LLOYDS BANKING GROUP PLC – Q12020 INTERIM MANAGEMENT STATEMENT – TRANSCRIPT
(amended in places to improve readability only)

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LBG PRESENTERS:
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António Horta-Osório
Good morning everyone and thank you for joining our Q1 presentation. In light of the coronavirus outbreak and the exceptional circumstances that we find ourselves in, I thought I would give a brief overview of how we are supporting our customers and colleagues in these difficult times, supported by our balance sheet strength and multi-channel distribution model.

But first I would like to express my gratitude to my colleagues across the Group, who have shown exemplary dedication and professionalism, often in response to near-impossible demands. I know that many of my colleagues will be anxious about the health of loved ones and the impact of coronavirus on their communities, but they remain focused on serving our customers every day. I therefore want to thank each of them for the remarkable contributions they are making to this national effort at work, at home and in their communities. With their support, we are also committed to helping our customers manage through this crisis.

None of us can be certain how long and how severe the impacts of this pandemic will be, but we must recognise that our support for customers is already, and will continue, to impact our profitability and capital build. I will outline some of these measures in a moment, but as a responsible business we recognise that it is the right thing to do in supporting our customers and helping Britain return to prosperity. However, I am confident that the strength of our balance sheet and our resilient business model mean we are well placed to underwrite these commitments and play our part in helping Britain recover from this crisis.

I will summarise some of the measures we are implementing and I will then hand over to William who will run through the financials before we open up for questions at the end.

I will start in slide 2 by looking at how we are supporting customers and colleagues through this unprecedented social and economic challenge.

Coronavirus is having a significant impact on people and businesses in the UK, and around the world. Our core purpose is to Help Britain Prosper, and this is now more important than ever before. We fully recognise that shareholders, as well as our customers, will judge us by how we live up to that mission.

We are treating our retail customers flexibly and sensitively, including granting around 880 thousand payment holidays to date, while implementing dedicated support channels within just 2 weeks of the start of the lockdown for our elderly customers and those customers who are doing such a wonderful job for the NHS.

We also remain focused on how we can support our colleagues and communities. This includes suspending all headcount reduction programmes while committing to pay all of our staff, in full, regardless of how their work has been impacted. This is important as it removes uncertainty for our colleagues and leaves them free to focus on supporting our customers and serving their communities.

We have also enhanced our financial support for our charitable partners and the Group's independent charitable Foundations. I believe it is vital to further increase the support we give to mental health charities in these challenging times.

As mentioned, we remain fully focused on supporting our customers and our operational resilience is a key element of our ability to do this. Around 90 per cent of our branch network remains open and, importantly, our digital banking proposition has remained fully operational throughout the lockdown, despite the significantly increased registrations and daily logins we have seen.

We also have around 45 thousand colleagues working from home, having increased it from around 15 thousand, within just three weeks. I will now turn to slide 3 and look at how we are actively supporting our customers.

We have further enhanced our support for customers, including through the various Government initiatives which have been put into place over the last few weeks. We have granted around 400 thousand mortgage holidays to date, helping customers through short-term financial difficulties. We have also granted payment holidays across our other retail lines, while increasing the limit for contactless card spend to £45 and giving our customers interest-free overdrafts of up to £500.

Insurance and Wealth has also adopted payment holidays, whilst implementing a simplified claims process, ensuring that customers have their claims paid sooner and reducing the strain the process places on the NHS.

Our commercial businesses have supported clients with around 37 thousand overdrafts, capital repayment holidays and deferred payments, all backed by our £2 billion Covid-19 fund for SMEs and Mid Corporates.

As I mentioned previously, we are fully behind the Government's various schemes and have worked closely with the Government to make them work. Lending under these schemes will involve extending our risk appetite during the crisis and despite the protection offered by Government guarantees, there will inevitably be some additional losses in due course.

At the end of last week we had approved over £400 million in CBILS loans and this has already increased to over £500 million at the close of business yesterday. Our CLBILS proposition is also now fully operational and we have registered as a Commercial Paper dealer so we can support our larger clients to access the CCFF.

The Government and the Bank of England have both acted swiftly and decisively, and their actions will help to mitigate the impact of the crisis. However, there is also an important role for all of the banks to play and we are committed to putting the Group's full strength to work in support of the UK economy. By doing this, we will help to reduce the negative impact on the UK economy and speed the recovery. I will now turn to slide 4 and look briefly at the economy.

As I said in my introduction, there is significant uncertainty ahead and the outlook is challenging, although the final impact on the economy will depend on the severity and duration of the economic shock. Economic forecasts have recently turned sharply negative. In finalising our results at the end of March we assumed a base case for GDP of minus 5 per cent in 2020 with a recovery beginning in 2021, although we have to recognise that the outlook may deteriorate over the coming quarter.

We have also seen customer activity fall significantly since the end of February and William will talk about the impact that this has had on our financials. As William will explain, alongside our central assumptions we are, as previously, also providing our current estimates of how we might be impacted in a more adverse scenario.

Clearly, given the lower activity levels and the significant change in the rate environment, among other factors, the operating environment is now very different to when we reported in February, and our previous guidance is no longer appropriate. The outlook is likely to remain uncertain for some time and we will update the market once there is greater clarity.

However, as I have said, despite the challenging outlook, we are well placed to play our part and I will now turn to slide 5 and look at how our strengths and capabilities will enable us to support the UK's recovery.

The Group benefits from several core competitive strengths including, as you have heard me explain many times, our prudent approach to risk, our capital strength, our market-leading-efficiency and our multi-channel distribution model. Together, these strengths mean that we face into this period of uncertainty with continued confidence in our financial resilience. Our prudent approach to lending supports our low risk balance sheet, which has seen no net loan growth over the last 10 years and over 80 per cent of the Group's total lending is now secured.

Although the economic outlook is uncertain and impairment will inevitably be impacted, our strong balance sheet is benefitting from our prudent approach to lending. We have a clear strategic focus on prime UK retail business, which includes over 75 per cent of our loan portfolio. Our commercial portfolio includes around 35 per cent exposure to SME and Mid Corporates clients, which is over 80 per cent secured. Importantly, we have limited exposure to the most at-risk sectors of the economy at this stage, and William will give you more details on this shortly.

Our liquidity and funding position remains strong, including no net wholesale debt. The loan to deposit ratio has reduced further as a result of strong deposit inflows across both individual and corporate customers to our trusted brands, more than offsetting the increase in our loan book over the quarter.

On capital, our CET1 ratio of 14.2 per cent means that we have significant resources available to support our customers, especially after the reduction in the UK Countercyclical Capital Buffer.

I have talked to you many times about our relentless focus on efficiency, and this will now give us even greater capacity to support our customers and to absorb additional costs associated with the coronavirus outbreak, such as enhancing home-working capabilities.

Finally, our multi-channel distribution model includes the UK's leading digital bank, and this is playing a vital role in continuing to serve customers throughout the lockdown. We have gained 217 thousand additional digital users since the end of March alone, including 33 per cent of new registrations from customers over 60 years old, up from around 13 per cent previously.

It is these strengths that will form the core of our response to this crisis. Coronavirus represents an unprecedented challenge for the Group, and the whole of the UK, and we will be tested over the weeks and months ahead. However I have great confidence in the resilience of our business model, the strength of our balance sheet and most importantly the professionalism of our staff.

