LLOYDS BANKING GROUP PLC – 2020 FULL YEAR RESULTS – PRESENTATION TRANSCRIPT
(amended in places to improve readability only)

Wednesday 24 February 2021 – 9.30am

LBG PRESENTERS:
Robin Budenberg, Chair
António Horta-Osório, Group Chief Executive
William Chalmers, Chief Financial Officer

Robin Budenberg
Good morning everybody and welcome to today's presentation. You will be glad to hear that I do not intend to be a regular participant at these events but I did want to say a few words today.

Firstly, I wanted to say how privileged I feel to be Chair of Lloyds Banking Group. It is a great organisation with wonderful people and a vital purpose given today's environment.

And secondly, given the importance of maintaining momentum through chief executive transition, I wanted to say a few words about Strategic Review 2021 before handing over to António and William.

This is an important time for the Group. Our primary role in line with our purpose this year must be to support the UK's recovery from the pandemic. But, given the continued acceleration of change in our external environment, we must also be active in evolving our own strategy.

In order to maintain momentum, Strategic Review 2021 combines specific short-term no regrets actions with an agreed long-term direction based on the transformation of the business over many years under Antonio's leadership. It will also allow Charlie Nunn to continue to shape the future of the business when he arrives in August. The Board is confident this is the right approach.

In order to achieve these objectives the team has taken the six key elements of our agreed longer-term direction and for each of these has identified clear areas for investment focus this year.

In turn, these areas of investment focus have a set of specific underlying deliverables due this year and, where appropriate, over the medium term. This will allow us to make demonstrable progress on our journey this year and lay solid foundations for the future.

The Board and management team are excited about Strategic Review 2021. By enhancing our businesses and our capabilities in this way, we will be able to make real progress towards our aim of building the UK's preferred financial partner, whilst also playing an active role in Helping Britain Recover.

Now I would like to hand over to António and William. Thank you.

António Horta-Osório
Good morning everybody, thank you for joining our 2020 full-year results presentation and thank you Robin for your words. I will begin by providing a brief overview of results and our recent strategic progress. William will then discuss financials in more detail before updating you on the Strategic Review 2021.

Turning to slide 3 of the presentation. 2020 was a challenging year given the significant impact coronavirus has had on our customers, colleagues and communities across the UK. I am deeply proud of the vital work that has been done by the Group to support the UK economy and to help Britain recover throughout 2020.

Our colleagues across the Group continue to demonstrate extraordinary resilience and dedication, supporting our customers and communities in very difficult circumstances. Our long-run transformation and investment has enabled continued delivery and positioned us well through the pandemic.

We have continued to serve customers through their channel of preference and, testament to this customer focus, we have delivered record customer satisfaction levels during 2020 across multiple channels. We have also seen the strength of our franchise further reinforced, with deposit growth across our trusted brands of £39 billion in the year.

In addition, despite the pandemic changing the way in which the majority of colleagues worked in 2020, we saw record employee engagement scores, above the UK high performing norm.

As we look ahead, we remain absolutely focused on working with all of our stakeholders to ensure a sustainable national recovery. As a result, our core, long-standing purpose of Helping Britain Prosper has never been more important.

Turning to Helping Britain Prosper on slide 4 of the presentation. We launched our Helping Britain Prosper Plan in 2014, the first UK bank to launch such a plan. Over the years it has served to unite the Group behind an inspiring set of evolving environmental and societal ambitions which have enabled us to deliver significant impact in key areas where we believe we can make the biggest difference as the UK's largest financial services provider.

This includes championing diversity as the first FTSE100 company to set public gender and race targets, as well as being one of the largest corporate donors in the UK.

Recognising that societal demands are evolving, we must continue to strive for further progress in delivering a more responsible, sustainable and inclusive organisation. To support this, we have today announced a number of new, exciting actions that will complement our existing ESG ambitions and support our purpose.

Turning now to our financial performance on slide 5. The Group's financial performance in 2020 was inevitably impacted by the low rate environment, as well as depressed customer activity and the significant deterioration in the economic outlook in the first half. As a result, net income of £14.4 billion was 16 per cent lower than 2019.

We maintained our rigorous approach to cost management, with total costs down 4 per cent, although this did not fully offset the more challenging revenue environment, with pre-provision operating profit down 27 per cent.

The impairment charge of £4.2 billion was largely taken in the first half. The economic outlook has improved slightly since Q3 and our actual credit experiences continue to remain stable.

Our balance sheet remains strong and we delivered stable RWAs of £203 billion in the year while growing in selected areas such as mortgages, especially in the second half of the year.

Given our strong capital position at the year end, the Board has recommended a final ordinary dividend of 0.57 pence per share, the maximum allowed under the PRA guidelines.

Turning to slide 6 on the economy. We have seen unprecedented levels of contraction in the UK economy in 2020 as a result of the lockdown measures. The economy has, however, benefited from significant levels of Government support which has been fundamental in limiting the impacts from the crisis.

HPI has performed well in 2020, as customers took advantage of the stamp duty holiday and additional savings to adapt their home preferences to the changing environment.

In addition, while customer spending fell sharply in March and April, we have seen some recovery throughout the year although some sectors are still well below pre-crisis levels.

We have started to see the unemployment rate gradually pick up, but this continues to be supported by the Coronavirus Job Retention scheme, which has been extended to the end of April.

Finally, while UK consumer credit fell sharply as spending was constrained, growth in household deposits increased to over 10 per cent, as consumers reduced spending and increased savings. This has been the right approach given the very significant uncertainties the pandemic has produced.

As an integrated provider of banking, insurance and wealth needs, we believe this higher savings trend offers attractive opportunities for future growth.

Turning now to slide 7. Ahead of William taking you through the latest evolution of the Group's strategy I would like to briefly reflect on our business transformation since 2011. In this period we have successfully shifted our focus from one of restructuring to one of selective growth and investment. Successful execution in this period has created clear competitive advantages. In addition to significant improvements for customers and colleagues, we have delivered for shareholders across a number of areas.

Moving now to look at the most recent stage of this journey, GSR3, on slide 8. In 2018 we launched GSR3 with the aim of transforming the Group for success in a digital world. Despite our external environment changing significantly during this period, we achieved the majority of our targeted outcomes, with outperformance in a number of areas underpinned by record investment. Over the last three years we delivered for our customers with innovative products and services. We continued to expand the reach of our digital franchise and created a comprehensive Insurance & Wealth offering, two areas that I will talk about in more detail shortly.

And finally, we continued to equip our people with the skills and capabilities to deliver our transformation while creating a Group that everybody can be proud of. These successes during GSR3 have laid the foundations for the Strategic Review 2021.

Turning now to slide 9. We have the largest digital bank in the UK with 17.4 million digital active users and 12.5 million mobile app users. Both of these have grown at pace over the course of the last three years.

Importantly, as you have heard, growth in these channels has been matched by an increase in customer satisfaction.
We have been able to effectively respond to changing customer preferences and we believe that a key component of our competitive advantage is our differentiated multi-brand, multi-channel model, supporting our segmentation strategy, alongside the largest branch network in the UK.

The growth in our digital channel also provides the Group with capabilities to effectively compete with new digital-only challengers, with an annual cost to serve of just £15 per customer for those customers who opt for a digital-only offering. This value that we can create through digital for our customers is the result of continued targeted investment and we see further opportunities here.

Turning now to our Insurance & Wealth business on slide 10. Our priorities in Insurance & Wealth during GSR3 were to drive momentum in the business and create the capabilities for future growth. This has resulted in market share gains across multiple Insurance markets, such as 5 percentage point increases in both Home Insurance and Corporate Pensions.

In addition, our strategic actions have enabled an enhanced wealth offering that will allow us to meet the various financial needs of our customers.

At the end of 2018, we announced a strategic partnership with Schroders combining our significant customer base with the extensive distribution capabilities of Schroders' investment and wealth management expertise.

While the pandemic has inevitably caused some delays, our ambition to become a top three financial planning business remains unchanged, although we now expect to achieve this by the end of 2025, two years later than originally planned. This partnership not only enhances our customer offering, but will also provide greater income diversification in a low rate environment.

Turning now to summarise on slide 11. Our successful transformation across GSR1 to 3 positions the Group well for the future. We have built clear competitive advantages, including our leading focus on efficiency, which has created the capacity for increasing levels of investment.

In turn, this has enabled ongoing improvements to our customer offering and internal processes, as well as providing the optionality to unlock new investment opportunities while producing sustainable and superior returns for our shareholders. This, combined with our other core capabilities, creates the strong foundations for Strategic Review 2021.

Thank you. I would now like to hand over to William who will discuss our 2020 financial performance before presenting the Strategic Review 2021.

William Chalmers
Thank you António and good morning everyone. I will now run through the 2020 results, before discussing Strategic Review 2021 and then opening up for Q&A.

Turning first to slide 13 with an overview of the financials. Net income of £14.4 billion is down 16 per cent year on year. As you know, this was largely driven by the bank base rate reductions, change in asset mix and lower levels of activity.

