

## LLOYDS BANKING GROUP PLC – 2020 Q1 IMS – SELLSIDE ROUNDTABLE

(amended in places to improve readability only)

**Monday 4 May – 4.00pm**

### **LBG HOSTS:**

William Chalmers, Chief Financial Officer

Carla Antunes da Silva, Group Strategy, Corporate Development & Investor Relations Director

Jon Burgess, Group Financial Controller

Toby Rougier, Group Corporate Treasurer

Douglas Radcliffe, Group Investor Relations Director

Angus Armstrong, Chief Economic Adviser

James Hillman, Finance Director, Wealth & Insurance

Israel Santos, Finance Director, Retail

Alan Brindley, Finance Director, Commercial

Andrew Edwards, Chief Operating and Risk Science Officer

### **Douglas Radcliffe**

Good afternoon everybody and welcome to the Lloyds Banking Group Q1 Sell-side Round Table. Clearly it is not quite a roundtable given the circumstances, but we still felt it was a good idea to provide you with the opportunity to ask some additional questions on key topics after our Q1 results from last Thursday.

William Chalmers will host the call. We have also got a number of other senior members of the team who may be called upon to provide further details. The call is scheduled for an hour and without further ado I think it probably makes sense given the time to go straight to the questions.

### **William Chalmers**

Hi this is William Chalmers on the line, thank you very much for joining today and happy to take questions. We have as Douglas said the team alongside of me here so as issues come up we may refer to the team or the team may want to add to some of the comments I make. So I will stop there, happy to take questions.

### **Question 1 – Robin Down, HSBC**

**I have got one really nerdy question to start with which is to come back on the IFRS 9 transitioning. I think it looks to me like you have about £200 million benefit in the first quarter, obviously offset a bit by the phasing in. How do you see this developing in Q2 and Q3? What I am interested in is if you front-end loaded the provisioning in Q1 then we should see some migration from Stage 1 into Stage 2 into Stage 3 in Q2 and I am guessing as you then reduce your GDP forecast and change your macroeconomic scenarios, your expected loss might go up. So should we really be ignoring IFRS 9 transitioning now? Do you think it is going to be a relatively small effect from here on in or could it be more significant?**

**And the second question slightly unrelated on the dividend side, and of course nobody can hold you to any sort of commentary or forecast here, how are you thinking about the dividend come year-end? If the Bank of England gives you permission to pay something is there a threshold CET1 ratio that you would be thinking about year-end? You know if we are sitting there in the thirteen somewhere would you be looking to reinstate the ordinary dividend? Just any kind of colour about how you might be thinking about that would be very helpful.**

### **William Chalmers**

I will give some comments on the IFRS 9 transitional point and will hand over to Jon to add any comments he may wish to add. In the round I think you are right around IFRS 9 transitional, it is not a huge impact for us. In the accounts as a whole it is of the order of 20 to 30 basis points. I think we disclosed in the Pillar 1 13.9 per cent absent transitionals, 14.22 per cent as you know with them. So it is not a huge boost from our perspective. We did take some benefits from Q1 transitionals which was of the order of 6 basis points, so that adds in, but against that we are obviously conscious of the rundown in transitional benefits that we will see from 2020 into 2021 where it goes from I think 70 per cent down to 50 per cent. If we see changes in the course of 2020 in terms of our IFRS provisioning of, let's say a change in economic scenarios, then the transitional benefits will at least temporarily benefit from that movement. I would not necessarily expect it to be a big part of our overall capital structure and I would not expect it to deviate materially from where we are today.

The only other point I would make is that we have noted obviously what has happened recently with statements around the transitionals. I don't know what will become of those. We don't quite know how to fully interpret it right now and we don't know

whether the PRA will choose to apply it or not in the UK, but even if it does again it is not going to play a huge role in the overall capital position.

Which then just leads me onto your second question in terms of the capital position of dividends. In essence, nothing much has changed around the capital position. That is to say our capital target is as it was at the year-end which is 13.5 per cent. We note the change in regulatory position underpinning that by virtue of the countercyclical buffer being reduced., so obviously there is a greater difference between our target capital ratio and that of our regulatory minimum and you know we will see how that fares over the course of the year. It is worth adding in that context, as of Q1 we have a very strong capital position of over 14 per cent, that is in excess of our capital appetite. We have to see how that fares over the course of the duration of the year. And then we have to leave it in the hands of the Board as to what they will decide to do with any excess capital that may be around at that point.