I will now hand over to William who will run through the financials in more detail.

William Chalmers

Thank you António, and good morning everyone. I am going to give an overview of the Group's financial performance in Q1. After a decent beginning, in the first quarter we have started to see the emerging economic impact of the coronavirus crisis. We are well placed to face an uncertain future, but this will of course impact our performance going forward.

Turning first to slide 7, I have a summary of the financials. Pre-provision operating profit of £2.0 billion is down 19 per cent on the prior year. Supported by a net interest margin of 279 basis points and a continued focus on costs, pre-provision operating profits were solid. However, statutory profit before tax of £74 million and the return on tangible equity of 5.0 per cent were both heavily impacted by the impairment charge of £1.4 billion in the quarter.

The results also include £387 million of negative below the line insurance volatility, relating to the exceptional market movements we saw in the quarter. This stems predominantly from falling equity prices and rising credit spreads. It is worth noting that this volatility is market-led and we have seen some of it reverse in April, but it is clearly too soon to make a call on Q2.

TNAV per share of 57.4 pence is up 6.6 pence in the quarter, including 4.9 pence of support from the increased net surplus in the Group's defined benefit pension schemes. This is again, driven by widening credit spreads and has also seen some initial reversal in April.

As you have heard, the balance sheet remains strong. The loan to deposit ratio has reduced to 103 per cent as strong corporate loan growth has been more than offset by deposit inflows, largely from those same corporate clients.

We have also completed £6.9 billion of wholesale funding year to date. Alongside the Term Funding Scheme, this means we now have only a small residual funding requirement in 2020.

Our capital build has clearly been impacted by the statutory performance in the quarter and the limited RWA increase. However, benefitting from the 83 basis points from cancelling the 2019 dividend, the CET1 ratio is now very strong, having increased to 14.2 per cent. I will now turn to pre-provision profit on slide 8.

Net income is down 11 per cent, impacted by the exceptionally low rate environment and a slowdown across all of our key markets, both of which we expect to continue in Q2.

The net interest margin is down 12 basis points on prior year, at 279 basis points. We expect to see the full impact of these lower base rates, changes in balance sheet mix and fee forbearance landing in Q2.

Other income in the quarter was £1.2 billion. Post the coronavirus outbreak, this was impacted by lower activity levels across the Group, as well as a market-led write-down in the assets of Lloyds Development Capital and the Business Growth Fund of approximately £100 million.

We will maintain our focus on costs and indeed, will absorb additional coronavirus-related expenses in 2020 while continuing to see absolute costs reduce. That said, I should stress that this benefit will of course be significantly outweighed by the revenue headwinds that we are anticipating.

Turning now to slide 9 and the impairment charge in a little more detail. The total impairment charge of £1.4 billion reflects our updated economic assumptions, as well as the impact of coronavirus-related disruption on existing restructuring cases.

As you can see, the underlying impairment charge of £368 million in the first quarter is higher than last year, but this comparison is impacted by the very low commercial net charge in Q1 2019. Indeed underlying credit quality we are actually seeing in the first quarter remains robust.

Our IFRS 9 economic scenarios they have deteriorated significantly and drive the £844 million forward looking modelled charge you can see on the slide.

As you know, we run multiple economic scenarios around a base case and have maintained the probability-weightings on our four cases. The severe downside, to which we attribute a 10 per cent weighting, now generates an expected credit loss of over £7.0 billion, a pick-up of £2.1 billion compared to the base case.

Although consensus is expecting a V-shaped recession, in our base case we have prudently assumed that GDP grows by only 3 per cent in 2021. We have also assumed that house prices fall 5 per cent in 2020 and unemployment stays above 5 per cent in both 2020 and 2021 and rises much higher in Q2 2020, in particular. These are all important points to consider when you look at the expected losses that we model under IFRS 9. Together, this means that our stock of ECLs now stands at £5.2 billion, a cushion that is over £1 billion higher than at the year end.

The charges taken in Q1 are based on our analysis at the quarter end and our view of the economic situation at that point as we look forward. Clearly the economic situation remains very fluid and uncertain and it is possible that there will be changes to our outlook in the coming quarters.

As António mentioned, in the current economic situation it is inevitable that both the existing book and our new lending will be impacted, though this will be partially offset by Government guarantees. The extent of the final impact however, will depend upon the severity and duration of the shock and how economic data and behaviours evolve.

Looking at slide 10. The Group's balance sheet is well positioned for the current environment, given the Group's prudent approach to lending and the clear strategic focus on prime, UK secured lending.

Secured lending, as António said, makes-up over 80 per cent of the Group's balance sheet, with £310 billion in Retail and £30 billion in SME and Mid Corporates. The rest of the loan book comprises our prime UK consumer portfolio and our prudent exposure to UK Large Corporates.

Looking at the AQRs by division, they have increased significantly on the prior year although, as with the total P&L charge, this is predominantly driven by the forward looking ECL uplift associated with the worsening economic outlook.

At an underlying level, the total AQR of 33 basis points and the write-offs of £393 million are both in line with our through-the-cycle expectations and evidence the Group's underlying credit quality.

Again, we will not be immune from loan losses in the coming cycle, but we do start from a good place. Let me now turn to the strength of the portfolios, starting with the Retail book on slide 11.

Retail, as you know, has a deliberate focus on high quality mortgages with an average loan to value of 44 per cent and 9 tenths of the book with an LTV below 80 per cent. As you will be aware, our 2006 to 2008 vintage mortgage book drives out-sized losses in the Bank of England's annual stress testing exercise, but this portfolio is reducing at around 12 per cent per year. In addition much of this portfolio originally had LTVs over 100 per cent, but the average is now slightly below the rest of the mortgage book at 43 per cent, while over 9 tenths of these loans have an LTV below 80 per cent.

More generally, we have seen significant interest in repayment holidays from mortgage customers, and have granted around 400 thousand to date. The average LTV of these customers is about 50 per cent and there is no particular correlation to vintage.

Our prime credit card book has seen limited draw downs with balances down 6 per cent since the year end, largely driven by the over 20 per cent reduction in customers' credit card spending levels in March. We currently have around 220 thousand customers benefitting from payment holidays, having introduced them in April.

Finally, our motor finance book is predominantly secured and subject to risk-based pricing assumptions and residual value provisioning. Having said that, there are uncertainties given the used car market is effectively closed right now.

So to turn to Commercial Banking on slide 12. The commercial portfolio benefits from a diverse client base and sector caps and limits across the book. The significant de-risking undertaken in recent years means that around 75 per cent of exposure is to investment grade clients. We have limited exposure to riskier sectors, including only £2 billion to leveraged finance and low average LTVs in our commercial real estate book.

Less than 3 per cent of Group lending is to the sectors seeing the greatest impact from coronavirus and the associated lockdown and we are working closely with those affected clients. We saw around £8 billion being drawn on revolving credit facilities and other Corporate and Institutional facilities in March. This drawdown was more than matched by commercial deposits as clients sought to preserve liquidity. We will continue to work with clients to understand their needs, though it is interesting to note that RCF drawings have slowed significantly in April.

Alongside this, while lending balances in Commercial Banking have increased by £5.3 billion in the quarter, RWAs have increased by much less. This is because undrawn facilities are already risk-weighted at 75 per cent of the level of the drawn balance.

