funding?

George Culmer
Well what happens on deposits is will be interesting, and picking up all the questions on how this can persist, the asset pricing and cost of capital. Perhaps one goes with the other, because it is less competitive on the liabilities and people can live with what is going on on the asset side of things. To your very valid point, if things change and you suddenly get into a much more aggressive funding cost then that is a slightly different ball game.

So we thought we saw about a year or so ago a change in liability pricing, but that sort of dissipated. You obviously had the Marcuses come in, and you have some of the challengers I think price up in response. But even that hasn't destabilised the market in terms of liabilities. We were pretty flat against core savings Q1 and where we were on Q4. But we still think there is opportunity there.

But you are right, if things change in terms of liability pricing, then people will have to pause and rethink that in terms of what happens. But we haven't seen anything material come through.

Question 14 – David Lock, Deutsche
Have you seen any change in the velocity of money within your accounts since your Open Banking and Open Banking has come in? No change in speed?

Toby Rougier
No. We have seen no change. It is something that I ask every US bank I go and see as well because they are clearly living in a different rate environment to the rate environment that we are living in. So they should experience it earlier. But I haven't seen as such.

Question 15 – Joe Dickerson, Jefferies
Staying on the liability side, you had a fairly important decline on the tactical deposits and also if I look at the Retail savings numbers. You have given us in the past some of the costs of these deposits. There's not a huge tailwind to be had from these, but nevertheless it is helpful.

George Culmer
I mean tactical deposits down to about £15 billion.

Joe Dickerson, Jefferies
It was £15.6 billion.

George Culmer
And then the cost of those, I don't have what the blended cost of that is to hand. We will dig it out.

Question 16 – Tom Rayner, Numis
Going back to your mortgage strategy point, would a better strategy not be, given you're the lowest unit cost provider, just write your natural share in your core business, accept maybe that has a slight negative impact on your targeted ROTE and then you would actually be growing your core business and there wouldn't be any of these other issues and if it succeeds you would also then start to benefit more from the unit cost argument?

George Culmer
But what about back book attrition and impact on that.

Further question
But if you put that lovely chart up that said, that shows there is not that much differential anymore, I mean it is still some way to go?

George Culmer
I would have to do a lot, when you say that lovely chart?

Tom Rayner, Numis
The mix, the pricing gap chart. It is much less than it was a few years ago. I mean back to front book.

George Culmer
I mean where are we now? About 190 basis points or so in the back book, 2 per cent in terms of mortgages. You would have to do a whole lot of unsecured and a lot of commercial lending and other asset lending to offset it.

The market wants growth then we go and give some growth and I will just write market share, I will write 20 per cent new business. But in terms of impact on the back book and attrition rates, the impact would be gaining a penny to lose a pound.

Further question
Do you think the market gives you full value though, the profitability that you can hold onto for another few years by not writing your full share? If we start to look forward and say "that is the way you are going so that is kind of where I am going to rate you anyway" so you would actually have not much to lose by just getting on with it.

George Culmer
Do you really think that would be the right way to run it?

Tom Rayner, Numis
I don't know, I just write about it.

Question 17 – David Lock, Deutsche
Have you changed your retention strategy at all? Are you contacting customers earlier?

George Culmer
Across the piece yes. As I said in earlier questions, the focus on retention is huge in terms of early call outs and that type of stuff.

Further question

Am I right in thinking there has been a change because it used to be for three months you could get on a new deal earlier, but has that got longer now that period where you can try and get people early?

George Culmer

Not that I am particularly aware of, I don't think so. I don't think there has been any material shift.

Question 18 – Raul Sinha, JP Morgan

Have you had regulatory approval for the Schroders JV already and is that expected to start in the second quarter?

George Culmer

No it is still subject to regulatory approvals and the timetable is still to stand it up at the end of Q2. So it won't start trading until then. It will continue as is, because we are transferring the Lloyds funds and Lloyds advisors etc.

Mike Harris

But the new entity with the Schroders part of it will be Q3. We will be standing the business up at the end of Q2. Still waiting for approval on that bit.

Question 19 – Fahad Changazi, Mediobanca

You mentioned as you pay down the pension the Pillar 2A comes down?

George Culmer

Well, should.

Further question

Is that significant? A couple of basis points? How should we think about that? I am not sure how much of an impact?

George Culmer

Well it is significant. When we look at the increase in profits and the flat capital, as you have called out a number of times, one of the reasons for that is about making those pension contributions. Those deficit contributions. And we have disclosed this, the 0.4, 0.6, 0.8, 1.3... It is a fair chunk of change over a period of time. But all things being equal I will lose the 100 over here but I should get 57 per cent of it back. If I put money in to reduce the deficit or increase the servicing of the pension scheme, that is the starting point for the PRA charge, the pension risk.

So these are fairly decent sums of money. Now, because you obviously have market movements and all those types things that impact that pension deficit, including things like longevity etc. But you also have to get through the PRA and the vagaries of the Pillar 2A. There is an element of regulatory subjectivity that sits over the top of that as well.