In the context of this challenging environment, the Group continued to demonstrate cost discipline, with costs down 4 per cent. Meanwhile, the cost to income ratio has clearly been impacted by the revenue environment but remains low compared to peers.

Pre-provision operating profit of £6.4 billion included £1.4 billion profit in Q4; broadly in line with Q3. The impairment experience in the fourth quarter has been better than expected at Q3, reflecting a somewhat improved macroeconomic outlook and stable credit experience in the quarter.

Statutory profit before tax of £1.2 billion was down 72 per cent year on year, due to the income developments and of course the impairment charge taken in the first half. TNAV was stable at 52.3 pence per share. Meanwhile, the CET1 ratio increased to 16.2 per cent, post the full year dividend of 0.57 pence per share.

I will now turn to slide 14 and look at how the Group's customer franchise performed across 2020.Total mortgage balances were up £5.2 billion in the year and, in line with our expectations, the open book was up £6.7 billion in the fourth quarter.

We expect open book mortgage balances to continue to grow in the first quarter of 2021 and expect net open book mortgage growth over the full year. Credit card balances were significantly impacted by the pandemic reducing levels of activity, with balances down 19 per cent for the year. Motor finance and unsecured loans were also lower, a 6 per cent and 5 per cent reduction, respectively.

Given the continued activity restrictions, we expect consumer finance balances to be lower in the first half of 2021, before starting to recover in H2. In Commercial, SME balances were up £8.5 billion, predominately driven by Bounce Back Loan lending. We have now delivered more than £12 billion of Government guaranteed lending, with a market share of 17 per cent. Corporate and Institutional balances were down £8.6 billion in 2020 as corporates reduced RCF usage and as we continued to work on low returning relationships.

In totality, this resulted in flat AIEAs over the year. Based on current macro economic expectations, we expect AIEAs to be flat to modestly up in 2021.

Retail deposits were up nearly £31 billion over the year with current account growth of more than £20 billion. This was ahead of the market. Commercial balances were up around £8 billion. Here, the increase in SME deposits, partially driven by Government-backed lending held on deposit, more than offset the Corporate and Institutional reduction, the latter again significantly a function of our pricing activity.

Turning to net interest income on slide 15. Net interest income for the year was £10.8 billion, a decrease of 13 per cent on 2019. Given the stable AIEAs, this was largely driven by rate and yield curve headwinds, and also partly a function of customer assistance measures, for example in overdrafts, together resulting in a NIM of 252 basis points.

Our Q4 margin of 246 basis points was slightly better than the guidance given at Q3. This benefited from a number of tailwinds including lower funding costs, better mortgage margins, RCF repayments and a small benefit from deposit repricing. The principle headwind was reduced earnings from the structural hedge.

Looking forward, we expect the net interest margin to be in excess of 240 basis points for 2021.Mortgage margins are expected to continue to be attractive for the time being, alongside further optimisation in Commercial. This will be offset by lower unsecured lending balances and pressure from the structural hedge, the latter particularly in H2.

I will turn to slide 16 to look at the margin dynamics in more detail. Now I have already mentioned the strong mortgage performance that we have seen. We have built higher balances at attractive new business mortgage margins, with completions in Q4 at circa 190 basis points. This is higher than maturing front book business and helped offset the structural hedge drag in Q4. Consumer finance meanwhile continued to be impacted by the change in asset mix in H2,particularly the reduction in card balances. The margin dilution in Commercial Banking in the second half was partly driven by the volume of Bounce Bank Loans and CBILS. Although the margin is lower than lending on standard terms, we of course benefit from the government guarantee.

Now turning to slide 17 to look at deposits. The deposit story in 2020 has been little short of remarkable – an increase of nearly £40 billion.

In Retail, we have seen inflows from new customers, whilst existing current account average balances have also continued to increase given reduced spending.

Commercial balance increases were largely driven by cash reserves, partly through Bounce Bank and CBILS loans being placed on deposit; as well as lower outgoings. The deposit margin was broadly in line with H1 and continues to be lower than 2019 given the lower rate environment. Growing deposit balances in turn, provide an opportunity to build on wealth and financial planning propositions to better support customers, as you have heard from António.

Turning to look at the structural hedge on slide 18.Total structural hedge earnings in 2020 were £2.4 billion. The hedge balance has increased by £7 billion in 2020 to £186 billion; up £1 billion in Q4. Swap rates began to recover in the fourth quarter and we have seen that recovery continue this year. We have taken advantage of this to reinvest maturities to a longer term, with the weighted average life of the hedge increasing accordingly to 2.5 years at the year-end.

Furthermore, hedge capacity has also increased, providing additional flexibility going forward. The £25 billion increase in capacity is significantly driven by balance sheet mix, alongside deposit growth. For example, £11 billion of the increase in capacity is a result of moving a portfolio of commercial deposit balances from base rate linked to managed rate during the year and hence a proportion are now eligible to be included in the hedge.

Looking forward into 2021, given the circa £60 billion of maturities and current yield curve expectations, we expect the hedge earnings to reduce by circa £400 million compared to 2020.Thereafter, in 2022 and 2023, we expect the annual income headwind from hedge maturities to be materially lower. Now turning to slide 19 to look at other income. Other income of £4.5 billion was down 21 per cent on 2019, with OOI in Q4 of £1.1 billion. Over the year Retail other income was impacted by lower interchange fees and Lex fleet volumes. Commercial was impacted by reduced levels of client activity, specifically within transaction banking. Insurance and Wealth was impacted by lower new business, negative assumption changes and a reduction in non-recurring items.

And in Central items, income was impacted by reduced gilt gains and we also saw some impact during the year on our equity business.

Looking forward, as we begin to see the easing of restrictions and increased customer activity, we would expect other income to gradually recover. We also continue to invest in income diversification opportunities over the medium term.

Now moving to slide 20 and costs. In 2020 we further reduced both operating costs and BAU costs by 4 per cent, with delivery of our enhanced cost target of below £7.6 billion. This equates to circa £300 million reduction in absolute costs in 2020 and circa £600 million across the last 2 years. In year, we balanced headwinds from Covid costs with tailwinds from reduced variable remuneration.

In relation to investment spend, and consistent with the last two years we capitalised 63 per cent of above the line cash spend. Remediation of £379 million, 15 per cent lower year on year, reflects charges across a number of existing programmes.

Looking forward into 2021 we expect Covid-related costs to remain elevated, as we continue with hygiene expenses and potentially increasing customer financial assistance issues. We are also planning to increase variable remuneration costs in 2021. We expect to be able to fully absorb these headwinds through our ongoing cost reduction activity and for our operating costs to continue to fall to circa £7.5 billion this year. Opportunities remain to continue our cost trajectory over the medium term which I will briefly touch upon in the next slide.

Our focus on efficiency and cost reduction is fundamental to our business model. We have reduced BAU costs by 24 per cent since the start of GSR 2. This in turn has created room for significant business investment in recent years and continues to do so. Today we continue to look at our strategy for cost reduction across the Group.

We look at a cost framework involving three parts.

Number one, our BAU cost management is outstanding. It continues to offer opportunity, for example, third party suppliers, organisational design and automation.

Second, Covid related opportunities. Whilst the pandemic has brought additional cost pressures in the near term, we believe there are both ways to manage this carefully and also medium-term structural opportunities, for example, in workplace and in travel.

Thirdly, there are emerging strategic opportunities presented by technology, both in our operations and in our interactions with our customers and colleagues. These require investment.

Indeed, as we continue to adapt our business to the changing environment, we will maintain high levels of strategic investment, with £0.9 billion committed this year, including technology R&D. I will talk more about this later on.

Now turning to slide 22 to look at impairments. The observed credit experience in Q4 has been very stable. The Q4 impairment charge is £128 million. Within this, the Retail charge of £383 million in the quarter is only a little above the pre-pandemic run rate and in line with Q3. Commercial charges in Q4 remain low, and coronavirus impacted restructuring cases have performed better than expected, generating a small release in the quarter.

The macro economic outlook has improved slightly since Q3, despite the current national lockdown, given vaccine rollout and the extension of Government support. We now expect peak unemployment to be 8.0 per cent in Q3 2021, lower than the previous expectation of 9.0 per cent in Q1. HPI performance has also been better than expected in 2020, as António mentioned earlier on.

This improved macro-economic forecast generates releases in our models. However, given the unusually wide range of uncertainties in the current environment such as virus mutation and extended lockdown, we have taken an additional £400 million management overlay to partially offset these. Our Q4 impairment charge of £128 million is net of this additional overlay.

Based on our current macro economic assumptions we expect the 2021 impairment charge to return closer to pre-pandemic levels and the net asset quality ratio to be below 40 basis points.

Now turning to slide 23 to look at coverage. Our total stock of ECL of £6.9 billion is £2.7 billion higher than December 2019. £4.3 billion of that relates to Stage 1 and Stage 2 exposures which provides significant resilience to absorb headwinds as and when losses begin to emerge. Meanwhile, coverage levels have increased across all products and write-offs continue to be at pre-crisis levels across the book.