As António mentioned, we are enthusiastic participants in the Government-sponsored lending schemes as we believe that the schemes are of the utmost importance to large sections of society. There will inevitably be some losses from these schemes in coming periods, although the final amount will depend upon the severity and duration of the economic shock.

Let me move on to slide 13 to look at liquidity, funding and capital in a little more detail. The loan to deposit ratio reduced to 103 per cent as a result of the flight to safety we have seen within commercial deposits, as I mentioned earlier. We have also taken an opportunistic approach to wholesale funding as the markets have remained open for us. We have completed nearly £7 billion of funding to date across the HoldCo and OpCos since the year end.

Given our funding to date and our access to the new Term Funding Scheme for SMEs, which we estimate to be up to £39 billion, we will now have only a small residual funding requirement in 2020.

On capital, our CET1 ratio of 14.2 per cent is comfortably above our requirements, particularly since the reduction in the UK Countercyclical Buffer to zero. The headroom over the current requirements of 11.3 per cent, of nearly 300 basis points, or £6 billion, plus our solid pre-provision profitability that I mentioned earlier on, gives us significant capacity to absorb potential credit risk while continuing to lend in support of the real economy.

As I mentioned a moment ago, we have seen limited risk-weighted asset expansion in the quarter. RWAs are up £6billion, of which £2.3 billion is due to the previously-flagged securitisation rule changes in January of Q1, while a further £2 billion relates to currency and CVA.

Our stance on Large Corporate lending means that we have so far seen very limited ratings migration, although clearly there may be some further impact in future quarters.

And finally, to turn to slide 14. In conclusion, the UK faces an uncertain outlook. However we remain absolutely focused on supporting our customers, whilst protecting our colleagues and remaining present in communities across the UK.

Our multi-channel distribution model, with the UK's leading digital bank, is enabling the Group to continue to serve customers throughout the lockdown.

Our efficient low risk business model and enhanced capital strength give us even greater capacity to absorb potential impairments while continuing to support our customers.

Looking forward, we will come through this crisis together. In the meantime we are learning a lot. During and after the crisis, we will further build on our connectivity with customers, adapt our product range and continue to build the Group's strategic cost advantage through new ways of working.

We will, of course, be tested but I have every confidence in the strength of our business and the dedication of our colleagues. And with this, we will maintain our focus on supporting customers and the UK economy.

That concludes the presentations for this morning. Thank you for listening. António and I are now ready to take your questions so I will hand back to the operator. Thank you.

Question and Answer Session

Question 1 – Joe Dickerson, Jefferies

Thank you for taking my question. Is the way to dimension the downside on impairments just to take the severe scenario and then add a remaining quarterly run rate, call it a couple of hundred to a couple of hundred and fifty million a quarter over three-quarters, and think about that as the downside of a range, assuming some sort of recovery in the back end of the year?

Then secondly on the roughly two billion credit allowance on Other Retail, can you give some colour on how much of that is allocated towards the card book versus other portfolios? Thanks.

William Chalmers

Thank you Joe, I will take your questions in turn. Maybe just to start off and give you some context on the IFRS 9 charge that we have taken. The IFRS 9 charge is by design a forward looking charge. The charge of £1.43 billion that we have taken this quarter is predicated upon three inputs. One is the underlying charge which as you know is £368 million. Second is for restructuring cases that have been blown somewhat off course by Coronavirus related difficulties, which is £218 million. And the third is the modelled forward-looking charge which is £844 million. So the total charge is a combination of those three, the last of which is forward looking.

By definition and by design as I said earlier on it is a front loaded charge. So as we look forward there are two factors that we need to pay attention to. One is whether the economics change and whether our base case changes with it. And clearly if it does then you will see that forward looking charge be modified accordingly. And the second is the absence of perfect foresight. When we look forward we don't have perfect foresight about what will happen to our restructuring cases for example, about what will happen to our Stage one cases for example; including the payment holidays. And about the success or otherwise of Government schemes that we see. So as we look forward to Q2, Q3, Q4, I am not going to give you a precise number but I will say that the IFRS 9 charge again is by design front loaded. I would not suggest that you annualise that charge. And then as we look forward to Q2, Q3, Q4 we will have to take both the economic factors and the absence of perfect foresight point into account.

On your second question as to unsecured. The charge today has a component that is related to Retail which is close to £900 million and a component that is related to Commercial Banking which is about £550 million. If you look at that spread in the Retail charge today, much of that, probably two-thirds to three-quarters of that is around the unsecured book. And that is not surprising because the unsecured book is likely to be first hit by unemployment, whereas the secured business, as long as we see some sort of recovery in the context of 2021, should be proportionately less hit. So I hope that gives you a sense as to the elements of the unsecured and secured in our overall Retail component Joe.

Question 2 – Aman Rakkar, Barclays Capital

Morning guys. Thanks for taking my questions. I have three please. First was on capital, 14.2 per cent CET1 ratio, I was just interested in how much IFRS9 transitional relief you may have benefited from in Q1? And to that effect are you able to disclose a proper fully loaded IFRS9 CETI ratio? That would be the first one.

The second, thanks for the disclosure on ECL coverage. Forgive me if I have looked at the wrong place, but I haven't been able to find it. I was wondering if you have told anywhere what your coverage is on Stage 2 loans? That would be really helpful.

And I guess the third is a kind of follow-on to the prior question about the ECL charge. Just about how likely you think you are to take that additional £2.1 billion charge that you have laid out on Slide 9, if the downside scenario were to manifest. I totally appreciate the comments that you are not thinking about a V-shape recovery in 2021, but I guess when you do look at things like your assumption around unemployment, you could argue it looks a little less conservative than perhaps what we have seen at some of the other banks. There was a bank that reported a base case which looks fairly similar to what your downside scenario is for unemployment which would suggest there is a pretty decent chance that perhaps we could get that charge in Q2. Do you think that is a fair observation? I would be interested in your thoughts on that.

William Chalmers

Thank you. I will address your first point last because it is an important point. When you look at our economic assumptions, it is important to take into account both the assumptions in year 2020, but also the assumptions in year 2021 because both are very important drivers of the IFRS 9 impairment charge that we take. I am obviously not going to comment on other banks, but if you compare them to the outside world, it is very important to take each of those two years into account. Both the deterioration in 2020 and the pace of the recovery in 2021 and look at that on a net basis. I will also add that if you look at our base case, while we have got a 5 per cent GDP down year on year average in 2020, within the year there are significantly worse outcomes. So Q2 GDP for example is 7.4 per cent down. HPI and unemployment similarly are down below the averages stated in the numbers that we have given today. So look within the year for comparative purposes.

Then I would also add to that the weightings. We have weightings in our MES which are 30 per cent base case, 30 per cent for downside case and 10 per cent for severe downside case. And each of that downside case and severe downside case have some pretty pessimistic assumptions built in them. So severe for example has 7.8 per cent down year on year, 2020 GDP. And within that has 11 per cent down within Q2. We are taking a weighting for that within our overall MES charge. So it is important when you look at our charge and you look at the assumptions on which it is based, you take into account not just the base case projections but also the downside and the severe downside because that is what is informing our charge.

There are a couple of points there which hopefully are helpful. Again maybe just to finish off on that, don't just look at GDP, look at HPI as well and look at unemployment. And again build that into your comparison.

