LLOYDS BANKING GROUP PLC – 2019 Q3 IMS – SELLSIDE ROUNDTABLE
(amended in places to improve readability only)

Monday 4 November 2019 – 5.00pm

LBG HOSTS:
William Chalmers, Chief Financial Officer
Carla Antunes da Silva, Group Strategy, Corporate Ventures & Investor Relations Director
Jon Burgess, Group Financial Controller
Toby Rougier, Group Corporate Treasurer
Douglas Radcliffe, Group Investor Relations Director

Douglas Radcliffe
Good afternoon everyone and welcome to the Lloyds Sell-side Roundtable for the Q3 Results and indeed the first Roundtable run by William Chalmers, our new FD. In addition to William you have also got on the table Toby Rougier, Group Treasurer, Jon Burgess, Group Financial Controller and Carla Antunes da Silva who is Head of Strategy, Corporate Ventures and IR. We will run these like a similar approach to previously so we will go straight into Q&A, but I should just mention before we start that as per the results call and in line with the planning process, we will not be providing any additional 2020 guidance. That will be something that we will present with the 2019 Full Year Results.

When you are asking a question if you could just state your name and your company when stating the question and then, William, I think it probably makes sense to go straight into Q&A.

William Chalmers
Thank you for coming and I recognise many of you from my past life, but some of you I don't know, so pleased to meet you and welcome to the Group. Do you want to kick off with questions?

Question 1 – Robin Down, HSBC
Hi everyone, Robin Down, HSBC. A couple of questions on the mortgage side and margins. Of the current guidance 288 basis points for full year, in line with the first nine months, we can all kind of do the analysts thing and work out and apply to the numbers for Q4. Are we wrong to be doing that? 288 basis points forward guidance or are you trying to signal some sort of underlying fall in Q4?

And then the second question, in terms of the mortgage pricing going forward, not necessarily the 2020 guidance, don't worry. Where the whole industry seems to have gone, there is a lot better retention activity taking place particularly from big banks like you guys, you know customer comes to the end of the two year fixed and you are instantly on them offering a new two year fixed. In your case that is done on a premium price versus a new customer. How are you factoring that into your thinking about returns on new business in the market? Are you making some form of allowance for the fact you are likely to keep the customer on perhaps a higher spread over two years on a two year fixed? Are you going to factor that into the new business pricing?

William Chalmers
Well maybe on the first of those two, the margin calculation. 288, fairly precise, as you know, and we obviously thought about how best to express the expectation of the margin for 2019, and came up with 288 which, as said, is in line roughly speaking with 290 basis points off the back of that. So there is a degree of particularity about it which is intended to implicate something about how the margin has developed over the course of the year. That in turn, as I mentioned on the call, just reflects a bit of environmental pressure if you like creeping into the margin over each quarter and you can kind of see that as you progress.

And then as mentioned, there is a bit of effectively product alignment between the MBNA and the Lloyds card portfolios, going on in Q3 and you will see a bit more of that in Q4. It is tilted, the activity, I think I mentioned on the call, for the product alignment kicked off in August, it is going to end in December and we slightly tilted the product alignment benefit if you like into the last quarter. So if you do your maths after each of those pieces you will get to about the right conclusion for what an exit margin for the Group might be towards the end of 2019.

Robin Down
So we should take it quite literally?

William Chalmers
Yeah I think that is the intention. The intention is to give you some guidance. The intention is to let you know within that that environmental pressures are having a little bit of an effect and the intention is to let you know within that that the product alignment is loaded into the Q3 and Q4 with a little bit of tilting towards Q4 simply because that is we feel a conservative way to do it.

Your second question on mortgage margins and Jon you may want to comment as well on this point. The way in which the mortgages are priced is off the back of the expected cash flows that we expect to get back over time inevitably, and that is in turn predicated upon the capital consumption, the funding costs and any other returns that we expect to get over the duration of the fixed life of the product with any penalty payments attached to that. And to a degree, but on a pretty conservative basis, any kind of lasting affect thereafter. I think Barclays mentioned at the half year that they are seeing differences in terms of their SVR behaviour. I mentioned on the call that we see a little bit of that too, I think everybody has seen a bit of a shortening in life in that respect. But that is currently how the pricing is done.

Question 2 – Chris Cant, Autonomous
Apart from handling pricing policy from accounting books, you might price with a view to retention of the customer view on the initial two year fixed. So you might be willing to take a slightly tighter price because you think you can retain them at the end of the two year product period on a better rate. Presumably you don't allow for that in the effective interest rate you book during the initial product period?

William Chalmers
That is very largely correct, yeah.

Chris Cant
There was a bit of press last week suggesting that we might be in the market to buy troubled stocks. I just wondered whether you could comment on your approach to M&A? Obviously you have recently acquired a book, but that is quite different from acquiring a bank. So how do you see those two channels for potential inorganic growth going forwards?

William Chalmers
Just adding a little bit more colour on the first of those two questions. I think the question came up on the call actually around would we or are we at risk of taking SVR type, EIR charges of a similar type to what Barclays are. Our accounting is different on that point and does not really take account of EIR on a projective base in that way, so our view is we may see some changes in behaviour around the SVR but it is not going to hit us on an EIR base.