So I am not sure I am adding much terribly new to the picture there, but that is deliberate in a sense, because the capital thresholds are as they were and we just have to see what position we are in at the end of the year for the Board.

#### **Robin Down**

**Obviously there was the Dear CEO letter from the Bank of England saying that all the banks would be given a substantial amount of time to rebuild buffers post crisis. I was just thinking whether or not meant if we ended up with a CET1 ratio of say 13 per cent and not 13.5 per cent, whether you would still feel comfortable given that substantial amount of time to rebuild the capital buffers with reinstating an ordinary dividend at that stage?**

#### **William Chalmers**

It is a fair question. I think at the moment it is just too early to comment in any detail on it and we will look at the issue if and as it arises towards the end of the year. The Board's commitment to return the excess capital is as strong now as it ever was. We haven't changed our capital target for the time being. If at the end of the year the picture is looking a bit more transparent with a bit more forward looking visibility, then we may take a view at that time and establish a view from the Board at that time.

Jon I don't know if you want to add anything to the comments I made earlier on IFRS 9?

#### **Jon Burgess**

No, I think they are accurate and complete.

#### **Question 2 – Rohith Chandra-Rajan, Bank of America**

**I have a couple of questions please, one on credit quality and one on the margin. So just on credit quality looking at the coverage levels, Other Retail looks like it has got 3.7 per cent coverage, but I imagine there is quite a difference between the motor finance book and the unsecured parts of the book. So I was wondering if you were able to break that out at all, so coverage between motor finance and the unsecured elements of the other Retail book?**

**And then the second question was just around margin. I appreciate that it is difficult to give guidance given the uncertainty, but in terms of what you were saying around Q2 in particular, I think you said that half of this 30 to 40 basis points decline that you are expecting in the quarter was rates driven. I guess the rates impact is not immediately felt in full, so I was just wondering in terms of that half of 30 to 40 basis points from rates how much you expect in Q2 and what is the phasing of the subsequent impacts might be very broadly?**

#### **William Chalmers**

On the first of those questions as current levels in unsecured and motor, the team will add anything that I may miss. It is safe to say that we cover unsecured bearing in mind the fact that it is unsecured and we cover motor bearing in mind the fact that it is a secured asset class. And so naturally the coverage levels will differ for each of those two. I don't think we go beyond that at the first quarter, so I will leave it there.

On the margin point you make, most of that rates impact will be felt within Q2. There are some leads and lags on pricing in respect of mortgages and in respect of savings, but they are not terribly consequential and we want to have played into enough of that by the time we get into second quarter. So the majority of the rates impact that I referred to on the call on Thursday in terms of half of that 30 to 40 basis points will be played in by the time we get into the second quarter and that which isn't is pretty immaterial.

#### **Rohith Chandra-Rajan**

**Could I just come back from the coverage, if I look at RBS or Barclays they have got coverage on their unsecured books of sort of 9 to 10 per cent. Would that be a reasonable estimate for how your unsecured books are covered?**

### **William Chalmers**

Again I am not really going to get drawn into a number where we don't disclose for Q1. I mean it is safe to say I think we would take a look at the book and we take a look at the fact that it is prime credit quality book and we cover as we think appropriate going forward. That is as much as I will say for now.

### **Rohith Chandra-Rajan**

**Okay if I put it another way, if I assume there was no coverage on the motor finance book, I think the coverage ex-motor finance would only be around 5 per cent?**

### **William Chalmers**

Well again there is some coverage on the motor book. I am not going to comment on the coverage beyond what I have already said.

### **Question 3 – Alvaro Serrano, Morgan Stanley**

**A couple of questions on the margin actually. You have mentioned it is 50 per cent rates driven, 50 per cent other factors. Just on the rates and qualifying up what Rohith was possibly referring to is obviously LIBOR hasn't come down as much as it should, what effect does that have? It sounds like not much, but I would have expected that would have delayed the rates impact and maybe it sounds like it doesn't, but maybe you could explain why?**

**And second, on the other parts. I don't know how much colour you can give on the weighting of the overdraft fee waiving has on the margin? And where I am coming from that maybe you can offer a bit of colour is, if we think about the second half and hopefully the recovery of that margin, it feels like charging clients again when unemployment will be rising and it is going to be a pretty tough economic environment, once you give something for free it is kind of difficult to start charging for it again. What are your thoughts and what is the planning around charging again for those overdrafts and how do you see that playing out? Obviously maybe qualitatively more than quantitatively.**