To come back onto one or two of your other points there. The first of your questions capital. The IFRS 9 incremental benefit that we took in the first quarter was about 3 to 5 basis points or so. The IFRS 9 component of our overall CET1 element is not terribly much, it is about 20 to 30 basis points. But as you know it is diminished in 2020 down to 70 per cent and it is expected to diminish further in 2021 down to 50 per cent in accordance with regulatory guidance to phase out reliance upon transitionals.

And finally Stage 2 coverage. The way in which we construct the MES modelling is we do it from a bottom up basis at all times with an overlay approach. That overlay approach during the quarters do not change Stage 2, does not change Stage 3, rather the progressional deterioration I should say of loans into Stage 1, Stage 2, Stage 3 is assumed within our overall £1.43 billion impairment charge. So we don't as a result disclose to you the Stage 2 and the Stage 3 numbers, the deterioration of the asset is assumed and built up within our overall charge.

Aman Rakkar
Okay, thanks for that. One quick follow-up. So if you were to take the £2 billion top up in Q2 from the macro economic assumptions, would you expect significant IFRS 9 transitional benefit with regards to capital on that £2 billion?

William Chalmers
Yeah again I think the first thing to say is when you look at our assumptions within IFRS 9, please pay attention to the earlier points around the base case, the downside case, the severe case. Please pay attention to the fact that the IFRS 9 charge is deliberately front loaded by design so again do not annualise it on a quarterly basis. So when you are reflecting on that point I would just draw a bit of caution to the way in which you reflect upon it. As of Q2, if we see a deterioration in our economic base case and if we see any kind of impairment changes to that, then needless to say that will impact upon our ability to take advantage of transitionals. But as said we are only very modestly reliant on them right now and it will be phased out according to the plans that are currently applicable as or partly phased out as of 2020 moving into 2021. I hope that answers your question.

Question 3 – Raul Sinha, JP Morgan
Good morning António, good morning William. If I could have a few questions, starting on the guidance. I appreciate that there is a lot that is unknown in terms of the outlook, but I was wondering if you might be able to help us on the drivers for both the Net Interest Income as you see and Other Income as we head into the second quarter? And in particular if you could draw within net interest income, is the sensitivity to interest rates going to increase as liability rates hit the lower bound? And so then could you update your sensitivity if there is any change in terms of what you have talked to us about previously?

And then on the Other Income line, if you could address the impact of the High Cost of Credit review as well as the impact of the measures, the relief you are providing to your customers such as free overdrafts, how much of that is going to impact the Other Income in the second quarter and perhaps the run-rate? That would be really helpful.

William Chalmers
Thank you Raul, a lot of questions there, but I will do my best to answer each of them. The first point on guidance. Our approach on guidance is that we can give you a picture as to how the business operates in a lockdown environment. But we can't give you a picture as to how long this crisis is going to last. And so we deliberately stepped away from giving you full year guidance, but we are happy to comment on how the business is operating in the current lockdown scenario. So hopefully that can allow you then to make a judgement as to how long you think the crisis is going to last and plug in whatever numbers you would like to from that basis.

So just to give some context to your questions Raul. The net interest income point first of all. Net interest income ended up in Q1 as 2.79 per cent. That did not include much of an impact from all of the various coronavirus related disruption that we have seen including the base rate change. It was in evidence in the last couple of weeks in March, but obviously the weighting of that in the overall Q1 results was not significant. As we look forward, there are a couple of different things going on in net interest income. First of all the rates change. We have moved from 75 basis points to 10 basis points. In doing so we have experienced liability related floors. We have also reduced the ability for the structural hedge reinvestment to make us money. That in turn is sensitised in the annual report as you are aware. So we see in the annual report parallel shift to 25 basis points costing us £150 million, parallel shift of 100 basis points costing us £700 million. I would stress that is not a linear relationship. So by the time you get to a 65 basis point cut you have already absorbed most of that hit. So that is one piece going on.

The second piece going on is mix change. You have got mix change here whereby Retail unsecured balances are lower. You have got mix change here whereby the new mortgage market is largely closed. And as you know from the year-end discussion, we were experiencing new mortgages coming on at more favourable prices relative to the old mortgages that they were replacing.

And then finally we have got a mix change going on which is around the commercial bank and the drawing down of our RCF portfolios which is dilutive to margin. So that is the second area.

The third area, interest free overdrafts. Interest free overdrafts as you know, we are giving interest free overdrafts to the extent of £500 to help tide people through this crisis which is an important role that we can play to help this crisis to be easier for many of our customers. So that is the third area.

And in the fourth area, we have also got natural progression of the book. And we talked about that a bit at year-end, the natural way in which the book churns over time.

So there are a lot of things going on there. The four points that I have made in relation within the net interest income. To give you some sense, in a lockdown context what does that mean for our Q2 margin? It means around 30 to 40 basis points. Now we are not going to give you an annualised margin off the back of that because again that would imply that we have knowledge of how long this crisis is going to last. But we can tell you that in Q2 the impact on the margin is around 30 to 40 basis points coming off that starting point of 279 basis points that I mentioned earlier on. And it is a function of those four inputs that I just commented on.

Other operating income, couple points to make, one is there is a core stability to other operating income. And then the second is that there is some variability around the margins. So if you look at other operating income in Q1 first of all, if you took away the market volatility that we saw in particular in relation to Lloyds Development Capital, then other operating income would have been about £100 million higher which is pretty much what we told you at the year-end results a couple of months ago. The challenges that we have seen in other operating income in Q2, and again these are lockdown comments, so this is what we may see in Q2 rather than necessarily what we will see for the full year. The challenges that we see within other operating income for Q2 are at the margin on top of that core stability. We are going to see less payment revenues within Retail, so less interchange fees. We are going to see less car sales, so less Lex related fees which as you know comes in our other income line.

Moving down, Commercial Banking. We are going to see fewer transactions. So some of that market softness that frankly we have been talking about for a little while now, unfortunately that is going to continue. We are also going to see less transaction mandates, Global Transaction Banking was one of our growth areas as a business. We are not going to see so much movement within Q2 as long as the lockdown persists.

And the third area, Insurance. Insurance has a few gives and takes in it, but just to give you some context. We are going to see in a very low interest rate environment less bulk activity than we are expecting to see. Trustees not surprisingly are going to be reluctant to place bulks in what is a low-reward environment for them. Workplace and other growth areas of ours, we are going to see less transfers of schemes and therefore less opportunity. However there are some areas in Insurance that are core products, and they don't go away. Home insurance is a good example. And by the way we are seeing and hope to see further mitigation of some of the claims experience within that area. Protection is another example. Again these are products which don't change, people need them and most of them are accessible even in the lockdown environment.

So in other income, the way I would look at it is to say there is a core stability to it, but we are going to experience a degree of pressure in the margins beyond that. We are going to see less growth than we might have hoped within other operating income. We may see some pressure at the margin around it. But it shouldn't be particularly significant versus where we start today. So again these are lockdown comments and they are not comments that persist once the lockdown has lifted.