The second point around M&A policy, I will obviously never comment on any particular rumours or speculation that might be around given names. I think as I said before and no doubt will say it again, as a general matter, we will look to M&A not as a basis for our strategy which will always be organic, but where it makes sense from a shareholder value point of view we will look at it. But again I will never comment on names and I would not read anything into that, but I would never comment on names.

Question 3 – Alastair Ryan, BAML
Alistair Ryan, Bank of America. Just push on mortgage market shares. It was strong in the third quarter and you said on the call that pricing was then not quite as good. It was better so you did more, then not quite as good. What is the framework that you are operating in now, is there a new regime pricing versus market share? George used to talk about a minimum market share he was comfortable writing, whether that is still your thought process, whether the goal is all around customer retention and market opportunities, just framing that for us?

William Chalmers
Well we are effectively the largest mortgage issuer in the UK and that is important to us. The open book is typically quite an important piece of our overall thinking and that is why you see some of the public statements around that as you have seen in the past. Having said that, there is a strong commitment to terms of any given a piece of business already, any business area that we work in. And there you will see a bit of an ebb and flow in terms of where you choose to enter the mortgage market from an origination point of view and when we don't. Something like Tesco gave us flexibility to maintain commitments to the open book position. But at the same time to do so on terms that we felt were attractive, vis-à-vis origination, organically or via acquisition.

What does that mean? I mean I don't think we would put precise numbers on it, but we certainly look to maintain a reasonably healthy share of the origination market. The last quarter was getting up towards 19-20 per cent. That was off the back of what we felt to be favourable organic pricing in the market. So that gives you a sense of where we would get to in a favourable market. It doesn't mean we will get to the same place in a less favourable market. And in fact and just to finish off, I think you will see us not as heavily engaged in the open book market in Q4 as you saw us in Q3 for that very reason. So I wouldn't expect to see everything carried through towards the end of the year.

Alastair Ryan

And just to follow on that, has there been any shift in that? Different banks think about mortgage profitability differently depending on average cost versus marginal costs, leverage balance sheet, risk weighted assets etc. Has there been any shift in Lloyds thinking? You were probably the bank that was most fully costing when you were thinking about margin profitability which is one of the reasons for people to do more relative to their stock because they were probably more profitable than you. Is there any change in that or is that just a steady?

William Chalmers

No not since I came in certainly. Not to say we won't sort of change our views over time necessarily, I am not really saying that we will be, I don't want to hold myself to any particular statements. The approach on mortgage pricing takes into account capital, takes into account funds transfer pricing, takes into account liquidity pricing, takes into account the operational costs that we may need to put around that. And you know you can see that some will be tuned to enter the market when we don't necessarily. That maybe because we adopt a slightly more, well we like to think of it as disciplined approach. They may have an approach whereby they are trying to build market share or use up excess liquidity or whatever it might be, but it won't necessarily coincide with ours. Ours is influenced and dictated by those inputs and we won't necessarily religiously hold to it in every single situation, but as a general matter we will. Jon I don't know if you want to add anything?

Jon Burgess

Just that we do look through all of those lenses for everything we do on a weekly basis, but not one sort of overrides the other, they are all considered.

Question 4 – Andrew Coombs, Citi

Andrew Coombs from Citi. If I could just ask a question related to the NIM, but more specifically to the structural hedge. When we think about everything else for your book, we think about accurate front book re-pricing, business mix, average pricing, the structural hedge for you, you use it much more tactically than some of your peers. So that is potentially a bigger delta going into next year. It is a case of three options, you either carry on not rolling it which was I think George previously had 6 basis points, start rolling again, or you even re-employ the £13 billion you carry and have not got invested and that is actually a major delta on your interest margin gains for 2020. So conceptually how are you thinking about the structural hedge at this point? What becomes the key determinant of the driver going forward as to how you act around that? Is it the case of you would want to see Brexit result to see what the swap rates then do, or would you make a decision beforehand?

William Chalmers

Well I will make some comments on that, and Toby should add. The structural hedge as you know is built around the philosophy of I suppose really two things. One is making sure that we don't have excessively volatile earnings in the business whereas you know everything is more or less brought back to three month LIBOR. And two, is to ensure that we manage shareholder value in the way that we see as appropriate. The neutral position for the structural hedge is to be fully invested and so we came into the year more or less in that shape. But at the same time we won't necessarily always invest it where it doesn't make sense to do so. So if you are in a situation which is like today, i.e. three month LIBOR and five year money doesn't actually, there is not a lot of difference between them, then we will be a bit more judicious about when we choose to invest.

There are no particular thresholds about when we will start to invest from a price point of view. It is very outlook dependent and you just mentioned a couple of factors if you like that might play into that outlook. The local situation being one of them and however the market might react to that is obviously important. If we don't invest there is a partial erosion of that hedge which I think I mentioned on the call, over the course of the next 15 months around the £40 billion mark. If rates turn and depending upon the outlook, we may therefore choose to invest, but there is no particular threshold level at which we will pull the trigger if you like.