Toby Rougier

In Pillar 2A terms, it is effectively a stress of your accounting position. As far as your accounting position improves in making deficit contributions, the stress similarly improves. So in theory you should see the improvement in your Pillar 2A.

Further question

Towards the end of the conference call you made a comment that you are looking to do with other things around the insurance operation to further de-risk it, did I hear that right?

George Culmer

Yes we do a number of things, in fact we have done a number of things over the last few years and will continue to do so in terms of de-risking, whether it is hedging strategy, be it markets, be it longevity. So better asset liability matching.

Further question

When you say longevity you mean additional reinsurance?

George Culmer

Potentially yes, in terms of managing the risk position of the Insurance business we have done a lot over the last two years and we will continue to do so.

Question 20 – Chris Cant, Autonomous

On Other Income, in terms of your guidance for the full year to be circa £6 billion. Earlier you said you expect Commercial to be down 4 to 5 per cent, you have always said that the Retail picture remains challenging. So baring from the stellar performance in bulks, given us you think the number is going to be for gilt gains this year and LDC, I am struggling to see how you get £6 billion. What am I missing in the mix there?

George Culmer

Well I would expect Insurance to be a good result as we go through the piece. In Commercial probably down half year, let's see where they end up at the full year. In terms of Retail, I think things will probably stay pretty tough I would have thought when I look across the piece. Although interestingly if you look at it on a net of Operating Lease Depreciation charge, you have seen lower Lex volumes and therefore slightly lower top line, but also less OLD alongside that. But I think things probably will stay a bit challenged from the Retail business.

But what we've said is that it will stay challenging in OOI, but we would be trying to get close to last year's number. I don't think we said a hard £6 billion, but we certainly said we would try to get close to last year's number which certainly was around the £6 billion.

So I would expect Commercial to be weak which hopefully will come back, I would expect Insurance to continue to perform strongly as we move through the year. And whilst things like LDC will be down year on year I would still expect there to be a strong contribution as mentioned earlier. So if I put the pieces together, I am still sitting here hoping to get close to that £6 billion by the end of the year.

Further question

In terms of the Central Items or Head Office fees, I think last year you had your Vocalink gain in there at £146 million,

George Culmer

We separated it out quite clearly didn't we, the Vocalink, which is why we separated out the £50 million as well.

Further question

In terms of how you guided, yes, but it was obviously an Other Income item, but when I am thinking about the Head Office Other Income for last year it was £340 million, if I take out gilt gains, take out Vocalink, that would have been a negative number. And I think you are saying LDC is in there as well. So if I was to take obviously the income from LDC out wouldn't it imply quite a big negative Head Office sort of underlying Other Income? What is that? Is that dissipating in some way during the course of this year to give you the confidence?

George Culmer

I can't think what the negative would be in OOI in the centre because we have equity gains in there as well. So your OOI, that is coming off the stat number? No, there shouldn't be a big underlying negative in OOI at the centre. You will have LDC, you will have asset gains, you will have some other equities that sit in that position, there won't be a big negative for OOI.

Question 21 – Martin Leitgeb, Goldman Sachs

How should we think about the structural hedge going forwards? If swap rates don't pick up should we expect that the balance would come down further and the duration would reduce the input further? Can you see an opportunity to get locked in at a higher level and the impact to a lower contribution to NII and potentially NII could continue to slow a bit in the coming quarter

George Culmer

Our natural position is to be fully hedged as you have heard a number of times and so that would be the £185 billion and the 4 years. As I said on the call we are £172 billion, 3.5 years. I am not going to comment publically on how low we would go because the natural position is to have a hedge in place. And so something actually we were discussing this afternoon as to how long we might stay out of markets etc and what level might you go down to. And it is something that we will make a determination on based upon what rates are etc. at the time. But we still think it is the right approach in terms of flexing our approach dependent upon what rates are out there. It is a bit hard to speculate on what we might or might not do in different rate scenarios. But currently if we don't see there is value out there we are not going to reinvest. But it is a bit hard to give you any sort of precise "I won't go below 60 per cent or I won't go below 70 per cent". It is dependent upon how we see the situation at the time. I don't know if there is anything else I can specifically say.

Question 22 – James Invine, Soc Gen
If we get a Countercyclical Buffer cut this year with Brexit....

George Culmer
Countercyclical cut did you say?

Further question
Yeah. I know it won't be you in the hot seat, but how does the Board think about it? Can you see a cut but if it is a bad Brexit you won't change your targets, you won't pay down to that level on the buyback. Or would you actually release more capital for a bigger buyback or price the products more aggressively?

George Culmer
The countercyclical, that is probably quite a good one to pick to ask an awkward question. In terms of the how the Board might respond, going to some of the earlier questions around things like SRBs and stuff like that, the Board is comfortable in that because essentially it is within my control and therefore is a good way of targeting.