I was just going to move to your impact of High Cost of Credit question Raul is the final point you raised. I am not going to comment too explicitly on that. What I will say is that overdrafts roughly speaking are down 15 per cent by quantum. But I would also add to that that the chargeable balance by virtue of that £500 interest free component, the chargeable balance of overdrafts is down about 50 per cent. So you can see that chargeable balance again in the lockdown period, for the duration that those things last, has a significant impact which is coming back to the net interest income sensitivity that I gave earlier on. It gives you an idea as to where we get to and why we do.

Question 4 – Andrew Coombs, Citi

Good morning. Perhaps a couple of follow-ups. Firstly just coming back to the previous question on net interest income. Obviously some of the four points you made in terms of the hedge rollover and the rate sensitivity, the mix effect, the interest free overdraft and then the churn on the book. Some of this is obviously very temporary in nature during the lockdown. And other parts you can extract data to a greater extent. So perhaps you could provide us with some idea of how much overdraft income that was contributing to the net income interest previously? I would have thought it was in the low single digits. But that would be helpful as a start.

Secondly, on the other operating income, there is this £100 million charge that you have also drawn out on Lloyds Development Capital from a private equity mark. Could you just give us a feel there for the size of that portfolio and any additional risk that you see there?

And then finally on the economic measures, I think you have alluded to this already, but I just wanted to clarify. Obviously the majority of the charge you have taken thus far has been on cards and commercial. When you do look at the difference between your probability weighted and your severe, that £1.8 billion increase, a billion of that is on mortgages. And I think you alluded to it earlier, but I am assuming that is because of your 2021 assumptions in the severe downside more so than your 2020 assumption, is that fair?

William Chalmers

The first one, I am not going to disclose much more than what I have already said. The only point that may be useful to you as you think about this is to give you one indication within that overall sensitivity on net interest income. And as I said before it is subject to many uncertainties, I hope I gave you that impression earlier in my comments. But subject to those uncertainties, the rates component is probably around half of that overall 30 to 40 basis points that I mentioned earlier on. Now the incremental points that I mentioned, mix change, interest free overdraft, natual progression of the book, that is the other half.

On the Lloyds Development Capital point, Lloyds Development Capital experienced as I said in my script, around £100 million charged, that came in through the other income line. I would also add that there is a further cushion for Lloyds Development Capital within the PVA charge that we have taken. And so we have undergone a re-valuation of the assets that Lloyds Development Capital has and that enters into the other income line. We also have a further cushion within the PVA charge which takes it to the ninetieth percentile of certainty as you know. That provides a further capital cushion against further potential adverse experience in that area.

The point on Lloyds Development Capital that you asked around the size of the portfolio and the risk. The size of the portfolio it varies obviously, but it is typically between £1.5 to £2 billion. The point that I would like to stress with Lloyds Development Capital is that clearly the decline in equity values presented some challenges. The lockdown environment may present some challenges to some businesses, but we hope we have embodied that in the £100 million charge that we have taken because again we did that on a look forward basis. But equally Lloyds Development Capital has presented us with many opportunities in this environment. And it is an environment which we would hope the Lloyds Development Capital is able to take advantage of going forward and we have no doubt that they will.

Finally your question on the charge and the probability weighting severe and why does it gravitate towards secured. Your observation is exactly right. When you move from the base case to the severe case, what you are looking at is a continued negative GDP environment and indeed HPI environment in the course of 2021. If that happens and obviously we very much hope it won't, then what it does is it pulls down asset charges. And as asset values come down, so the ability to restore asset values in the context of secured assets gets worse. Now again we are on average loan-to-value within the portfolio of 44 per cent so we have a very considerable cushion before we have to worry about that. But, in line with every other mortgage provider, it does get impacted if HPI comes down. And in our severe case, you do get a longer, more protracted downside which in turn drives asset values down through the HPI change.

António Horta-Osório
Andrew just to compliment what William just said. So we have 90 per cent of our mortgage portfolio with a loan-to-value lower than 80 per cent. And this is the outcome of many years as you know of having underplayed on the mortgage market because we were concerned, especially London and the South East, about high value properties. And that is why we have 90 per cent still with a loan-to-value below 80 per cent. On the downside scenario we are assuming over the two years a 20 per cent decrease on house prices so as William was saying you would have an impact on the margin and those properties if repossessed would increase the losses that we would have to incur. So you were absolutely right on your point.

Question 5 – Jonathan Pierce, Numis
Hello there, I have got two questions please. Sorry to come back on this transitional relief point. The Pillar 3 shows that your IFRS 9 add back went up only by about £71 million in the quarter. Now I guess it would have fallen £100 million all else equal. But in the context of what looks to be about an £800/850 million Stage 1 and 2 charge, it does suggest that you had very little transitional relief in the first quarter on the ECL build. So just to confirm that is right and again to come back to what would happen if there were to be further Stage 1 and 2 build in the second quarter and beyond. Have we rebuilt the IFRS stock now to a level where only additional Stage 1 and 2 would get the full 70 per cent release? So that would be question one.

Question two is on car finance. I mean 85,000 holidays strikes me as quite a lot given these were only launched a few weeks ago. And I don't know what the average balance is, but the securitisation data suggests maybe in the order of £27,000 per customer which would suggest maybe over £2 billion of the car finance book is already under some form of payment holiday. Is that correct and if not could you give us a number by balance please?

William Chalmers
I will take the second of your two questions first. On the motor finance book it is an important business to us and it is one that we have targeted effectively over the last few years in a cautious and prudent way, but none the less it is an important business to us. In terms of the numbers that you mention, the motor business that has taken payment holidays by number of customers, I am not going to give you balances, but I will give you a number of customers is about 8 per cent. So it is considerably lower than the type of number you were talking about and hopefully that gives you some basis for the answer to your question. So the risk there, a couple of points I would make. One is it is a secured asset, two is that the pricing assumptions for the motor business have been and continue to be very much through the cycle and risk adjusted pricing assumptions that we are making. And third is before we came into this situation and certainly again in the £1.43 billion charge that we have taken, we have increased the provisioning level within the residual value component of the motor business that we have. So we had some coming in, it is also a component of our forward looking model charge. And that hopefully gives us a further cushion to work with on the motor book. So I feel comfortable with where we are on that.

On the IFRS 9 transitionals, as you know it is complex and something which deserves a more detailed conversation in due course. But to give you some idea. If we take out IFRS 9 relief, it is disclosed in the Pillar 3 document, we are looking at a CET1 ratio of about 13.9 per cent. That is about 30 basis points lower than the 14.2 per cent that I just mentioned earlier on which is consistent with my earlier number. Hopefully that gives you an idea. And then as we look forward into the context of 2020, the change to provisioning that we may take if we have recourse to change Stage 1 and Stage 2, should come into the transitional relief. But we will see how that progresses at that time.

Question 6 – Martin Leitgeb, Goldman Sachs
Good morning. I just wanted to touch on the payment holidays and it seems like one of the industry bodies is suggesting that as many as one out of nine mortgages has been impacted by those payment holidays. And I was just wondering if you could shed a bit of colour, were you surprised by the quantum of take up and what is the expectation from here in terms of how many of those clients might potentially struggle going forward with their mortgage payments?

And the second question is just related to the Government guarantee schemes, so the values on loan guarantee schemes. I was just wondering if you could give us a sense of what proportion of the loan book going forward might potentially be covered by those schemes? Looking at the volumes we have so far it seems like a comparatively small proportion of them might be covered. So I just wanted to check whether that is right.