Turning to the next page. The balance sheet remains strong with circa 85 per cent of Group lending secured.

In mortgages, the quality of our book continues to improve with the average Loan to Value ratio now 43.5 per cent, down 1.4 percentage points compared with 2019. More than 91 per cent of the mortgage book now has an LTV of 80 per cent or less.

Looking at our Retail credit experience we continue to see low new to arrears levels across the portfolio, at or below pre-crisis levels, despite the majority of payment holidays ending.

Let's take a look at payment holidays. Payment holidays have been effective in managing customers through the crisis. 98 per cent of first payment holidays have now matured, with 89 per cent of customers resuming payment. Of the remaining 11 per cent, half are on extended payment holidays and half are in arrears. Roughly a third of those in arrears were in arrears before the payment holiday was granted.

New payment holidays granted remain very low compared to H1 levels, with only 28 thousand initiated during the latest national lockdown.

In Commercial, the vast majority of commercial repayment holidays have now matured with more than 85 per cent repaying.

Now I'll look briefly at the Group's exposure to certain commercial sectors on slide 26. Within the Commercial portfolio, our exposure to the sectors most impacted by coronavirus remains modest, at around 2 per cent of Group lending.

We have seen some deterioration in the credit ratings of these vulnerable sectors during the year, as expected, with the percentage of investment grade reducing 8 points to 38 per cent. As context, however, our new to Business Support Unit levels in H2 were in line with pre-crisis levels. SME credit performance meanwhile remains stable with less than £20 million of write-offs in 2020. Our Commercial Real Estate portfolio continues to be managed, with average LTV at 50 per cent, and through significant risk transfers.

I will now move on to slide 27 to look at below the line items. Total below the line items in 2020 were significantly lower than in 2019, given the reduction in the PPI charge.

Restructuring costs were however up 11 per cent year on year. I will talk briefly on these in the next slide. Volatility and other items included negative insurance volatility, the usual fair value unwind, and a loss of £106 million relating to liability management exercises, largely in the fourth quarter. This was partially offset by positive banking volatility.

As you can see, we have taken a PPI charge of £85 million in Q4. This was principally driven by the financial impact of delays in operational activities given coronavirus, and the final stages of work ahead of orderly closure of the programme. Today more than 99 per cent of pre deadline queries have now been processed.

Moving down, the in year tax credit of £161 million reflects the DTA remeasurement benefit in Q1. Statutory return on tangible equity was 3.7 per cent in 2020. Looking forward, and in order to aid comparability across the sector, the Group will report its statutory RoTE without adding back the post-tax amortisation of intangible assets. On this new basis and given improving profitability, the Group is targeting a return on tangible equity of between 5 and 7 per cent in 2021, on a path to our medium term target of earning higher than cost of equity returns.

Now moving on to slide 28 to look at restructuring charges in more detail. Restructuring charges of £521 million included £233 million in Q4.

Following the resumption of role reduction activities, severance charges of £156 million in 2020 were accelerated in Q4. Property transformation costs of £146 million were largely in the second half, as branch and office rationalisation activities picked up.

Technology R&D charges relate to costs associated with our initial investigation of new technology capabilities. I will provide more detail on the initiatives here later on in the presentation, but these activities are at an exploratory stage and represent a series of opportunities that we are looking at, to deliver and to accelerate transformation.
Looking forward, we expect to continue to increase investment in technology R&D and therefore expect restructuring charges to be somewhat higher in 2021.

Moving on to look at risk weighted assets. Risk weighted assets were flat in 2020; supported by strong RWA management.

In 2021 we expect RWA's to be broadly stable on 2020, with continued optimisation within Commercial, offsetting some expected credit migration and asset growth. As we look forward into 2022, we do expect RWA inflation from regulatory change. Further out, we do not expect the impact from the Basel 3.1 output floor to be material until the latter part of the implementation phase towards 2028.

Turning to Capital. Our CET1 ratio ended the year at 16.2 per cent, following the announced dividend of 0.57 pence per share. This strong capital base remains significantly above both our ongoing internal capital target of circa 13.5 per cent and our regulatory capital requirement of around 11 per cent.

The CET1 ratio included 51 basis points from the change in treatment of software intangibles during the final quarter. CET1 also continues to benefit from the 115 basis points of IFRS 9 transitional relief. We expect slightly more than half of the 83 basis point in-year benefit to unwind in 2021, with the remainder in 2022. Therefore, in 2021, we expect capital build to be impacted both by profitability and by the expected IFRS 9 transitional unwind.

Terms have now been agreed in principle in respect of the valuations of the Group's three main defined benefit pension schemes. Future deficit contributions will equate to circa £800 million per annum, plus 30 per cent of in year capital distributions, up to a limit of £2 billion per annum, until the deficit of £7.3 billion has been removed.

As António mentioned earlier, we have today announced a dividend of 0.57 pence per share. This is the maximum allowable under the PRA guidelines. The Board remains committed to future capital returns. In 2021, the Board also intends to accrue dividends and resume its progressive and sustainable ordinary dividend policy at a dividend higher than the 2020 level. As normal, the Board will consider the size of the final dividend payment and the further return of any surplus capital, based on circumstances at the year end.

That concludes the review of the financials and we will now move to a short video from our Executive team outlining Strategic Review 2021, before I discuss that in more detail.

I hope you enjoy it.

[Video]

William Chalmers
Welcome back everybody. I hope our short video helped to give you a flavour of our vision for Strategic Review 2021 and the work that the Board and executive management team has put into it over the last few months. I will take you through a few of the highlights now. Firstly, turning to slide 32 on the opportunities and challenges ahead of us.

As you well know, 2020 was a year of significant change for both society and the economy as a result of the pandemic. We have also seen a significant acceleration in longer term strategic trends in our sector, including the move to digital.

While change of this scale undoubtedly creates challenges and the path to recovery for the UK will not be linear, the strong foundations we have at Lloyds position us well to rise to these challenges. We want to take a leading and transformational role in many of the opportunities that change creates.

I will now provide an overview of how we plan to do this, with an overview of Strategic Review 2021 on the next slide. Strategic Review 2021 will deliver meaningful improvement for our customers and colleagues. It will also support the creation of sustainable shareholder value through revenue generation and diversification, further efficiency gains and disciplined growth.
In Strategic Review 2021, we will accelerate our transformation to build the UK's preferred financial partner. The following points are key:

First, as you heard earlier, our purpose of Helping Britain Prosper is more important than ever. In Strategic Review 2021 we will centre this effort on Helping Britain Recover, supporting our customers' financial health and resilience through areas of focus that are fully embedded in the business.

Second, across our core business areas of Retail, Insurance & Wealth and Commercial Banking we will bring further alignment and improvement to unlock co-ordinated growth opportunities. This will be supported by further enhancing our core capabilities that enable sustainable success in the new environment, specifically technology, payments, data and our people.

Third, Strategic Review 2021 includes clear execution outcomes for the year, underpinned by long term strategic vision in each area. Our business and capability priorities, as outlined here, are built on our transformation to date. They were and will continue to be, the foundations of our success, long into the future.

All of these aims will be supported by significant levels of strategic investment. Together with our execution credibility, Strategic Review 2021 will thereby ensure that the Group continues to build momentum, during a period of management and environmental change.

To begin, I would like to turn to Helping Britain Recover on the next slide. The impact of the pandemic has been felt by everyone. Its social and economic effects on the UK are likely to be long-lasting.

As a result, consistent with our purpose to Help Britain Prosper, in 2021 we will focus on Helping Britain Recover, with objectives that are fully embedded in our business. Our response takes action in five key areas where we believe we can make a difference. Measures include supporting our personal and business customers through the recovery with dedicated financial and wellbeing support; expanding the availability of affordable and quality housing; and delivering on our broader environmental and societal objectives.

Through our actions in these areas, we will play our role in creating an environmentally sustainable and inclusive future for the UK. In doing so, we will build a successful and enduring business of which we can all be proud.

Turning to our business facing initiatives on slide 35. To give you a framework, in each of our two customer segments and four capabilities, we lay out our opportunity, our areas of investment in 2021 and some examples of how you can expect us to measure our success in 2021 and beyond.

Looking first at personal customers. Our personal customer franchise has truly unique foundations. We hold a relationship with around half of the UK adult population and operate the largest digital bank in the UK as part of our multi-brand, multi-channel strategy.

As we look ahead, we see scope to grow our franchise by significantly deepening our relationships with priority segment customers. Meeting more of our customers' broader financial needs, particularly where a number of these are currently met by other providers, is a priority. This will be achieved by increasing personalisation and by leveraging our unique capabilities as an integrated provider of both banking and insurance & wealth services. We will also look to reduce our cost to serve across segments through further digitisation.

For measures of success, in 2021 we expect to grow the open mortgage book. We will also maintain our all channel NPS which hit record high levels in 2020.