Toby Rougier

The only other thing I would add, at the half-year we did give some sensitivity answers to help you think about this, and that sensitivity still holds for Q3.

Andrew Coombs

And I guess if opportunistically it just doesn't make sense if the three months and five year are close enough, then that's the case, full stop, it is not a case of managing the margin in any way shape or form, so that is the status quo, I guess, as it stands today.

William Chalmers

Yeah I think that is right. I think there was a little bit of risk being taken off the table as we did when rates took a bit of a turn around the late summer, early autumn I think it was. That was helpful, but it was relatively short term. That is fine, but your point overall, should you invest money where you don't get any more for tying yourself up than you do for taking three month LIBOR, that is the way we look at it.

Question 5 – Jonathan Pierce, Numis

Can I ask on that point, it is Jonathan Pierce from Numis. You mentioned on the call about some hedging strategy in the third quarter looking forward to the fourth quarter roll in the hedge. Could you just give us a bit more colour on what that was? Whether that has protected you from the delta on the yield on the £10 billion that comes off in Q4?

William Chalmers

I won't put precise numbers on it, but it was certainly taking some of the risk of the end of the year off the table.

Jonathan Pierce

But should we still think about the £10 billion essentially coming from a rate of 1.5 per cent, whatever it is, down to base rates?

William Chalmers

Well I mean the rate if you followed what happened in the curve during the course of this year, it never unfortunately got up to 1.5 per cent level. So you can go and draw your own conclusions about what was on the table and the extent to which we were able to cover it.

Jonathan Pierce

Can I ask a follow-up on mortgage retentions as well? Clearly the internal product transfer market has become much bigger than the re-mortgage market between lenders. I am interested in any updated commentary around the extent to which you are retaining your customers and whether you think you are managing to retain more of your customers than the average bank out there? I think last year the re-mortgage market was £80-90 billion, but the internal product transfer market it was about £140 billion. So interested in the dynamic within that retention activity?

William Chalmers

I will make maybe a couple of comments, Jon may want to add one or two more. There is obviously an active retention strategy that is pursued within the bank. We are typically writing more two to three year product and five year product than we had before. So as that retention question comes up in the case of each individual mortgage, we are writing it with that term in mind.

I think our discipline around that to a large extent remains the same as the response I was giving earlier on and how we manage it remains in that way. I can't really comment on how others are approaching it, but that is kind of where we are.

Jon Burgess

The only difference this year is the change slightly to the two to three and five year point.

Jonathan Pierce

Are you writing more five year fixed now than two year?

William Chalmers

I would need to check on quantities but we are certainly writing a chunk that makes this change, versus where we were.

Question 6 – Ed Firth, KBW

Ed Firth from KBW. Could I ask a couple of questions? First back on the mortgage pricing. You in common with all the banks are telling us how brutal mortgage pricing is and how desperate it is. But if I look at your risk weighting on mortgages, you are only putting, I don't know, a couple of pounds for every hundred pounds that you lend. And if I look at swap rates on a five year fixed you are making easily 100 basis point spread. So I am just struggling to see why that is such a brutal environment, I mean that seems to me more than adequate in terms of returns.

William Chalmers

I think the inputs in a sense are fairly transparent in terms of the way in which one can analyse the mortgage market. We look at it along the lines as commented earlier on and we make what we consider to be a respectable return. We see others in the mortgage market who write mortgages at levels that are below what we would necessarily choose to write. So we obviously by definition think they are in some cases at least, sub-economic terms. It fluctuates, at the same time, as said earlier on, we are kind of in and out of the market. It is difficult for me to say much more than that because it is just a reflection of the inputs.

Ed Firth
But am I missing something then in the maths? As you said it is reasonably transparent, we know what the risk weighting is, we know what the capital allocation is, it is a 30-40 per cent cost:income business. We can see what swap rates are, I know that a five year fixed rate mortgage is 1.6-1.7 per cent today, even if you are not at the very front end, it can't be costing you more than 60-70 basis points to finance that. Is there something that I am missing in that maths which says to me that actually no, for Lloyds it costs you more, returns are much tighter than that? It seems to me that the competition in the market is more on the savings side. Today I can go out and get a two year fixed rate savings product, pay me 2 per cent which I find utterly extraordinarily. To me the mortgage market looks there or thereabouts.

William Chalmers
I guess every bank has its own perspective on what appropriate funds transfer pricing is which is an allocation of the transformation margin if you like. It is an area that Toby obviously controls within Lloyds. So I think that maybe there is a bit of a difference there, but I don't think you are misunderstanding anything.

Toby Rougier
You have got what you end up calling a gross margin. So your customer pay rate less your swaps rate, but you have to factor something in for your credit spread. Because we are funding that to term and so that is not the same as the three month LIBOR term. So you have got to factor something into that and then cost of credit and capital, those would be the other elements.

Douglas Radcliffe
And also if you build a leverage basis as well from our side internally we would look at it on both leverage and capital basis.