And related to that how much of an impact can those schemes have in terms of the NPL cycle? And I was just wondering looking at your severe downside scenario with the £7 billion expected credit loss, that seems compared to the Bank of England stress test losses, comparatively mild, is the reason for that those current schemes?

António Horta-Osório

Thank you Martin. I am going to take your first question and William will take the second and third. Just to start by saying we are very comfortable with our mortgage portfolio as a whole. As I just mentioned in a previous question, we have an average loan-to-value of 44 per cent and we have 90 per cent of the portfolio with a loan-to-value of less than 80 per cent which results from our prudent stance in the last several years in terms of participation in the mortgage market and different segments. So this is the first point I wanted to raise.

The second point I wanted to raise is if you think about the customers on the Retail side as customers, which is the way we look at them and not as customers per product, you will realise that mortgages is no doubt the best product on average. On average mortgages will be the best product to help customers go through short term financial needs. Why is that so? Because as I just said, we have a loan-to-value of 44 per cent on average. That means that our customers have more than £300 billion of wealth on their homes unencumbered. So if they have a short term financial need either in credit cards or a personal loan or the mortgage itself, the best way and in our advice to them is mortgage is on average, the best product for them to consider in terms of addressing a short-term financial need.

The third point, we have on our portfolio, of the 880,000 payment holidays which I mentioned to you, on the mortgage side the percentage of our book in terms of customers is reallyonly, and it is like we were saying in relation to motor finance, is 17 per cent of the customers. So 17 per cent of the customers have asked us to do this. We think this is as I said the right product to help them and the most secured as well for the bank in terms of facing potential short-term financial needs.

William Chalmers

Martin on your second and third questions. As to the potential emergence or evolution of payment holidays. It is just too early to say with any conviction as to how this fairs. What I would say is reiterate some of Antonio's comments there. The stance that we are taking is to facilitate customers though what we see as a temporary income interruption. There is clearly some customers who have asked for payment holidays, those that are affected or those that are worried, but also many customers are doing so out of precautionary concern. And likewise some of the Government policies that are being adopted in turn will help address any payment holidays issues that may occur in the context of mortgages. So there is a number of offsetting factors. It is also fair to say that the income split and the vintage split of payment holidays within mortgages showed no particular bias or skew. And so we feel pretty comfortable about that combined with the fact that the loan-to-value of those payment holidays is at 50 per cent.

So if we look forward and clearly it is early days Martin and everything is going to depend on the severity and the duration of this situation. But the mortgage payment holidays are an area where we feel comfortable doing what we are doing and we believe that it is the right thing to do.

Your final question was around the stress test. It is important to note there are some quite big differences between the ACS stress test from the Bank of England and what we are experiencing right now. And just to draw a couple those out, first of all the Bank of England stress test was a high rate stress test and that had very different consequences for much of the customer base and the borrowing that we have in our portfolio. This is clearly a low rate stress and as a result again we expect to see different asset price performance off the back of it.

Two, the Government activity is now very significant. We have just been talking about one aspect of that, but that really should lower the consequences for unemployment, lower the consequences for corporate defaults, and accelerate the recovery that we would hope to see in 2021. And that is the third point, that the longevity of this stress we hope will be shorter. As you can see in our case it is shorter versus the Bank of England stress which is a multiyear stress.

And then finally conduct. Conduct in the ACS was a big part of the stress. That in turn you can know where we are on PPI, we hope is substantially at least behind us. And so that is another difference between the ACS stress test and stress we are experiencing right now.

And the final point I would make is that the Bank of England stress test is predicated upon perfect foresight. We don't have perfect foresight and so there is a methodical difference and difference in approach that is there. But I think the substantive differences between the Bank of England stress test versus what we are going through right now are really very considerable and worth taking account of.

Question 7 – Claire Kane, Credit Suisse

Good morning, two questions please. The first on the net interest margin guidance you have given on the call. Of the 30 to 40 basis points impact which suggests a low point in Q2 of about 240 to 250 basis points for net interest margin. The 15 to 20 basis points from rates, do you see that improving as you re-price deposits later in the year so that that

should ease up? And then regarding the other 15 to 20 basis points, could we also see that, the majority of that ease up if you do then start to charge customers on overdrafts, providing that doesn't get extended by the Government? That is the first question please.

And then the second question, just to follow up on the ECL around credit cards, of the £889 million Retail charge you took, and £729 million for other Retail. Could you split out the £729 million please for credit cards pand explain to us the overall driver you think credit cards will be for the ongoing outlook for ECL charge going forwards please? And can you just clarify that all of your payment holiday customers are still in stage 1?

William Chalmers

Yeah thanks Claire. Just dealing with each of those questions. First of all on the net interest income. The 30 to 40 point basis points that I mentioned earlier on, whether or not it's the component of it that is relating to the rate pressure is alleviated by re-pricing deposits later in the year. 'It may be' is the answer. I think it is just too early to call exactly how that will come out. The two factors that I think will be important there, one is the competitive environment, and clearly how does that evolve? Number one. And number two, you have seen our loan to deposit ratios today and they have come down and so we feel very comfortable from a loans to deposit funding perspective. Which in turn gives us the ability just to think carefully about how we might price the liability side of the balance sheet going forward. As we do that it may create opportunities, we will see. But we will just have to see how the market evolves.

The second part, how will the other pieces of that net interest margin comment that I mentioned earlier on evolve. Again it is too early to say and as I said what we have tried to do is give you a picture of how the business in lockdown works and therefore in Q2, but not do too much work about estimating how long that lockdown, the associated social distancing measures will last. But what I think it is fair to say is that the reason why we are experiencing that pressure in Retail, less spending for example. The reason why the mortgage market is largely closed for example, the reason why corporates are drawing on RCFs is all because of the lockdown. As you see the lockdown ease and provided that the social distancing is not too aggressive, then one should expect to see some alleviation in that pressure. How substantial that is and how quick it is I think is very much going to depend upon what the Government allows the economy to do and allows people to do.

The further point I would make on that interest income comment is I have talked very much around the 30 to 40 basis points in terms of the margin effect. Just bear in mind there is another piece of the puzzle here which is around average interest earning assets and what they do in Q2. And we have seen some expansion in that regard off the back of the drawings from corporates in particular. We just have to see how that fairs in the context of Q2. That is an outstanding balance right now. You can see it in the numbers. Whether there is further corporate drawing or not is uncertain. I guess it will depend in part upon how the economy fairs. That corporate drawing has slowed down in April. I think we have to see whether or not it picks up again at the Quarter end in Q2. It may or may not do. So just bear in mind the average interest earning assets at the moment are a little ahead of where they were because of that change in activity.

The ECL in cards. I think the one point that I would make on cards without going into too much precision is as you see the ECL play out over the course of the year, the ECL in respect of the unsecured balances has a relatively linear relationship to the variables that are within the MES. So we would expect to see that has a relatively linear relationship to unemployment for example. It also has a relatively short life which means in turn that if you have a more protracted economic scenario in respect of this recession, i.e. if the recession is more protracted then you should start to see unsecured play a relatively lesser role in the overall ECL charge partly because it has a short life. So hopefully that gives you some context if you like as to how it plays out in the context of the charge.