Looking beyond this, in line with our focus on meeting more of our customers' financial needs, we intend to deliver £25 billion net new money growth in Insurance & Wealth by 2023. The latter represents wholly organic growth and a further progression from the open book growth delivered in GSR3.

Moving now to Best Bank for Business on slide 36. Our vision for Strategic Review 2021 in Commercial Banking is to be the Best Bank for Business.

Our Commercial business has outstanding reach. This is supported by our brand and scale, our above-market growth in SME and a strong presence among large corporate clients, including active relationships with more than 60 per cent of the FTSE100.

Our actions here centre on enhancing our capabilities to better serve the financial needs across our client base, while maintaining our strong returns discipline – a disciplined and strengthened business.

In SME, we are investing in opportunities to add value to our client offering, including our digital proposition. This will build greater origination and self-service capabilities for simple working capital products, alongside improved client driven solutions, such as online financial management services. The combination of these will result in a more than 50 per cent growth in digital-linked origination in 2021, as well as supporting a 5 point increase in NPS over the next three years.

We will strengthen our Corporate & Institutional offering by increasing product and delivery capabilities across core Markets areas, such as FX and GBP rates. Our investment here is in re-platforming and digitising to deliver more competitive capabilities and a more efficient model. This is intended to improve share and client returns in our existing relationships where we are underrepresented and where we have a right to win.

Turning now to our investment in technology on slide 37. During GSR3 we significantly increased our investment in technology. This enhanced the scale and speed at which we could deliver transformation initiatives and improved our offering for customers. However, with the pace of change accelerating we must of course take the next step. We need to further modernise our technology architecture to deliver better customer propositions and to structurally improve operational efficiency and agility.

In 2021, as previously mentioned, we will continue to improve our digital offerings for both personal customers and commercial clients, increasing self-service capability. This includes doubling the volume of releases on our mobile app in 2021, while investment in cloud will allow us to create new features for customers more quickly and more efficiently. Improvements at scale are necessary for continued customer satisfaction, to allow us to maintain our record mobile-app NPS.

As a further component of our technology modernisation, in 2021 we are investing in the foundations for transformation by further proving and leveraging our public cloud capabilities. This is a precursor to simplifying our legacy estate.

While I must stress we are currently at an early stage, significant opportunities exist. Around 60 per cent of our technology estate is currently targeted for migration over the longer-term, with a significant proportion of this to be achieved over the next three years.

I would now like to spend a few moments discussing our technology R&D investment in more detail on slide 38. As highlighted on the previous slide, our investment in technology over GSR3 allowed us to significantly improve our customer offering, while contributing meaningfully to ongoing reductions in the operating cost base.

We are now looking at the significant impact that next-generation technologies could have on our organisation, by delivering a step change in customer propositions and efficiency. Consequently, we are increasing our R&D investment in this area. This is supported by a number of our strategic partnerships with specialist providers.

As an example of what we expect to achieve with this investment, in 2021 we are undertaking a pilot to safely migrate around 400 thousand back book customer accounts to a new bank architecture, to test these capabilities. We expect this to deliver around a 40 per cent reduction in the applications associated with the legacy architecture of this portfolio, giving us insight into possible broader benefits.

Our experience in 2021 will determine the pace and scale of further roll-out and we will update you on our progress accordingly. These new technologies have the potential to deliver meaningful enhancements to customer propositions and experiences, and to deliver a simpler, more efficient and more agile organisation. Quite apart from other benefits, this is required to unlock the next generation of cost opportunities over the long term.

Success is, of course, not guaranteed, but we believe it is right to make an investment of this kind. Indeed, it is our efficiency has given us the ability to consider investments such as these, which, in turn, are in part aimed at further enhancing our efficiency.

Charges relating to this R&D investment are included in our strategic investment spend and will be taken within restructuring.

Turning now to payments on slide 39. In line with the nationwide scale of our franchise, the foundations for our payments business are outstanding. We are a leading player in this market as the largest card issuer in the UK and the fourth largest acquirer. It is also a sub-sector in the midst of significant change where we have a very strong position both to defend and to grow. Our brand, our reach and our issuer-acquirer strength provides opportunities to build the business in an attractive market delivering additional revenues and greater diversification.

For example, in Retail, e-commerce represented nearly 50 per cent of all debit spend in 2020. We aim to preserve and build our leading share. In Commercial, our share of customer relationships is significant but we are nowhere near matching that share in merchant acquiring.

Accordingly, in 2021 we will invest in enhancements to our consumer payments experience through increased functionality, such as Click to Pay and rewards based products and offers. This will support the maintenance of our leading spend market share in 2021 and allow growth in credit card spend market share from 2022.

In Commercial, we will build on our GSR3 investment by further improving our cash management and payments platform. This will foster an ecosystem of services across payments, cash management and liquidity needs, allowing share gains among our corporate clients.

In parallel, to seize the significant and critical opportunity in merchant acquiring, we aim to enhance the distribution capabilities of our merchant services proposition. This will deliver 15 to 20 per cent new client growth per annum, starting in 2021.

Moving to data on the next slide. We operate one of the largest databases within the UK. We see this as a unique asset that should allow us to deliver huge value-add to our customers. Our investment to date has significantly improved our use of data. Today, 20 per cent of customer needs are met by data-led marketing, where we are able to more effectively communicate with our customers and deliver solutions that matter to them. This number is a start, but it also offers significant upside.

In Strategic Review 2021, we are therefore prioritising investment in data capabilities to deliver more effective outcomes for our customers and our colleagues.

Through better integration of and access to data, we will be able to meet customer needs more rapidly and effectively and enable more personalised propositions. This will unlock opportunities in identifying and meeting more existing personal customer banking and insurance needs.

As part of this we are investing in materially extending machine learning and advanced analytics capabilities across the organisation to support customer and business outcomes. For example, by widening the use of machine learning we will deliver at least a 10 per cent reduction in fraud.

In advanced analytics, we have a number of use cases underway across multiple products. For example, we are targeting a 20 per cent increase in home insurance needs met through our direct channels. There is obvious scope to extend these capabilities to a broader suite of products across the Group over time.

Advanced analytics will also be used to deliver early insights into financial vulnerabilities, particularly important as our personal customers and business clients recover from the effects of this pandemic.

Our investment in advanced analytics is expected to deliver a 50 per cent return on investment in the first year, creating capacity for further investment thereafter.

Finally, but critically let's look at reimagined ways of working on slide 41. As you heard in António's earlier remarks, colleague engagement is at an all-time high at 81 per cent and above the UK high performing norm. Our colleagues have been nothing short of outstanding in the way in which they have responded to the environment and changes in their ways of working over the last twelve months.

The pandemic has accelerated many of the trends previously evident in the workplace. These require a reduced office footprint, but also enhanced workspaces to foster collaboration and creativity. It is very important that we respond to this opportunity to best serve our colleagues and to also enhance efficiency.

In Strategic Review 2021, our areas of focus for investment include refreshed values and behaviours to build on our purpose-led culture and further embed Helping Britain Recover into the organisation.

We will also invest in reducing our office footprint with a cumulative reduction of around 20 per cent over the next three years, including 8 per cent in 2021. Combined with the 23 per cent reduction in GSR3, this reflects a significant change in our footprint.

Alongside these steps, we will develop our workspaces and ways of working to best reflect changing colleague expectations, while we further invest in our talent through up-skilling and career pathways. This is intended to deliver a more diverse, skilled and future ready workforce that will support progress towards our gender and race targets which reflects the society we serve.

Turning now to slide 42. With our focus on execution, we are also providing guidance for 2021 financials, consistent with the objectives that I have outlined. Clearly all guidance is based on our current macroeconomic assumptions. We expect the net interest margin to be in excess of 240 basis points. We continue to see further opportunities on costs and expect operating costs to reduce further to circa £7.5 billion.

On credit quality we expect a net AQR of below 40 basis points for the year. The combination of these should support improving profitability in 2021 and we expect a statutory RoTE of between 5 and 7 per cent for the year.

On capital, we expect to see broadly stable RWAs in 2021. In respect of capital distribution, we are very pleased to have been able to resume dividends, given their importance to our shareholders. In 2021, the Board intends to accrue dividends and resume its progressive and sustainable ordinary dividend policy at a dividend higher than the 2020 level.

As normal, the Board will consider the interim dividend at the half year and the size of the final dividend payment and further return of any surplus capital, based on circumstances at the year-end.

On our strategy in a time of management change, we hope today that we have portrayed to you a continued strong focus on execution, underpinned by a strategic vision for sustainable success in the new environment. We believe these factors will enable delivery of a medium term statutory RoTE in excess of our cost of equity.

Finally, to summarise on slide 43. I appreciate that we have covered a lot of ground across a number of topics this morning.