Ed Firth
Thank you. And my other question was about non-interest income which I guess was the big surprise. You mentioned I think on the call that you have quite a substantial Markets business. And I was just trying to get a sense, can you give us some idea of how big that is? You know Nat West Markets is about, I don't know, well they can't decide actually, somewhere between £1-1.5 billion, but can you give us some sort of orders of magnitude of what is your rates business delivering, FX, that type of stuff so that we can get some idea of perhaps the swing around that non-interest income number?

William Chalmers
I don't think I am going to break down the Commercial business in those terms. I mean you see the kind of asset size we have within the Commercial business which is in the public domain. That gives you a sense of the size of the Commercial business, but that is obviously spread out between various different activities and the lending being the main one within that.

The Markets business is just one of the components of the Commercial business. It is, I suspect, smaller than what they have over at RBS, it is certainly smaller than obviously most of the institutions that describe themselves as such, but we have never really given disclosure on the individual line items within Markets and for the time being at least we are not going to start now.

Ed Firth
But can you give us some idea, so I mean it is smaller than Royal Bank, but some sort of idea of market shares then? Because obviously if that is the big swingometer, and I guess it probably was in Q3, I guess it could bounce back one day as well?

William Chalmers
To go back into that debate, I think I mentioned a few different things for the Q3 other income line which was a combination of Insurance. I think I said Retail was sort of flattish which is correct. Insurance versus Q2 or Q1 for that matter was lower, didn't have a repeat of the change of asset manager piece, didn't have a repeat of the mortality piece. Workplace pensions had auto enrolment to its benefit in Q2, didn't have that in Q3. So there are a whole bunch of points there. The central items point didn't have any gilt gains in it, not what you would call gains of any significance in it. There was, I think I mentioned, a tough comparator in the form of LDC benefits from 2018. So there are a bunch of different things in there, whether it is the Insurance line or whether it is the Central line, but a little bit of it is the Markets business within Commercial as well, as one or two other things in Commercial indicating generally lower levels of activity within that business.

So I would not want to place undue importance on Commercial Markets. I think there is a bunch of other non-Commercial businesses, and within Commercial to a degree, there are one or two other strands.

Ed Firth
In terms of looking for some sort of, I don't think I'll call it bounce back or some sort of normalised level. What should we be looking for then in the market that would give us some indication that things would be looking better? And I am not talking about next quarter. As you go into next year, do we need to see a swap curve, do we need to see steepening of the yield curve and that should bring it back to some sort of connection there in terms of activity? Is it just broader economic growth? Is it, I don't know, everything is Brexit so is it Brexit? What is it that will make us think that actually the 1.2 is back to 1.5 or 1.6?

William Chalmers
Sure, it is a good question. Certainly if you look at Q4 it is as I described, it is as it is. I think as you look forward if you pull apart each of those areas. Insurance, I think there is a long-term secular driver within the Insurance business but there is going to be ebbs and flows within the business and I am not going to say that we are going to be on a long-term ramp up every single quarter, because I am sure it won't be true. But there are secular drivers behind the business, whether it is the provision of retirement products, whether it is bulk annuities, whether it is the wealth business that we started and so forth, that is all helpful. But at the same time in an environment where long-term interest rates are at levels that they are, for example, the Insurance business draws heavily off the 15 year swap curve, it is tough. You know it provides a headwind if you like even to a business that has a secular driver behind it and unfortunately we can't escape that any more than anyone else can.

So I think that is a piece there. I think if you look at the Commercial business you are kind of looking towards a bit of a return in the investment activity, a kind of animal spirits type analysis. You need people to start making investment decisions for the business to benefit from that and as I mentioned on the call, with any given piece of activity there is usually a range of ancillary benefits that hopefully you will get your share of and that has been very helpful.

Again to a degree I guess that is linked to the economic outlook which in turn is linked to the rates outlook so there is a bit of same factors again there. I think Retail, we are building the Retail business, the current accounts market share is good evidence of that. The Retail outlook at the same time is flattish, I would say. Having said that there are one or two regulatory pressures typically in the kind of vulnerable customer area which will play themselves out over the next couple of years. That is a physical inhibitor to offset some of the more positive trends that come from building the business.

And then in terms of other items, it is a variety of factors which again will ebb and flow without a strongly discernable trend at any given moment. What LDC produces next year, we think we have some idea of, but it will come up and down. What gilt gains there will be similarly, so that is a little bit harder to predict.

Question 7 – Martin Leitgeb, Goldman Sachs
Martin Leitgeb from Goldman Sachs. Could I have two please and the first one on savings rates, specifically instant access. I think you are paying around 20 basis points at the moment. Is there an opportunity do you think if swap rates are to remain flattish as they are now, that you could address some of the impact from the flat yield curve by cutting or lowering the savings rate without having a base rate cut, or is a base rate cut kind of a pre-requisite in order to execute full optimisation on the savings book?

William Chalmers
Well as you know most of the pressure in the spread is coming from the asset side and there is relatively little actually on the liability side from the spread perspective. That has, you are right, historically the spread has been somewhat stabilised by taking liability side benefits. There is a little bit more to go for there, I wouldn't say it is a huge amount so I wouldn't want to overplay it particularly, but there are still some retail balances where we probably pay a slightly higher spread than we necessarily would need to. Again I wouldn't want to over dramatise it because it perhaps is not as big as it was 3-4 years ago and some of the relatively more expensive wholesale funding likewise has run off 2-3 years ago too. So there is probably less on the liability side to play with than there has been historically, but there is still a little bit there. Toby anything to add?