### **William Chalmers**

On the second of the two questions, the weighting of the overdraft fee income. I mentioned earlier on in the call on Thursday, the interest free overdrafts is obviously a component in the overall rebasing of the margin in Q2 and lockdown scenario by about 30 to 40 basis points that I mentioned and it does have a role to play. I think I mentioned also that the overdrafts in terms of volume are down by about 15 per cent, but in terms of chargeable balances are down by about 50 per cent. So that gives you an idea of the overdraft component in that overall pressure on the margin that we are seeing.

Your point around whether or not we will see a second half recovery in the overdraft margin and whether or not we will be able to charge customers. I think that is going to be a question of a number of things as you say. What is the environment like at that time? What is the political environment like at that time? What is the competition doing at that time? I think there is a kind of evolution that we will see over the course of the year. In terms of people's behaviour and in terms of the politics which will as said, depend upon the progress of economics, the overall response to that, but certainly the expectation is that there is a business as usual resumption at some point in the course of the year. We will see how quickly that is allowed to proceed, it is too early really to second guess it right now. I think it is not our working assumption that the overdraft free caps of £500 per individual is necessarily a facility that lasts into perpetuity. So we will just have to see how that progresses.

On the margin as to rates, you are right, LIBOR has been higher than base and it has probably stayed higher than any of us might have expected for a period of time. That will have some benefit in the course of the pricing. As you know a chunk of the pricing for customers on the commercial side, is off of LIBOR as a base and there may be some benefit from that. It is not particularly factored into that 30 to 40 basis points guidance that we saw. I don't think that we wanted to necessarily call out a pronounced LIBOR trend or differential versus base rates in the second quarter. Whatever LIBOR relief that there might be in there however temporary it is, is not a feature of that 30 to 40 basis points. I would also just add as you know, that differential between LIBOR and base has been becoming more compressed in the last few day and that would be our expectation over the course of the second quarter.

### **Question 4 – Guy Stebbings, Exane BNP**

**Firstly on the payment holidays, obviously this is going to distort asset quality trends quite considerably over the coming months. So firstly when you compare your approach to peers do you notice anything? And the reason I ask is because if you look at the number of payment holidays even adjusted for market cap, especially on the card book versus Barclays for instance, it does seem quite high. So given your book performs just as well under stress test, it seems slightly surprised, is there any colour you can give there?**

**And then what are your central assumptions around how many people might fall into permanent arrears after the holidays and whether it would be much higher on say cards then motor then mortgages perhaps?**

**And then I had a quick follow-up on ECL provisions this time on the mortgage book. I think it is actually lower now than it was a year or so ago in terms of the outstanding provisions against the book. I know it is quite sensitive to the run off portfolio which has obviously gotten smaller, but it still strikes me as slightly odd that the provision should be lower now. So anything you can comment around that please? Thanks a lot.**

#### **William Chalmers**

On payment holidays, as you know we have payment holidays on a range of products, mortgages, cards, motor. Taking each of those, maybe the best way to answer your questions is to give you some sense of the volumes of those payment holidays as a proportion of the book [customer volume] which may help address your question as to relativities. Mortgages are about 17 per cent of the book or thereabouts, cards are about 3 per cent of the book or thereabouts, motor is around 8 per cent of the book. So I don't know whether that helps answer your question as to how we stand versus others. It is probably also worth saying, not surprisingly that the levels are levelling off. That is to say we had a fair few applications as you can imagine in the early periods and the applications now are levelling off and we would expect that to continue to be the case over the course of the second quarter. So I won't make any comparison as to exactly what others are because I don't think that is really appropriate, but that gives you some idea as to the size of the volume of payment holidays in each of our areas.

The risk around payment holidays, I think on the mortgage side and this probably retracing some of the ground on the call on Thursday. On the mortgage side, well on all sides let me say it is too early really to say what the correlation between payment holidays and risk might be, permanent arrears as you said. It is too early for all of the different products. But it is the case that as said, it is our stance in all cases, whether it is cards or mortgages or motor, to do what we can to help customers through what we see as a temporary interruption. It is also the case, not surprisingly that those people who took these payments holidays out are those that are affected or those that are worried, but also particularly those have taken some of them, precautionary stance on the current situation. The Government policies will play into the tendency of payment holidays to revert into anything more significant thereafter as will obviously the length of the crisis and the effect of it and so forth.