Before closing I wanted to take a moment to reiterate the building blocks of Strategic Review 2021. As a Group we have a very clear strategy that is fully aligned to our purpose and represents a further evolution of our long-run transformation. In Strategic Review 2021, we will intensify our focus on Helping Britain Recover with key objectives aimed at this outcome, fully embedded in the business.

Strategic Review 2021 will unlock co-ordinated growth opportunities across our core business areas of Retail, Insurance & Wealth and Commercial Banking. These objectives will be enabled by four enhanced capabilities that cover the breadth of our organisation.

And finally, as just highlighted, to deliver Strategic Review 2021 we have clear execution outcomes for the coming year across all of these pillars, with each of these underpinned by long term strategic vision and supported by significant strategic investment.

This combination will enable the team to effectively deliver Strategic Review 2021 and to build the UK's preferred financial partner.

Thank you for listening. That concludes today's presentation and we would be happy to take questions. I am aware that we only have around 30 minutes scheduled for Q&A but we can run a little longer if necessary. We will take questions from here. Thank you.

Question and Answer Session

Question 1 – Raul Sinha, JP Morgan
Good morning everybody, thank you very much for taking my questions. I have one on strategy and a couple of follow-ups on numbers. On the strategy, obviously the delay in terms of hitting the top 3 financial planning business target to 2025 is quite understandable. But I was wondering if you could give us a bit more colour on where you managed to reach currently with the joint venture in terms of the numbers. What do you think are changes from here that will actually accelerate customer acquisition on say market share gains to enable you to achieve that target?

Then on the numbers, could you comment a little bit more on the NIM trajectory and whether you expect NIM to be down in the first half of the year, especially in the first quarter, given the unsecured and other backend loaded recovery.

Then on RWAs, it looks like there are quite a few capital headwinds heading towards us in 2022 with the pension contribution you outlined and you have got the 51 basis points of intangibles rolling off. The third part I was looking for was any quantification on the RWA headwind that we have to factor in 2022? Thanks very much.

William Chalmers
Thanks very much Raul for the questions. Dealing with each of them in order. On SPW, the last couple of years has been primarily involved in setting up SPWs so it is in a position of strength to ensure the offering to our customer base. In that respect, we have had the asset migration to the new platform and have set up 11 regional hubs. We now have increased referral volumes coming through and also have a new CEO in place to deliver the plan. So as your question points out, we have had a delay in meeting our ambitions primarily because of the Coronavirus crisis, but we think the business is now very well set up to deliver the plans going forward and indeed to be a big part of that £25 billion AUM target as laid out earlier on. Hopefully that answers what is changing from here and why we expect the business to succeed going forward.

On your second question, NIM trajectory, I actually suspect it will be the other way around. We have come out of Q4 at 246 and our guidance is in excess of 240. During the first quarter we expect to see the NIM be relatively solid. The principle pressure is the structural hedge in the second half and in that context it is worth pointing out that some of the rates activity we have seen lately including the steeping of the curve has been very helpful in mitigating that pressure on the hedge in the second half of the year. But the balance is somewhat along the lines as I just portrayed.

On RWAs for 2022, the picture as I outlined in my comments earlier on is one of some certain regulatory headwinds. We are seeing those from a combination of CRR-II number one, mortgage floors number two and CRD-IV number three. That is also supplemented by asset growth and that is clearly part of achieving our RoTE target in excess of cost of equity, which is clearly very welcome. It is also complemented by our usual disciplined RWA management approach, which is both using the market but also addressing sub-optimal returns in the commercial portfolio where appropriate.

So those are all factors that play into it. By the time we get to 2022, we think that credit migration will be relatively limited. But if we take all of those in sum Raul, we are aware of consensus being at £215 billion or there or thereabouts and we are pretty much comfortable with that.

Raul Sinha
Thanks very much William.

Question 2 – Guy Stebbings, Exane BNP
Morning, thanks for taking my questions. Could I firstly come back to NIM, thanks for your comments so far, just to check what your assumptions are in terms of mix on the asset growth and in particular on the consumer side? You hinted at a drop in the first half and recovery in the second half. I was wondering where you think it will end up and what is baked into your NIM guidance. Will card balances still be a fraction lower by the end of this year versus where they started the year? And are you assuming any more deposit repricing over the course of 2021?

Also linked to that I wanted to check the average interest earning asset guidance to be flat to modestly higher than in 2020. Is that versus the full year 2020 average number 435, or the Q4 number of 437 or where you exited 2020, just to know where we are starting from?

And then on other operating income, in particular insurance which has seen quite a big drop in the second half of 2020, if we ignore the volatile life and pension experience and other volatile items and just focus on the new business income, I think it dropped to £394 million for the full year and was just £150 million in H2 driven by workplace planning retirement income and annuities. I was wondering how much of a rebound in some of these lines you would expect to see in 2021 and what sort of time frame you expect them to pick back up to, to what we saw in prior years? Thank you.

William Chalmers
Thanks Guy, to address them in order, just look at the NIM first. As we look forward into 2021, we have a couple of tailwinds and a couple of headwinds in the margin. The tailwinds that we see are clearly in the mortgage book. We are seeing much higher front book mortgage margins which in turn is replacing lower margin, therefore, there is a positive effect on the margin from that mortgages margin differential.

Secondly, I mentioned earlier on Commercial banking optimisation, which again is intended to address the lower returning relationships. There is also a certain amount of commercial banking activity such as the reduction in RCF for example, which then supports the margin.

And then I mentioned in my script earlier on some certain liability management actions that we have been taking which again reduce our costs of funding and therefore lend strength to the margin.

On the flip side of that, there are two or three headwinds. Back book running off is one of them, although that clearly gets less as the back book get smaller. Secondly, mortgage volumes. Mortgages at the current pricing are very welcome and as you have seen we wrote £6.7 billion of the open book in Q4 and will continue to write at these very attractive prices. But as an average margin matter they weigh the margin down a little bit given the overall spreads to the average.

Finally the structural hedge, which as I mentioned earlier on is a dynamic that has been changing a fair bit over the course of the last few weeks by virtue of the rates rally that we have seen, number one. And by virtue of the fact that we have deliberately held back from investing when the curve was very flat last year, number two; which created capacity for us to invest now as we see that curves start to sharpen up a bit. The structural hedge dynamic was and to a degree remains a source of pressure in the second half. But the extent of that source of pressure is mitigated by virtue of the rates movements that we have seen.

You asked about deposit repricing and AIEAs. On deposit repricing, I will leave it up to the Retail and Commercial teams to take the right business decisions in the best interests of customers. But I would say that our average deposit margin is now pretty low off the back of the base rate changes that we saw and there isn't much room within the liability margin left. So it is with that caveat. Finally, the AIEAs are versus the Q4 number that we have given to you.

Insurance has been subject to certain headwinds during the course of 2020. A lot of that is to do with both the non-recurrence of some one-offs that we saw in the first half of 2019 as well as one or two non-recurring headwinds that were negative during the course of 2020. I would also point out in particular the assumptions review in Q4 for insurance, which was about £151 million. You will have seen that in our numbers, a combination essentially of expenses and the persistency inputs.

Overall, as we look at insurance, looking forward into 2021, we hope it will be marked by recovery levels of activity, which should allow the insurance business to perform more strongly. I do not want to put a number on it, but certainly as we look to OOIs as a general matter in 2021 we do expect resuming levels of activity when the lockdowns are lifted to contribute to the OOI growth during the course of the year.

Guy Stebbings
Okay thanks very much. Can I quickly come back to your comments on balance growth? You talked about the mortgage growth this year, still being return positive, but negative in terms of mix from a margin point of view. So from that you are expecting mortgages to continue to grow well above consumer balances for this year?

William Chambers
Let me address that Guy. You mentioned in your question, the overall outlook for unsecured balances this year is a relatively weak first half strengthening into the second half. What that adds up to in terms of net, I would not expect much movement on the area, it might be a small positive, it might be a small negative. But that predominantly depends upon activity. Some of the news from the Government announced on Monday is somewhat more positive than we had expected in that respect, i.e. it is a slightly earlier opening up of the national lockdown, which hopefully will lend itself to consumer activity and will help build unsecured. But our background assumption, which you will see in the conditioning assumptions for our ECL and MES cases was a bit more conservative than what the Government announced. Therefore, we might see a little better performance of unsecured than we initially expected. I think Guy on the particular point of your question, the open book mortgage growth is very much expected and if you were to take things on that like for like basis, it is likely that the mortgage balance outperforms the unsecured balance.

António Horta-Osório
Guy if I can give you some more colour to what William just said. As we said in Q3, the mortgage market continues to be very strong since the first half of last year. It is not only the pent up demand relating to the stamp duty incentives, which by the way will likely be extended to ensure a smooth transition. Also, because many home movers are moving houses based on their preferences given they now mostly work at home and they are moving to bigger houses outside cities and we are clearly seeing a big increase in both first time buyers and home movers. To give you an idea in terms of numbers, we have grown our open book of mortgages by £7.2 billion last year; out of which £6.7 billion was the growth in Q4. And to give you a second number we came into the end of the year with approved mortgages that will complete in Q1 or have already completed in Q1 of around £14 billion which is 50 per cent above the level of December 2019. We had very good momentum going into 2021 and I really believe that this market is driven by several factors and will continue to perform well over the next one or two quarters which is normally the degree of assurance and visibility we have when we speak about guidance and what we see on volumes and margins.