Toby Rougier
Yes and as we have successfully grown the current accounts balances we have used that to refinance some of the more expensive, slightly more tactical deposit business that we have and you have seen that in the shift that we have been doing gradually over time. There is a little bit more to go there, but not a lot more.

Martin Leitgeb

And then more broader in terms of how we are looking at market dynamics going forward and there are a couple of large players out there who are chasing market share in order to grow and they want to grow above market, particularly in mortgages, but not only. And how do you feel about the size of Lloyds? Do you feel, I think your earlier comment suggests that you are quite comfortable with the market share size? So if things were to get tougher would you be keen to retain your current size relative to the market or would you be happy to give up a couple of percentage points in terms of share just seeing that the market structurally rebalances for those new entrants?

William Chalmers

I think the best way to answer that is we try to manage both parameters. We are concerned about the position of the bank in the marketplace and that is clearly a strategic profile. At the same time we are also concerned about preserving value if you like and we balance the two and you have seen in the past, certainly pre-dating me, the kind of articulation of both constraints really and commitment to delivering things like the open book comment as well as at the same time making sure that we maintain value. I think you will see that continue as we go forward.

I wonder, it always slightly puzzles me, we are the biggest player presumably amongst the biggest scale economies within this business. When others write business at materially lower levels than we find acceptable, you kind of wonder what returns they get from them, but that is their concern. We think at the moment through a combination of organic and acquisitive activity we are able to balance shareholder value and commitment to open book stability if you like. That therefore allows us to deliver both at the same time and that will be the pathway forward.

Question 7 – Guy Stebbings, Exane BNP

Thanks, it's Guy Stebbings from Exane. Just following on from Martin's question, the first one on deposits. I think your tactical balances fell about £3 billion in Q3 which is quite a big fall. Was that spread evenly over the quarter? George used to give us the average deposit cost and I don't think we got that on the call so if you are able to give that it would be fantastic?

And then also a question on mix effects for margin. Historically changes in asset mix have been quite favourable for margin and we haven't seen that in the last couple of quarters and not in Q3. If there was a resolution on Brexit would you expect to grow credit cards etc. perhaps ahead of mortgage lending again and help on the margin side?

William Chalmers

Tactical deposits did come off a little. I don't think there was any particularly defined strategy about tactical deposits per se, other than just a general portfolio pricing approach that we adopt from a deposit base versus the cost from other deposits and where we can draw them from, whether it is current account or retail funding or whatever it might be, it is managed on a portfolio basis. And that is why you will see that pattern a little bit.

In terms of the average deposit cost, Douglas I am going to look over to you to provide that number.

Douglas Radcliffe

Okay, happy to. It is just over 40 basis points, so it has come down very slightly but not much, so that is for the total savings book.

William Chalmers

I won't provide a commitment at the moment to provide it every time, but you have it for now. And for Cards, I think we will utilise what opportunities we see in the market based upon a view on risk at the time and a view on value-added opportunity at the time. It is a little bit hard for me to say in the event of a Brexit would we push the accelerator on Cards or for that matter any products simply, because we don't quite know what a Brexit would look like, we don't know what the implications of that would be for either the Retail or the Commercial risk profile. And therefore how we would factor that in and what we would choose to do on the asset side, I think we would look at the time.

Question 8 – Joe Dickerson, Jefferies

Joe Dickerson from Jefferies. You said in the event of a Brexit, growing the card book, is that any kind of Brexit or is that a no deal Brexit? It has been in train for some time, and I have another question.

William Chalmers

Well as I interpreted Guy's question, it was, if we got a settlement in the Brexit discussion, i.e. a deal Brexit of whatever kind, would we then push more heavily on unsecured products whether that is cards or anything else for that matter? I think the answer to that is we would have to see what the macroeconomic circumstances are at the time and what therefore the best strategy is, product strategy in the context of the environment. Does that answer your question?

Joe Dickerson
Yes. So on PPI what are the remaining sensitivities that we should be looking at? Is it a conversation rate of PIRs which I think you called out at 10 per cent, or is that now known? What are the surprise factors that could lead to other charges that would be material? So that is question number one.

And then number two, just on digital. There is quite a bit of competition in digital banking, everybody has a different kind of strategy. As you come into the bank, how do you see Lloyds differentiating versus purism, therefore generating value for investors in the bank, on the digital side?

William Chalmers
On the first of those two questions, the PPI provision as you know has basically three components to it. One is the PIR and direct complaints from consumers and that is the kind of volume and quality type equation. The second is the Official Receiver and the third is the operating expenses, financial ombudsman and others broadly speaking. On the first of those three, we have been through in some shape or form the forms we have received, PIR and direct customer complaints and therefore from a volume point of view feel very secure as to where we are. Likewise from a quality point of view, we have been through hundreds of thousands, I guess by now probably millions of PIRs and therefore feel very comfortable on the quality point. On the Official Receiver we kind of have a good sense of where the Official Receiver position is. And on the operating expenses, up to an extent it is tied to the first of my three pieces, i.e. the PIR and the direct complaints.