But the Countercyclical, let's assume you go down to 50 basis points. Certainly when we were moving up, we factored in where the Countercyclical was at the time. So at the moment if we were consistent in our approach we would take it down the same way that we took it up, I would imagine, and this is me imagining, and not telling you, there will be quite a healthy debate around the Board around outlook and tenure of revised countercyclicality and how we might respond to that. But as for the Board, there has been no hesitancy in flexing capital and there has been no hesitancy in paying down to revised amounts. But I would imagine there would be some form of healthy debate as to, if it has come down, for how long do people think it is staying down, for what reason and what the outlook is. It is a good one to ask.

Question 23– Raul Sinha, JP Morgan
With the share awards, I think a lot of people across the organisation get share awards, I was just wondering if you would talk us through sort of what is the philosophy behind from a Management view perspective, is that share issuance is being encouraged across the organisation, do you expect that to grow a lot?

George Culmer
I am not sure it will grow a lot. We talked on the call about 700 million shares, most of that will be front end loaded, front end loaded this year by the way. Certainly António does have a philosophy about encouraging share ownership and share participation. So over the last few years there have actually been grants of free shares to each and every colleague within the bank. So in terms of promoting ownership etc. that is a key part of the philosophy of the running of the bank. That said, given the number of colleagues, I don't see that 700 million number growing exponentially.

Further question
So that is an annual number?

George Culmer
That is about an annual number yes, right.

Further question
And maybe just another issue of M&A. It has been a while obviously since the MBNA deal closed and as a bolt on acquisition, it probably satisfied most of the things you were looking for. I think you now find yourself in a position where you might have a little bit more capital flexibility later on this year and the pricing of UK assets is not very high, from a cyclical perspective. So have you considered potentially any bolt-on sort of acquisitions or anything from a strategic capability perspective that might interest you in sort of £1 – 1.5 billion range that you would do?

George Culmer
We are open to buying stuff, in the simplest sense because we think that we can generate value in terms of things like cost:income ratios that make us competitive and our ability to execute and integrate – a record of knowing how to do this stuff. We are also very open to the buy versus build type, in terms of accelerating to market or skills we haven't got. But we are also interested in books of business out there. Nothing in the scale of your £1–1.2 billion however.

Further question
Sorry what I really meant was MBNA style, bolt-on acquisition, is there anything that might be less than you know £2 billion in size that might interest you?

George Culmer
The answer is yes, but it will be significantly less than £2 billion, that is quite a big allowance to make. But we do remain out there, vigilant if we think there are assets, if we think there is capability that we would be able to acquire and add value.

Further question
And what are the areas that are something?

George Culmer
In Mike's business in terms of the Insurance world, when you look at everything from books, to businesses, through to platforms which we are still interested in. And across the banking side of things, again we will look at books of business if we think they are attractive. But again I would re-emphasise in terms of scale that we are not talking things that are going to consume a huge amount of capital in terms of completing.

Doing deals, I think, remains part and parcel of what we are about because we think we have got a price advantage and we have got a skills advantage in actually doing these things.

Question 24 – Chris Manners, Barclays
I guess this is your last meeting with us when you sort of pass on the bones to William and put a letter in the drawer in the Financial Director's office, what sort of advice would you give to him, I am curious, what you would want to pass on?

George Culmer
I will tell you one of the things I think the market hasn't got about Lloyds. One of the things is the ability to manage the business and pull levers. I stand here talking about growth and the wider mortgage strategy and what is going to happen to OOI and all those sorts of things. And you know, obviously we have got a franchise to run and a franchise to protect. And it is interesting when we go through things like the planning round, when we go to the Board, the Board basically says "convince me that you are making sufficient investment in the business to future proof your technology, to improve customer propositions and longevity." Convince them that we are doing all the right things there. And then when I am happy about that I will look at your financial metrics. I would very much do it in that order.

And the bit around Lloyds, the ability to manage the business and the ability to increase the profitability to my shareholders. I am going to give a good return. I will have increased capital contribution. And whilst you might say, okay our strategy can't last for 50 years, no it may not last for 50 years. But in the next few years I can be defensive on this, I can be aggressive on that. I can manage this. You know I will take costs down. I will keep tight on credit and, okay the top line may not be what people want to see in the top line, but the bottom line will grow. Capital distribution in terms of dividend will grow. And I can do this by pulling different levers and playing different parts of this bank.

So I am not targeted on growing the top line, we are targeted on growing that bottom line and we are targeted on returns and we are targeted on distributions. And that is how we look at the bank. Of course it would be great if the top line was growing too, it makes it much easier in terms of managing a business and doing all that. But if it isn't and we judge that now is not the time to be doing that either for macro or for business competition reasons, so be it. I have just got to work harder in terms of doing other bits of business. But that is what we are about, and that is what we have achieved and will continue to seek to achieve.

George Culmer
Thank you very much.

FORWARD LOOKING STATEMENTS

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