Your third question. Yes is the answer Claire. There is as you know a general practice amongst all of the banks that the taking out of a payment holiday in itself, does not cause a stage deterioration in respect of that asset. If there are other signs that do indeed suggest that there is an impairment in the asset then that is treated just as we would normally treat it. It doesn't matter whether there is a payment holiday or not, that is treated just as we would ordinarily treat it and take it from Stage 1 into Stage 2 in the ordinary course of business. And that has not changed by payment holidays.

Question 8 – Guy Stebbings, Exane BNP

Morning, thanks for taking my questions. I have two please. Firstly on risk weighted assets. We haven't really seen too much negative credit migration as yet. I am just trying to understand how much of a headwind that could be for the rest of the year? I know your mortgage book is quite through the cycle in terms of modelling, so hopefully that helps. And you have pulled out the fairly high risk weight density on your undrawn commercial balances. But if say the base case or the downside scenario were to hold true sort of what will expectations be for RWAs over the course of this year?

And the second question on costs, I am just trying to understand the balance between the headwinds from Covid-19 actions like lower headcount reductions etc with potential flexing in the investment spend. I think you had about a billion of discretionary investment spend last year of which round about 40 per cent of that was expensed. So can we assume a large chunk of that is pulled on? And then there was quite a sizeable non cash spend for regulatory issues last year as well. With some of the regulatory announcements in terms of delays on various model changes etc does that help much this year? That would be very helpful. Thank you.

William Chalmers
I will take each of those questions in turn. RWAs, the RWA experience that we have seen in Q1 is nothing to do with procyclicality really so far. We have seen securitisation changes which are regulatory inspired as of January that is about 2.3 out of the 5.3 billion we have seen in terms of RWA increase. We have also seen counterparty credit risk and CVA risk. That is market determined and is impacted every bank obviously including ourselves, but because we are a smaller market player is probably lesser from a proportional point of view.

And then we have seen one or two things like the threshold deduction in respect of insurance assets has moved to a risk weighted asset basis because our CET1 base has expanded. So I guess that is a good thing but it does increase our RWAs. So that is the RWA picture to date so far in this quarter. Moving forward, how do we see it? It obviously depends upon the extent of the downturn. We don't know how long it will be and we don't know how severe it will be. But having said that, we have got a range of models within the business. Those go from through the cycle to hybrid to point in time. As you pointed out the main mortgage model is through the cycle. Some of the other retail businesses retail models are point in time, but importantly all of those retail models are set to a regulatory calibration of downturn on the loss given default which in turn makes them less procyclical than they might otherwise be.

The commercial business is as you probably know built upon a Foundation IRB. And that means typically less sensitivity versus other advance models. And if you look at it in the context as you just said of the RCFs, it means we have a weighting for undrawn facilities and so we are proportionately less impacted by that.

Moving on from the models, the other piece of the question on RWAs as we look to the year looking forward is what happens with client demand. So far we have seen retail contract a little bit. We have seen commercial banking build a little bit. We are very much planning to be there for our clients in the context of this downturn. And so we will just have to see how client demand fairs. You have got a bit of a picture on it I think as of the close of Q1.

So if you wrap all of that up in terms of the range of models, and the client demand, what happens with the downturn, we may see some modest movement in RWAs, but we really don't expect to see it be significant. We don't expect it to be particularly material in the context of the balance sheet as a whole.

António Horta-Osório
I will take the question on costs to let you know, as you mentioned, several of the drivers. So what do we have versus the previous situation, again as William said, assuming the lockdown situation continues? We have on the positive side we have been supporting customers through the lockdown as we said in our speeches in terms of addressing the needs that they have, evolving needs, at pace as they need it. So we have been putting more people to help is processing CBIL loans, people have working extra time in terms of designing and implementing the proper products and supporting customers at pace. So that has obviously had a cost to us as we mentioned.

And on the other side we have as I mentioned in my speech as well, we have stopped any job losses which we thought was absolutely the right thing to do in these circumstances. So both of them versus our previous guidance to you, have additional costs for the right reasons to the benefit of our customers and our colleagues. What do you have on the other side? As I have mentioned before and you alluded to it, we have the discretionary investment spend, very significant, £1 billion a year. Again we are assuming that this lockdown is temporary and therefore we have taken action in terms of decreasing the discretionary investment spend and we are assuming at the moment a two or three month lockdown. So we have decreased the investment spending accordingly and also given the less capacity that we have of implementing change, working from home so that has a positive impact on costs. And I would remind you that it has a full impact on capital because all of the investment spend, either cash or through the P&L, goes out of capital immediately given its mostly intangibles.

The second positive point on costs is travel costs which by definition are decreasing very significantly and they are important. And the third one is variable pay because as a result it should go down, obviously variable pay adjusts accordingly. So all of these will in my opinion reasonably balance out each other. So you should not have any significant difference to our previous guidance.

And a final point I would add is that as you know very well our culture of full attention to costs and our track record in this dimension; this will absolutely continue. And I would also add that it is very helpful in the sense that it allows us to have a £2 billion pre-provision profit as a consequence of the low cost to income that we have which is an additional buffer in terms of the support we are giving to customers and in case other scenarios, not our base case scenario, indeed materialise.

William Chalmers

To pick up on your final question, you asked about regulatory delays in terms of I think it was in terms of RWA changes and so forth. We don't expect any regulatory impact on RWAs during the course of this year. We had our initial £2.3 billion in respect of securitisation in January. On a look forward basis we don't expect impact from any regulatory RWA changes this year. If we look forward beyond 2021, it obviously gets less certain but I would note the commitment to delay the phasing in of some of the so called Basel IV changes in the years thereafter. So let's see precisely what comes out of that, but that suggests a slightly more benign regulatory view in the RWA environment and a determination on behalf of regulators to ensure that banks do not feel under pressure on an RWA basis going forward. As I say, certainly for this year, we don't see any pressure. For the years ahead I think we just have to see how things evolve.

Question 9 – Edward Firth, KBW

Morning everybody. I have only just got a very quick one. And apologies if it is a slightly dumb question. But just to be clear on the impairments and the ECL charge. So if your assumptions are correct, your base case is correct, then for the rest of the year we should assume a quarterly charge of around £300-400 million a year, is that correct?

William Chalmers

I don't want to put precise numbers on it Ed so I am going to be a bit careful in terms of what I say. I mentioned that the charge was subject to two factors. One is a change in base case economics. And the second is the absence of perfect foresight that we have. Your question says let's assume that the first of those two is stable, i.e. no change in base case economics. And then what are the perfect foresight issues that come about? And I mentioned three, one is any change in restructuring cases that we have, two is progression out of Stage 1 into Stage 2 and 3 of assets both corporate and retail. And then three is the extent to which Government schemes and our assumptions around Government schemes as to their success in mitigating the economic outcome is correct, those assumptions are correct.

I am not going to put precise numbers on what we will see in Q2, Q3, Q4, all I will say is again you should not annualise the £1.4 billion, that the £1.4 billion is closer to 50 per cent of the overall charge than it is to 25 per cent. But somewhere in between those two with the point being closer to 50 per cent than it is to 25 per cent. And hopefully that gives you some idea.

Edward Firth

Yeah that is very helpful. Thanks so much indeed.