The £1.8 billion provision is our best estimate of what the provision is and should be and so not surprisingly we feel comfortable that that is where we should be. Having said that, if there is any uncertainty and I think every other bank would say the same, RBS would say the same I suspect and Barclays would probably say the same, it is in the first of those three pockets. Now, what we have done right now is our best estimate, and that is it, full stop. You asked about uncertainty and where it might be, I don't think we want to profess any great uncertainties of any such issues as in the first of those three boxes and, on that, we are kind of where we are on a best estimate basis. As I said on the call and I will probably say every time I mention this, George said never say never. So I will leave that with you.

Joe Dickerson
And on the digital front?

William Chalmers
Digital strategy. We have recently been announced as the UK's best NPS digital based bank and that is all very encouraging. The customer facing part of digital strategy is pretty clear in terms of the overall offering that we give to customers. We based it upon what we think the customers value most highly in digital offering and choose to invest our resources and focus our strategy on those points. There is a whole operational side of the digital strategy which as you know is basically just that, i.e. around defining the operation and making sure that we are as efficient as possible and we digitise as much as what might have been manual or more modular beforehand, but that is not a customer facing issue, that is an internal process issue.

What we haven't done so far is launch an independent digital bank in the way that perhaps RBS have, for example. That is for another day, we haven't chosen to go down that route.

Carla Antunes da Silva
We track digital disruptions quite closely so it comes to GEC and we look at all of the disruptions, especially the number of accounts because it is quite noisy. So Monzo, especially the number of accounts that they open. I think what we have realised is that there are sort of killer features that customer experience depends on. So what it has been is it has really raised the bar in terms of what we offer out there, hence the digital NPS, but this is a constant and it keeps us on our toes.

Question 9 – Russell Quelch, Redburn
Hi, Russell Quelch from Redburn. I wanted to come back to some comments you made on the Q3 call in respect of the RWA inflation. You said in the near-term you thought that you would be below the £6-10 billion range, so two questions within that. Number one, what gave you the confidence to make that comment? And number two, how should we think about RWA inflation into 2020 please?

William Chalmers
The RWA inflation is obviously an area we look closely at in the near term and try and assess what headwinds there are to regulatory change. The guidance given previously at the half year was around the £6-10 billion range and I think that might have even been a sort of nudge towards the upper end of that in the context of the half year. What we have seen since then is a refinement of regulatory expectations, a bit of a refinement in our own models and a bit of pulling forward of some of that regulatory or RWA shift and to a degree at least, a bit being put back into 2021. So there are at least three things going on there if you like. One is a little bit of pulling forward, two is a little bit of pushing back and three is a little bit of enhancement versus where we thought we would be at this stage.

Now, what I said on the call and I want to reiterate again is that all of that should be wrapped in a 'this is our latest thinking' type of envelope. So there is risk around this point and we are obviously seeking to refine that as we go forward and we can talk more about that when we get to February.

Russell Quelch
Thinking more into 2020 really what can we expect in terms of when we model the capital going forwards, how should we be thinking about that or do we have to wait until February really for that?

William Chalmers
Yeah, I think I would rather wait until the year end numbers. I have given you a sense of the headwinds and how we are looking at that. The rest of it is assumed within our overall planning process which we will come back to you during the course of the 2019 year end results.

Question 10 – Aman Rakkar, Barclays
Aman Rakkar from Barclays. I have two questions actually, maybe three. On Basel 3.1, whatever we should call it, there seems to be a prevailing view that we might get a delay on that. Is that a sense that you pick up from conversations with whoever that may be?

And then a second was on PPI. How many people are you employing to process PPI and presumably they are not around next year, is that something that we should think about with some savings?

And the third is a more philosophical point. There is pressure on structural hedge across the board, are you trying to be creative about the way you can offset that in terms of kind of range of assets you can invest in? Presume that is going to require some RWAs or whatever, but as you are trying to deliver that yield pick-up, is that something we can think about that you guys might be targeting?

William Chalmers
Maybe just dealing with each of those three and Toby you should obviously add on any one or all of these. But the Basel 3.1 point, I was about to say "there are certainly some uncertainties" is the best way you can answer it. And that's as to delay, as to the precise formula it might take, how it might be phased in over time. There is a lot up in the air and that is partly why we are not really giving any commentary on it because if we did it would feel like a running commentary, it kind of changes every time we speak about it. We will talk about it if and when we feel confident that we know what we are talking about and that is kind of as much as can be said around that area for the time being at least.

On PPI, how many people have we got on it? Too many is the answer and they will start to run-off, all being well, during the course of 2020 in line with our operational plans when we refine where we are on the PPI topic. So don't look for that in the opex, that is part of the £1.8 billion. It comes under the operational cost heading in the third of the three elements I mentioned earlier on, but it is still too many people.

The structural hedge. No I don't think there is any intention to loosen the restrictions under which we run the structural hedge. It continues to be run in just the same way as it has been in the past. Toby, do you want to comment?