Guy Stebbings
Very helpful, thank you.

Question 3 – Alvaro Serrano, Morgan Stanley
Hi good morning, thanks for taking my questions. A follow-up on the structural hedge and then one on the capital returns please. On the structural hedge you made it clear that there is more capacity to grow the structural hedge to £210 billion. Obviously, there's £60 billion rollovers this year. You have already flagged that the real drag is more the second half. I am just wondering if that £400 million which you said, is kind of mark-to-mark to the curves. How much of a growth in the structural hedge and reinvestment are you factoring in because with a bit of steepening based on historically how Lloyds has behaved I would guess that could grow significantly?

The second question is on capital returns. You continue to target 13.5 per cent. Should we continue to expect all of the excess capital to be paid out? I realise there is transition elements to factor in. The question I am asking is more related to the change of CEO and Chairman and is there going to be an ongoing focus on capital return, is that still going to be predominant or do you anticipate bolt-on acquisitions, M&A or some kind of growth initiatives that could temper that maybe? Thank you.

William Chalmers
Thanks very much Alvaro. To give a bit of context on the structural hedge, during the second half of last year, the last quarter of last year we were looking at around £2.4 billion of income from the structural hedge, on a hedge that lasted around 5-6 years. And that is how we broke it down. The numbers are not precise but they give you a sense as to what we were looking at. When we look at the hedge today, we have £60 billion of maturities in 2021 and by virtue of the hedge management strategy that we have; we are able to take advantage of the rate curve when it steepens as well as step back through the rate curve when it is flat.

As we look at that today and the 400 we have given as an indication of the recent status for those balances that we have locked in. If the curve stays in the shape it is currently at, and if we are able to lock in fully the benefits of that rate curve, then we would expect some benefit above and beyond the £400 million indicated. On top of that there is the unutilised capacity of £25 billion as you highlighted in your total of 210, i.e. the difference between 185 and 210 and that would give us further upside as well. All of this depends on the rate curve staying where it is or considerably increasing. If it does stay where it is, we should be able to lock in more benefits and that in turn should give us a little upside to the £400 million that you have indicated.

The capital returns question, 13.5 per cent is and remains our capital target. We are not changing that capital target today. In terms of what the Board will choose to distribute at the end of the year, that will very much be a matter for the board at the time. And it will be clearly based upon the regulatory and macroeconomic situation and the outlook for capital generation over the course of the coming years. I think the core point here Alvaro is that we are not changing our capital target. As to what Charlie chooses when he is CEO obviously that will be a matter for discussion with Charlie at the time and I do not want to second guess that or pre-empt it in any sense, I will leave that for the day. But I do think it is safe to say that the Board has historically recognised and I have no doubt will continue to recognise the importance of income and capital return as a key part of our investor story. I would be very surprised if that fundamental tenant changes.

You asked briefly about M&A. The only comment I would make there is that our strategy is an organic strategy. Having said that, if M&A opportunities come along that adds strategic value or shareholder value in a way that is consistent with some of the tenants I set out in strategic review 2021 then of course we will look at it. We do not expect anything major in the near term, but things that make sense we will look at.

Alvaro Serrano
Thank you very much.

Question 4 – Ed Firth, KBW
Good morning everybody. In terms of the detail William, if I heard you correctly, if you look at the hedge run-off, the next three years sounds like substantially less than half of it is running off. Is that right and is that just because of the very long tail or because of the way you structured it? Does it then come quite lumpy after that? It doesn't sit quite square with the total of 2.4 and then the 400 and then materially less.

The other one was when you mentioned restructuring charges. Could you give us some sort of idea of what you mean by higher? Looking back over the years, there is a huge gap people refer to so it would be helpful to get some idea of that.

The final question is a slightly more longer-term one. If we look at 2021 it sounds to me like a reasonably normal year. Your provision charges sound like they are going to be pretty normal. Capital will be a little bit higher, but you still wanted the hedge to run off. So net is pretty normal and yet you're targeting a 5-7 per cent return. So I guess you are not happy with a 5-7 per cent return if people think of that as normal. But what are the big drivers that make that materially different over the next 2-3 years assuming the interest rates and environment stays roughly where it is? Thanks very much.

William Chalmers
Thanks Ed. On the hedge profile, it is a very fair question. Essentially the pressure is reduced in 2022, simply because 2022 has a large number of short maturities maturing. And so the income pressure in 2022 in particular is relatively modest. As a result, you see the profile that we have called out here, which is 2021 as I have just discussed. We then have a significantly lower headwind in the course of 2022 because it is predominantly short-term maturities that come up during that year. That number is likely to increase a little bit further in 2023 as some of the longer dated stuff comes up for maturity at that point.

The other point to bear in mind here is that over the course of the last year or so we have typically avoided investing in the short end of the curve, where frankly returns have just not been worth investing in. And investing a little bit more in the long end of the curve particularly in the second half of 2020. That is what has given rise to slightly longer weighted average life in the context of the hedge and a shape that is a little bit less even or more elongated than we would have discussed before.

Point two restructuring charges. I will not put a precise number on it but somewhat higher typically means 10-20 per cent. Is 2021 a normal year? I hope not. I think if you describe a normal year as being one where we have half the year in lockdown, I really hope that is not a normal year. There are couple of points I would make there. One is, when we do not have 50 per cent of the year in lockdown we would expect activity levels to benefit each of our three main business lines in a way that is proportionate to much higher levels of activity.

Second costs, costs remains imperative on a BAU basis. We think there are also Coronavirus related opportunities. Finally, it is also a strategic matter as our technology R&D describes. And so the cost focus is pretty relentless at Lloyds and it will continue to be so over the course of the coming years.

Finally, impairment. Through the cycle the impairment charge is typically 30, 35 basis points. In fact, I think it struggled to make those levels in the recent historical past and has typically been lower. All of those factors mean that I would see 2021 as a transitional year and definitely not a normal year.

Ed Firth
Great, thanks very much.

Question 5 – Andrew Coombs, Citi
Good morning, returning to capital return, there is no mention of buybacks at any point in your report today. Can you just remind us of your thought process on buybacks and dividends, where you stand on that debate. Attached to that question, the new pension contributions link to 30 per cent of capital return, can you confirm that is 30 per cent of dividends or a percent of dividends and buybacks?

My second question, on the £400 million management overlay, what would you need to see to be comfortable for a release in that overlay? Thank you.

William Chalmers
Thank you Andrew, again I will take those in order. On buybacks, as you know Lloyds has historically done buybacks and they remain an interesting tool at the disposal of the Board in situations of surplus capital. The point I would make is that the capital position of the bank as we discussed is exceptionally strong with and without regulatory assistance in the form of software or transitionals. There is also alongside of that a commitment to capital return at Board level, which as I mentioned before is enduring. It is clear what the stock price is today and off the back of that it is also clear what the benefits of buybacks might be. Then at that point, I have to say it is really up to the Board at the end of the year to look at the situation, with respect to the final part of the ordinary dividend, and any surplus capital return above and beyond that, that might be appropriate. As I said that will depend upon Macro, upon regulatory, on business performance clearly and the outlook at that point. The underlying point though is that the Board is committed to capital return. Buybacks are an interesting tool in the context of valuations that we are seeing today.

The pension commitment is 30 per cent of in-year capital return and if we did a buyback that would include buybacks as well as dividends. It is worth just adding a couple of comments perhaps on the pensions point. Why do we think this is an attractive structure? First, we think it is a fair distribution of excess capital between the companies various stakeholders. Second, it gives us the benefit of less stress capital and that is because essentially we have now got downside flexibility where our pension contributions are de-risked. We effectively will pay out £800 million if the business does not perform. We will only pay out in excess of that as a function of in-year capital contributions.

The final point I will make, is bear in mind the term in-year. So think about the 2021 capital distribution based on the in-year 2021 capital distributions to shareholders, as opposed to necessarily the final year dividend and do your numbers on that basis.

The overlay is an important topic Andrew and one that obviously we have spent a lot of time debating and considering within the firm.

The £400 million overlay is an offset to model releases that are otherwise generated by the experiences we have seen. The reason why we have done it, is because the IFRS9 model has a set of conditioning assumptions which are basically the input assumptions around vaccination progress, end of national lockdown, Government policy support and that sort of thing. It takes those set of assumptions and then shocks those and creates a distribution of outcomes around the central base case. That is a powerful model that produces outcomes that are reliable and something by which we set great store. Having said that it does not accommodate a change in those input assumptions. Now if the virus mutates or if the vaccine programme is exceptionally slow, which doesn't appear to be the case; at least with the latter. But if those happen, that constitutes a change in condition assumptions, which is what we are trying to capture with this £400 million uncertainty overlay that I have described. What that means in answer to your question is, as those uncertainties recede, i.e. the vaccination programme is successful today; let us hope it carries on that way. Or the virus mutations appear to be under control or to a degree lockdown experience differs from our expectations, then we are able to look at the £400 million again and figure out whether that uncertainty overlay is still appropriate at that point. But that is the timing and that is the evidence we need before we take it off.