Question 10 – Chris Cant, Autonomous

Good morning, thank you for taking my questions, two please. I understand your reluctance to guide on 2020 given the uncertainty around the duration of the lockdown. But perhaps I could invite some comments on the shape of the business longer term given the shift to low rates and the pretty dramatic impact on NIM that you have talked about in Q2 just from the rates piece. So on RoTE, I know you have dropped the guidance, but for 2020 you have talked about 12 to 13 per cent which included about 1.1 per cent add back from amortisation. So basically you were looking for an 11 to 12 per cent apples to apples RoTE versus peer definitions but with a far more bullish rate outlook than we now see. If we are not stuck in a lower rate environment for the foreseeable future, what do you think the medium term, say 2022 RoTE looks like for this business? It feels like it could be dipping below 10 per cent as the structural hedge rolls over the coming years.

And second question related to that, just trying to think about the NIM development. Throughout 2019 you talked to us about the structural hedge and you told us that about £30 billion of the structural hedge would roll in 2020. Now that we are in 2020 could you please give us a number for how much will roll in 2021? Thank you.

William Chalmers

As you say, we are not giving guidance from 2020 because it would imply we know exactly when this crisis and the lockdown and any social distancing associated with it change or ends. Your question as to the shape of the business longer term, 2022 is obviously quite a long way away. I would, without giving guidance as to the expected RoTE at that point, I would say that the business has never been satisfied with sub-cost of equity returns. It has never been satisfied and has never delivered on a consistent basis sub-cost of equity returns, absent market aberrations. Now I really can't see a scenario where we are in 2022 and that assumption changes. So you know I think that is probably all I can say in terms of the outlook. The business will adapt to the circumstances that it finds itself in to produce a consistently superior return and certainly one that is above the cost of equity.

The NIM development point that you mentioned, the structural hedge question. We have actually taken advantage of some upturn in the markets earlier on in the year to take account of some of that structural hedge roll-off within 2020. So within 2020 as you can see from the slides we are about £173 billion invested. We have about £16 billion roll-offs during the course of 2020 having done the action that we took in the course of the first couple of months of this year. So it is down from that £30 billion that you mentioned and is looking more like £16 billion. I am not going to give you a roll-off assumption for 2021, I think you have a sense of the profile of both the invested structural hedge and weighted average life of just shy of three years. I will kind of leave you to work it out from there.

Chris Cant

If I could just check on the numbers then, could you remind us how much of the structural hedge rolled last year? Because I think it was relatively modest in the context of the £170-180 billion notional. And obviously a relatively small number is rolling this year in the context of the notional given the three year duration. So just remind us how much rolled last year and maybe that can help us fill in the gap? It feels to me like quite a large chunk of your hedge rolls next year noting that it is the first year beyond the GSR3 planning period for which you gave us that resilient NIM guidance. So I do wonder how much the three year hedge you put on sort of in 2017 is coming off next year?

William Chalmers

As to how much exactly rolled off last year I don't have a number in front of me but we can certainly get back to you on that.

António Horta-Osório

And Chris I think you should bear in mind that as you know we have been very open with you over every quarter when we discuss this, we do this in a dynamic way. And therefore for example as William has just said, of the £30 billion that were going to mature this year, we have already rolled in the first two months of the year £16 billion of those. And we rolled them to maturity that we thought were the most appropriate given the interest rate environment. And this is just an example, this is a dynamic process. So what needs to mature next year is not necessarily the difference in terms of your three years from what matured last year and this year because we are doing this dynamically according to circumstances. We are a very big bank operating in the retail and commercial banking space in the UK and we think we have an advantage in terms of sterling and that is why we believe we are providing and we can provide our shareholders with a sustainable advantage by the way we have managed the structural hedge over time instead of just doing it mechanically.

Question 11 – Robin Down, HSBC

Can I just ask you a couple of quick ones. Firstly in terms of the margin guidance. What are you assuming there in terms of TFSME drawdown? Are you planning on drawing down the full £39 billion and is the benefit of that almost free money included in that 30-40 basis points?

And the second question is probably a slightly cheeky one, but I appreciate you probably won't answer this, but if I look at your slide 18, the economic scenarios that you have got, the base case assumption for 2020 is minus 5 per cent GDP, unemployment at 5.9 per cent. That seems to be the same numbers that you have got in your upside case. And my understanding was that your base case is built on a sort of, that effectively you are looking at probability weighted versions here. But your base case does seem to be the same as the upside case for two of the most important numbers. And I don't really quite understand why that should be.

William Chalmers

On the first question, TFSME drawdown assumptions, the point that I would make there is that as you have seen the loan to deposit ratio for the bank is now very healthy at around 103 per cent so we are seeing a high level of deposits in the current environment coming in to the bank. That is both from retail where we have seen current accounts go up by £3 billion during the quarter. And it is also in the context of commercial where we have seen it go up by about £15 billion in the quarter. So we are seeing a very healthy deposit inflow into the business which in turn means that our desire or our need for further money from TFSME or any other source really is quite limited. But we will be asset led. You know that is to say if our customer needs are such that we need to build upon the balance sheet in retail or in commercial then we know that we have the TFSME there and available to fund that as you say at relatively low cost.

We also will take that into account in terms of our overall wholesale funding strategy where we have typically annually around £15-20 billion need. As I mentioned in my earlier comments we have taken care of a decent chunk of that in the course of the first quarter. With TFSME there, you would expect us just to be judicious about how much we use the wholesale markets versus how much we use TFSME to fund the balance sheet and ultimately client and customer demand. So we will take a view on TFSME based upon each of those two points Robin.

Your second point, the question as to the upside versus the base case. You are right to point that out and we have had a discussion with our economists on that particular point and any particular reasons why. I think the key point to bear in mind there Robin is that GDP is only one of a number of factors in the overall forecast. And the scenario takes account of severity across all the impairment drivers, whether that is unemployment, whether that is the bank rate, whether that is CRE prices. GDP in isolation is just not the most important driver in every case and so when you look at the discrepancy between the upside and the base case it is at least as important to look at some of the other drivers in the context of the comparison as it is of the GDP number.

Robin Down
I totally agree with that, but the unemployment rate is one of the key drivers, particularly as you said earlier for consumer credit. So I am just slightly surprised that the base case if you like isn't worse than the upside case.

William Chalmers
Yeah but I think that is because you are looking at it on the year average basis Robin. So if you actually take the core key numbers within the year average you will see that there is a significant difference within quarter between the base case and the upside case. I mentioned earlier on for example that in 2020 base, we have got GDP of down 7.4 per cent in Q2. We have got unemployment at 7 per cent plus in Q2. That is not the case in the upside. And so I don't have the quarterly upside in front of me to quote you now, I am not sure I would do if I had them, but there is a difference there within the year which is hard to see in the current scenarios for the year averages that you have here.

I think the second point I would make is you also need to look across the years. So don't just look at 2020. One of the points we have been trying to emphasise in this discussion is when you look at our IFRS 9 impairment charge, you have to look at 2021 as well as 2020. And then when you look at base case versus upside you will start to see some of the differences. GDP, unemployment for example in 2021 base case versus upside are different. But more importantly the point at the beginning of the call, when we look at our IFRS 9 assumption, again look at it versus others for a macro forecast not just for 2020 but for 2021 as well.

Robin Down
Brilliant, thanks.

William Chalmers
Thank you very much to everybody for joining the call.

António Horta-Osório
Thank you.

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