Toby Rougier
I don't have any particular insight on the final elevation of Basel 3 but CRR 2 was delayed quite meaningfully. I think we have had the EBA's recommendations on CRR, what will effectively become CRR 3. We haven't seen anything from the European Commission, let alone on the final process, let alone what is left to domestic interpretation of that, and which of those parts are still relevant to the process. So I wouldn't be surprised if it were delayed. I mean precedent tells you it is, so I wouldn't be surprised but I don't have any particular views on it.

Question 11 – Fahad Changazi, Mediobanca
Fahad Changazi, Mediobanca. Could I ask a couple of questions on insurance? H1 you had the ambition of being number one player for home insurance. How is that going and is the FCA pricing review an opportunity or hindrance for you as it is coming up?

The second point is on protection, again you were looking to be number three. And I was just wondering when you churned the mortgage book or as and when we get some Brexit clarity and you start ramping up mortgages do you expect to also book a lot of protection business as and when that happens? Can you give some idea of conversion at the point of sale, that is when you get protection?

And the third point related to bulk annuities. As you ramp up the protection business will you be able to write more bulks given you have the offset there? Given you are running more protection business, mortality risks one way, you write bulk business you can take the risk the other way, would you be able to write more bulk annuities as you write more protection?

William Chalmers
The ambitions as articulated at the half year still stand and that strategic direction hasn't changed. Our desire and ambition to invest in the business to achieve those objectives over time is very much strategy and stands.

The first of the three products, home. The FCA pricing review is obviously one of a number of ingredients to returns within the business. I think it is our expectation that over time that FCA pricing review will maybe shape the business a little bit, maybe refine pricing around front book, back book and so forth. But over time will likely play in favour of scale providers as pricing becomes more normalised, as it becomes more transparent. We would expect it to play ultimately in favour of scale providers and we would regard ourselves as one of those scale providers. So it is hard to be much more precise on that at the moment, but overall we obviously support the FCA in its work and we understand and endorse what it is trying to achieve. We expect over time at least with industry structure where we would be in a reasonably good position. We will see, but that is the expectation.

On the second of the two products, protection. You are right there is an opportunity to provide a customer product at the point of the mortgage product being sold and that is a sensible time for somebody to consider whether they need a protection product or not. So we do look at that, we look at protection both in terms of mortgage based protection and also in terms of non- mortgage based protection. I think it would be reasonable to assume and conclude that you are going to likely have a more fertile and interesting discussion at a point at which somebody is taking out a mortgage than you necessarily would do on the non-mortgage side. So you would kind of expect that kind of dynamic to prevail. We are building in that area, our proposition, and also our sales channel both branch and non-branch in that respect. That will, we hope, over time allow us to build the product and build the exposure and fulfil the kind of strategic ambition that you are alluding to.

So it is like everything, it is not going to be transformational necessarily overnight or in quarter or anything of that kind, but it is a strategy, it is an area we are investing in. It is an area that plays to some of our strengths both on the mortgage side and the insurance side and we will hopefully be able to make more of that over the coming quarters, coming years.

On the bulk side, I think the two constraints that we see on bulks are the pricing of bulks up front because there are definitely times when it feels very competitive and you will see other insurers going in with what we see as quite aggressive pricing. We have stuck to our pricing disciplines quite tightly there so we have lost business as a result when we can't match the pricing and we don't typically get engaged any more than we set out to do, i.e. we don't get into competitive auction processes, we just gradually nudge up our price or lower our discount rate. That is one constraint.

Then the second constraint is securing the illiquid assets which as you know you need to secure in order to make a long-term margin. And if you don't have those illiquid assets secured by the time you are writing the bulk, you are exposed and that is a risk constraint we have to manage around. But those are the two I would tend to single out rather than necessarily the mortgage point you are making.

Fahad Changazi
And in terms of your illiquid assets, my impression was that as a proportion, your illiquid asset backing in the annuity book is higher than Aviva or L&G. Is it because the portion is higher and that is why it is proving difficult?

William Chalmers
No I don't think it is. 'Proving difficult' wouldn't necessarily be the summation that I would take from the conversation. I think it is more a constraint and so we won't always be in the market if we don't think there is an opportunity to match the bulk that we are

looking at with the securing of illiquid assets. It doesn't mean to say we never do, we do. And as said before you will see a bit more bulk activity in Q4 because we have managed to pass both thresholds. And in the course of the last few weeks, one of two deals that will get close to matching our overall commitment in the bulks area for this year.

Question 12 – James Invine, Soc Gen

Hi, it's James Invine from Soc Gen. You have had a bit of a headache in the past couple of quarters from large single name corporates going bad. Can you give us an idea of how large they were relative to the rest of your corporate book? So how many corporate exposures that you have that could give you a similar sized headache over the next couple of years if they were to go wrong? And to what extent can you hedge these large exposures?