António Horta-Osório
Andrew just to add a little bit to what William just said, you should put this into the context of what we have been doing over the years in terms of building a low risk bank and we have discussed this over the years several times. We want to build and I think we have built a low risk simple bank based on the real economy of the UK and you have seen the track record that we have in that regard relating to write-offs. We can go backwards a series of years and you will have seen sustainably that we have had write-backs after provisions have been made. Given our coverage levels and the level of asset growth, you should include this management overlay as William described, but you should also include it in the broader context that we want to build a prudent bank. IFRS9 expects you to have an average case and we think given the huge uncertainties we should be on the prudent side as we have been building this low risk simple bank.

Andrew Coombs
Thank you. I assume I will still get your company at the first quarter results on the 28th April?

William Chalmers
Yes and was that a question as to whether Antonio will be at the first quarter results?

António Horta-Osório
Yes I will be at quarter one results so you will still have to bear with me one more time.

Andrew Coombs
That is very good, we will save the farewells till then. Thank you both.

Question 6 – Chris Cant, Autonomous
Good morning, thank you for taking my questions. Two on numbers and one on cap gen please. Other income in the fourth quarter, you flag this negative one-off from the insurance changes. I think LDC in previous years has been about £300 million a year. You had £122 million there in the fourth quarter in isolation. So it looks to me like the clean Q4 annualised run-rate for other income is about £4.3 billion. Is that a fair assessment of where you're at the moment as we look into 2021 and think about the normalisation effects of activity?

Then on costs, you have £7.5 billion guidance despite £150 million allowance for Covid-19 and variable remuneration effects. I think your remuneration call in 2019 was north of £300 million. So are you expecting a further normalisation of remuneration to be a headwind to costs again in 2022?

Finally, on cap gen. The £7.2 billion actuarial deficit is going to be taking ongoing bites out of your capital generation, you flagged the headwinds you expect to come from the IFRS9 transitional unwind, you flagged the RWA base rate

effects that is coming in 2022. You used to talk about cap gen and you used to give guidance on that. What is your expectation for the level of cap gen in basis points going forward, relative to the 170 to 200 you used to guide us to expect? Thank you.

William Chalmers
Thanks Chris I will go through them in order. First of all OOI in 2021. You mentioned a couple of moving pieces in Q4 and you are absolutely right, we got a bit of benefit from LDC, we got a headwind from the assumptions review within insurance. On balance, the assumptions review within insurance was larger than the benefit from LDC and so that is the way I would look at it. I will not put precise numbers on that but in essence, the assumptions review headwind was bigger than the LBC benefit.

Looking at 2021 OOI, it is one of the few areas of our P&L that we do not give guidance on. So I am going to stay away from changing that. But I will give you a sense as to the run-rate. If you look at the run-rate, not just Q4 but also Q3 once you take account of asset management market review charges and one of two other things it is around £1.1 billion. Now that is in a Coronavirus lockdown situation and as I have said a number of times in the course of our calls, we do expect to see activity recover and benefit OOI. How much? I think it is safe to say that in 2020 we lost somewhere around £350-400 million by virtue of three-quarters of lockdown. Now if we see 2021 experience two quarters of lockdown, we would expect to get a lot of that £350-400 million back. The way that I would look at the run-rate for OOI is activity and investment dependent as we have outlined in SR21. Importantly look at it as 1.1 plus the circa £350-400 million of activity that we lost in a year that hopefully has a bit more activity in it than we saw in 2020.

Costs, the £7.5 billion guidance that we have given, does look at the costs taking account of the headwinds that we will be seeing from both variable remuneration and also Coronavirus related costs. The reason why your maths is not quite right is because variable remuneration is built in over a period of time even though it delivers better outcomes in the first year. That then leads to a lagging effect in terms of the building of that variable remuneration build taking place in the successive years.

Now at one level I do hope the variable remuneration does go up because it is linked to profitability within the firm. If we see improved RoTE and profitability in the firm that will be a good thing and it will benefit our employees.

Third, capital generation. There are a number of moving pieces within capital generation and that is part of the reason why we have stayed away from being too categoric. You will be familiar that the experiences in 2020 around this topic were prone to air and not just from ourselves frankly, but every bank that reported really. As we look into 2021 there are a couple of pieces that I think are worth looking at. Historically as your question points out, we have seen 170-200 basis points of capital generation in the pre-pandemic days that was associated with a low to mid-teens RoTE. This year our RoTE is roughly half that and we have about half of our dynamic transitionals rolling off. Now there are one or two other moving pieces going on, that are gives or takes in that equation, but nonetheless if you take account of those two things you will be at least in the right ballpark for 2021. 2022 I am not going to go into, we have given guidance for 2021 and not beyond. The building blocks that you have identified Chris around RWA movements and the remainder of the transitionals for example are the correct building blocks. Then you might add into that both asset growth and our continued RWA management.

Chris Cant
Thanks for that, that is really helpful. If I could just ask for clarification on your remarks on other income. On the £350-400 million, you're saying that was activity lost per quarter relative to pre-Covid levels. When I look back at Q3 and Q4 of 2019 both pre-Covid, both quite clean quarters you were around £1.2 or £1.3 billion, so if you see 1.1 in the second half was that £350-400 a quarterly comment, an annual comment or half-yearly comment, just wanted to clarify?

William Chalmers
Sorry Chris I should have been clearer. It is an annual comment but bear in mind that there are only three-quarters of lockdown so essentially, what I am trying to say is £350-400m was lost over the three-quarters during which we had lockdowns.

Chris Cant
Okay that is helpful thank you very much.

Question 7 – Aman Rakkar, Barclays
Morning gents. A couple of points for clarification on NIM. Could I pressure you for just one additional bit of detail in your mortgage application experience, I think you called out 190 basis points completion experience in Q4, which was in line with your prior applications comments. I was wondering what is your current applications experience, where is that completing and if you are able to give us some sense of what you have assumed in your NIM guidance for 2021 that would be great.

The next one was on hedge. I was thinking longer term. In terms of your hedge capacity from what the Bank of England is talking about, the historic excess savings inflow that we are seeing is set to take a big step higher in the first half of the year, albeit maybe we are opening up a bit sooner than the bank was talking about. You may very well see a significant positive inflow in H1. How should we think about that affecting your business, does that free up some additional hedge capacity for you or is it a pain by what it might mean in terms of some of your asset markets?

Another question on RoTE as well. The 5-7 per cent guidance you were giving for 2021, I guess that is a reasonable enough range. I think it applies an £800 million net profit range. I was interested in what you see that uncertainty as, is that around the impairment charge, other operating income? Thanks very much.

William Chalmers
Thank you Aman. First of all on NIM and mortgage applications. I mentioned earlier on that we have seen very favourable mortgage pricing and hence the activity that we have undertaken in that market. The completed mortgage margins that we have been doing, the circa 190 as mentioned in my comments earlier on, there has been a little bit of softness in that recently and I wouldn't want to overstate it, but essentially what has been happening is that five year swap rates have been going up and pricing has not been keeping pace. So you are seeing a little bit of compression in that mortgage margin. The important point is there are still very attractive levels from both a historic and return on equity perspective. So that gives you a bit of guidance there.

In terms of what we assume. We have assumed the gradual softening in mortgage margins over the course of the year both as a function of some of the cyclical factors, eg the stamp duty ending. And to a degree we expect that demand to be significant in the first half, and still there but dampening down in the course of the second half and that then is aligned with our pricing assumptions for mortgages.

On hedge capacity, it is a good point. We increased our hedge capacity this year as I mentioned in my comments earlier on. But importantly of the £25 billion increase that we took, £11 billion of that was from reclassification of our commercial deposits, which is essentially just trying to manage the existing business that we have in a smarter way and make those deposits more stable and therefore more eligible for the hedge. Of that £25 billion increase, £11 billion of that was commercial and not related to the deposit inflows that we saw. The £14 billion was, but contrast that to £40 billion of deposit inflows that we saw during the year and there is still quite a bit of gap that we have not taken into account for our hedge capacity. At the moment, we are just trying to figure out how that develops over the course of 2021 and we are keeping it on short dated investment, so that if there is a customer reaction we are able to respond to that. We do not necessarily expect it as we think many of those balances are here with us to stay, but we are not banking it at the moment.

The turnaround for that is clearly if they do end up staying and we do end up in this environment where customers have greater proportionate balances than in the past, that will then have implications for our overall hedge capacity and we will look at that as we gather more evidence over the course of 2021.