William Chalmers

The reason why we singled out the exposure that we did at the Half Year and then subsequently at the Q3, actually we had two at the Half Year, was because we felt that what was going on there was atypical for the rest of the portfolio and had idiosyncratic risk in it. And so that was a function of a particular exposure and if you strip that away the underlying portfolio within Commercial is pretty straightforward from an asset quality behavioural point of view, i.e. there is nothing much going on there that you would choose to call out. It is also composed of a pretty well diversified set of exposures, obviously predominantly UK in nature, but nonetheless within the sectors that you would look at, including some of the more sectors that might trouble you more, e.g. retail are pretty well diversified and low concentration set of exposures.

The one that was singled out at the Half Year is a significant exposure for us. Again, that aligned with the fact that it is idiosyncratic in its nature, is why we singled it out. I think that also gives you a sense from that exposure at least is the hedgeability or otherwise of it.

James Invine

When does it go on your watch lists or is it completely out of the blue?

William Chalmers

No we have been looking at it for a while, keeping an eye on it for a while, certainly at least for the last 9 months and I think quite possibly before that.

James Invine

How labour intensive is it working out these problem exposures? And then if we go into a stress test scenario style downturn, do you have all the people on the ground that you need to actually work out what would become bad loans?

William Chalmers

We certainly keep a very close eye on the Commercial portfolio. I think the exposure that came along and claimed a bit of the AQR for Q3 was as I said before for us quite a large exposure. That takes quite a lot of time to figure out. I mentioned that it is 9 months since we have been keeping a close eye on it, because it is a large exposure for us we have actually been keeping a close eye on it way before that. But in terms of migration issue, that is the 9 months I was referring to.

In terms of the bank's capability to deal with the evolution of the portfolio, the Commercial portfolio, I suppose two statements really. I think one is because we feel relatively well diversified and because we feel that the sector exposures are manageable, we would strongly argue that we are relatively low risk. That's not to say that if a macro downturn happens we don't get hit, of course we do, but we would claim to be relatively low risk.

And then number two would be, yes I think we would have all of the workout and other credentials and teams that you might expect and we would expect to be able to deal with any issues that arise accordingly.

James Invine

Presumably you haven't just got an army of people sat around waiting for the next recession?

William Chalmers

Well, we always have a Collections Department, that is a kind of workout department, a Business Support Unit. All of those things are there, they are an overhead when times are good I suppose and essential when times are not so good.

Question 13 – Russell Quelch, Redburn

On the weakness in the second-hand car market and the lack of demand in primary markets, do you need to change strategy in that part of the business next year or do you see it as fairly transitory what is going on right now?

William Chalmers
I think the short answer on strategy is no, I will elaborate a bit more on that. The position in the car finance market is a strategic position from our perspective. So we run the Black Horse business and we run the Lex business, because they are strategically interesting businesses for us to be in as part of the overall UK presence and strategy that we aim to deliver to the customer base.

The issues in terms of the residual values that we have seen through the course of this year as I mentioned on the call, they have been two-fold really. One is driven by a large increase in predominantly PCP and other contracts during the course of the 2016-ish type period. After three years or so those become mature and so the supply of cars onto the market dampens down pricing. That is one factor.

And then the second factor is a perhaps a slowdown in consumer durables purchases. It is quite hard to discern precisely how much weight you attach to each of those two, but they are both somewhere in the mix I am sure. That is point one.

I think there is a little bit of tension if you look at the Lex business. Companies, to an extent at least, are having a debate about how much to supply company cars or otherwise so that is to an extent a factor in volumes. And then to an extent a factor in volumes is also our own price discipline, a bit like the mortgage discussion that we were having earlier on. We don't participate all the time everywhere in these markets, we are a bit more selective than that and choose to do so when we think it has shareholder value benefits. That in turn means that volumes will go up and down a little bit accordingly. But the strategy very much remains the same.

Douglas Radcliffe
I am conscious that we probably have time for one more question. Is there anyone who has not asked a question?

Question 13 – Robin Down, HSBC
I have a couple of small follow ups. Just to come back to the PPI costs question. It has been a few years I think since someone quoted the number, I think there was about 7,000 people involved in PPI claims, but they are all covered by the provisions in effect. Are they all temp staff that will just disappear or do we have to worry about some of that cost coming back into the main income statement?

William Chalmers
Well, Jon will provide a bit further colour on it. They are mainly PPI support staff and so we wouldn't expect a significant bounce back in the opex of the business on an underlying basis which, I think, is where your question is coming from.

Jon Burgess
Yes, the vast majority is flexible. There are some permanent staff employed in that operation. We have got unfortunately a fairly healthy running map to plan for those staff migrating back into…

Robin Down
We don't need to worry about that from a cost perspective?

William Chalmers
You shouldn't fear losing on opex off the back of PPI coming off, that is for sure.

Robin Down
The second question is a really geeky question. The Tesco mortgage book came in on the standardised risk weighting. Is there any opportunity to switch that across to Lloyds' model, or does that involve legal restructuring?

William Chalmers
No, it's a good question. That is certainly the plan. We have been deliberately quite conservative in terms of when we expect that to come in because you just never quite know how long it is going to take to get regulatory approval for this. But it is certainly the intention and the expectation that that is what will happen.

Douglas Radcliffe
Okay, thank you very much indeed. Thank you for coming again to this session. Thank you.

End

FORWARD LOOKING STATEMENTS

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