RoTE as you say is a 200 basis point gap between 5-7 per cent and that is deliberate. It is deliberate because we are clearly still in a highly uncertain environment. I will highlight two moving pieces that might move us around within that gap. One is activity and we do not yet know whether the Government plans will be held to target, we sincerely hope they will and the vaccine programme is testimony to their potential success there. But there is a degree of caution around the speed at which customer activity resumes. If we get more customer activity we will be at the upper end if we get less we will be at lower end.

The second is clearly impairments. As we discussed we are very well provisioned for the uncertainties that lie ahead. We have our ECL modelling, we have where we think the ECL modelling has come up short because of the unusual circumstances that we are in. We have put in place management judgements on top of that as you can see in our disclosures. That puts us in a very strongly provisioned position. If it turns out that the macroeconomics do not unfold in the way we have predicted then you would expect to see some implications for our impairments line and releases associated with that.

Aman Rakkar
Okay, thanks William

Question 8 – Jonathan Pierce, Numis
Good morning, thanks for taking the questions. One for the models please, the share count was up 786 million last year but obviously, some changes last year on the staff bonus that you pointed out. Do you have a sense as to what you expect the share count to go up by this year please?

I was wondering if you could give us a little bit more help on the RWA in 2022 because it sounds from what you are saying that £10-12 billion is possibly coming in 2022. I missed whether you said some of that was credit migration, or whether you were not expecting much credit migration. If you could give us a slightly better sense of the components like, best estimate, expected loss, mortgage risk weight those sorts of things?

Finally, could you give us a sense as to why the pension deficit hasn't budged at all in three years? I understand the comments on RPI but there has been some quite big contributions going in over that period and asset performance would have been expected to take the deficit down as well. So what has happened there please?

William Chalmers
Happy to deal with each of those Jonathan, I might slightly defer your first one for fear of getting too precise. The share count might increase a nudge more in 2021 versus 2020 off the back of employee compensation schemes. But I will defer that to the IR team.

Second, RWAs, there is a number of moving pieces in 2022 as I mentioned. The bottom line is we know consensus is around 215 and roughly speaking we are okay with that, pending the resolution of a number of regulatory uncertainties that are out there today.

In terms of the moving pieces I won't be too precise, safe to say that we have a chunk of headwinds from a combination of CRR-II, mortgage floors, in particular the individual mortgage floors and then finally CRD-IV, things around the mortgage model, definition of default for example, hybrid models being introduced and one or two other retail bits and pieces. Those in total lead to regulatory headwinds, which are there and are worth pointing out. Then we have on the other hand RWA management and asset growth and those two factors roughly speaking cancel each other out. Therefore, that gives you some idea.

Credit migration as we see it right now, is predominantly a 2021 phenomenon so by the time we get to 2022 there is not an awful lot of credit migration left. But obviously we have to see how all of that fares. And so one of the reasons we are not being too precise today is because there are not only regulatory uncertainties in the outcome for 2022, but also macroeconomic uncertainties. As those diminish we will be able to give you more precise guidance.

One further point I will make on RWAs which is sometimes asked of us, is what the impact of Basel 3.1 might be in the near term. Again, I am not going to be precise on this, but I will say that when we get to 2023 we do not see much impact from Basel 3.1 in the near term. In fact, it is relatively benign for us and the reason for that is because we are on a Foundation-IRB approach within commercial from which we get a significant benefit. I point that out because it is a feature of the position that we are in.

Finally, you mentioned pension deficit Jonathan. The pension deficit at its core has gone down since the last triennial. What has gone up is the RPI, CPI convergence, which has added about £1.7 billion to the overall pension deficit. So you are not seeing a reduction in the total number, because you have the core benefit that is reducing and has reduced to about £5.6bn offset by the RPI convergence with CPI which for us matters because we have a mismatch in assets and liabilities on RPI and CPI and as RPI converges that costs the pension deficit. So hopefully that give you some of the detail that you need Jonathan.

Jonathan Pierce
Yeah that is really helpful. Thanks for all that.

William Chalmers
I think that was the last question so I just want to say thank you to everybody for joining today and we will look forward to the conversations over the coming days. Thank you for joining.

FORWARD LOOKING STATEMENTS

This document contains certain forward looking statements within the meaning of Section 21E of the US Securities Exchange Act of 1934, as amended, and section 27A of the US Securities Act of 1933, as amended, with respect to the business, strategy, plans and/or results of Lloyds Banking Group plc together with its subsidiaries (the Group) and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about the Group's or its directors' and/ or management's beliefs and expectations, are forward looking statements. Words such as 'believes', 'achieves', 'anticipates', 'estimates', 'expects', 'targets', 'should', 'intends', 'aims', 'projects', 'plans', 'potential', 'will', 'would', 'could', 'considered', 'likely', 'may', 'seek', 'estimate' and variations of these words and similar future or conditional expressions are intended to identify forward looking statements but are not the exclusive means of identifying such statements. Examples of such forward looking statements include, but are not limited to, statements or guidance relating to: projections or expectations of the Group's future financial position including profit attributable to shareholders, provisions, economic profit, dividends, capital structure, portfolios, net interest margin, capital ratios, liquidity, risk-weighted assets (RWAs), expenditures or any other financial items or ratios; litigation, regulatory and governmental investigations; the Group's future financial performance; the level and extent of future impairments and write-downs; statements of plans, objectives or goals of the Group or its management including in respect of statements about the future business and economic environments in the UK and elsewhere including, but not limited to, future trends in interest rates, foreign exchange rates, credit and equity market levels and demographic developments; statements about competition, regulation, disposals and consolidation or technological developments in the financial services industry; and statements of assumptions underlying such statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will or may occur in the future. Factors that could cause actual business, strategy, plans and/or results (including but not limited to the payment of dividends) to differ materially from forward looking statements made by the Group or on its behalf include, but are not limited to: general economic and business conditions in the UK and internationally; market related trends and developments; fluctuations in interest rates, inflation, exchange rates, stock markets and currencies; any impact of the transition from IBORs to alternative reference rates; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the Group's credit ratings; the ability to derive cost savings and other benefits including, but without limitation as a result of any acquisitions, disposals and other strategic transactions; the ability to achieve strategic objectives; the Group's ESG targets and/or commitments; changing customer behaviour including consumer spending, saving and borrowing habits; changes to borrower or counterparty credit quality impacting the recoverability and value of balance sheet assets; concentration of financial exposure; management and monitoring of conduct risk; exposure to counterparty risk (including but not limited to third parties conducting illegal activities without the Group's knowledge); instability in the global financial markets, including Eurozone instability, instability as a result of uncertainty surrounding the exit by the UK from the European Union (EU), the EU-UK Trade and Cooperation Agreement, and as a result of such exit and the potential for other countries to exit the EU or the Eurozone and the impact of any sovereign credit rating downgrade or other sovereign financial issues; political instability including as a result of any UK general election and any further possible referendum on Scottish independence; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; natural, pandemic (including but not limited to the COVID-19 pandemic) and other disasters, adverse weather and similar contingencies outside the Group's control; inadequate or failed internal or external processes or systems; acts of war, other acts of hostility, terrorist acts and responses to those acts, or other such events; geopolitical unpredictability; risks relating to climate change; changes in laws, regulations, practices and accounting standards or taxation, including as a result of the UK's exit from the EU; changes to regulatory capital or liquidity requirements (including regulatory measures to restrict distributions to address potential capital and liquidity stress) and similar contingencies outside the Group's control; the policies, decisions and actions of governmental or regulatory authorities or courts in the UK, the EU, the US or elsewhere including the implementation and interpretation of key laws, legislation and regulation together with any resulting impact on the future structure of the Group; the ability to attract and retain senior management and other employees and meet its diversity objectives; actions or omissions by the Group's directors, management or employees including industrial action; changes to the Group's post-retirement defined benefit scheme obligations; the extent of any future impairment charges or write-downs caused by, but not limited to, depressed asset valuations, market disruptions and illiquid markets; the value and effectiveness of any credit protection purchased by the Group; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors, including non-bank financial services, lending companies and digital innovators and disruptive technologies; and exposure to regulatory or competition scrutiny, legal, regulatory or competition proceedings, investigations or complaints. Please refer to the latest Annual Report on Form 20-F filed by Lloyds Banking Group plc with the US Securities and Exchange Commission for a discussion of certain factors and risks. Lloyds Banking Group may also make or disclose written and/or oral forward looking statements in reports filed with or furnished to the US Securities and Exchange Commission, Lloyds Banking Group annual reviews, half-year announcements, proxy statements, offering circulars, prospectuses, press releases and other written materials and in oral statements made by the directors, officers or employees of Lloyds Banking Group to third parties, including financial analysts. Except as required by any applicable law or regulation, the forward looking statements contained in this document are made as of today's date, and the Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward looking statements contained in this document to reflect any change in the Group's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. The information, statements and opinions contained in this document do not constitute a public offer under any applicable law or an offer to sell any securities or financial instruments or any advice or recommendation with respect to such securities or financial instruments.