I think in respect of mortgages we don't see necessarily any particular correlation to permanent arrears. We have got a fairly even split, we have a fairly even vintage split, we have got LTVs of around 50 per cent. It is very hard to call it out. I think unsecured by its nature is going to be a little bit less certain in that respect and if you pick out that asset class as opposed to mortgages, then it will be understandable that you would look at that asset class as potentially having a slightly greater risk of moving from a payment holiday to permanent arrears. I mean that would just be a function of the asset class itself and the behaviour that you might expect around it.

I think having said that, it is a prime portfolio and it has been and continues to be. We haven't gone out and chased growth particularly aggressively in that portfolio over the years. And so we would see it very much in that context. But I think if you were to distinguish between risk of payments holidays in mortgages versus risk of payments holidays in cards, I think you would naturally say that the unsecured has a greater risk attached to it of that payment holiday turning into an arrears question at least as to a subset of them. Again it is a function of the product and to a degree is a function of the nature of the borrower's behaviour.

On ECL, I am not 100 per cent sure I understand the question. The ECL that we have taken, as you can see on the slide presentation we gave out on Thursday, takes our stock of ECLs which as you know is a balance sheet stock from about £4.2 billion as of December 2019 to about £5.2 billion as of March 2020. So what we have done there is taken a £1.4 billion P&L charge which is the impairment line that you are familiar with. We have then taken a write-off against all the various asset classes of £393 million and that then leaves us with an ECL increase of £1.037 billion which is the increase from £4.1 or £4.2 to £5.2 billion, about a billion. So I am not 100 per cent sure that I understand the question, but the ECL charge has gone up by about a billion from December through to March as it represents a charge of a stock item on the balance sheet.

#### **Guy Stebbings**

**On the ECL charge it was just around the stock on the balance sheet now as you say for mortgages of £1,345 billion. If I went back a year or so ago it was over £1.4 billion. So the stock on the balance sheet actually fallen and obviously increased in the last quarter, but is lower than where it would have been a year ago.**

#### **William Chalmers**

Well one observation to make there Guy, I mean the numbers that we had from December through to March is about £1.2 billion going up to about £1.350 billion. That is about a £150-ish billion increase in the secured ECL stock as of the first quarter. I think as we discussed a bit on Thursday, the nature of this shock is at the moment at least sees a recovery in the course of 2021 albeit

from our point of view not a particularly dramatic recovery. Nonetheless that in turn eases off on the secured pressure versus the unsecured and versus other asset classes. I think if we see a more prolonged downturn, more negative than what we are saying, certainly a lot more negative than what anybody else is saying, then that is the point at which you will see more pressure on secured assets and therefore more pressure on mortgage charges like this.

### **Jon Burgess**

William can I just come back on the earlier point about unsecured ECLs as well while we are on the subject. When you are doing comparisons, I am not going to get into specifics, but you also have to look at write-off approaches and timing of write-off. So our view is that for others, write-offs happen a lot later and therefore you see balances, highly provided balances sitting in stage 3 for much longer which dramatically distorts the comparability of ECL coverage that Rohith was alluding to earlier. And also the other point that you just made and reiterated William which is the major outlook which we consider our lending to be very much prime lending.

### **William Chalmers**

Rohith hopefully that gives you an answer on your point around coverage levels in unsecured.

### **Question 5 – Jonathan Pierce, Numis**

**A couple of questions actually on capital. First on Scottish Widows, I am wondering if you could give us some insight as to how you are thinking on dividend upstreams, whether the PRA's message to insurers more broadly will have any influence on the decision to upstream at the interims and I guess more importantly at year-end? That will be the first question.**

**Then the second question, I know we are some way from a formal set of disclosures on the pension fund. But I suppose we are four months into the year now and we can see that in 2018 actuarial deficits which I think is the latest update, weren't really that different to 2016. I guess in 2019 there has probably been improvements in respect to mortality and equity prices. So really just looking for an idea of where you think we may be heading on the pension fund because clearly they do start to significantly impact capital build into next year?**

### **William Chalmers**

On the Scottish Widows point, the insurance dividend it is really too early to say actually as to where we get to by the end of the year on the insurance dividend. A couple of comments that hopefully will provide context in that regard. First off it is a well-capitalised business as you know. Its actual solvency is in excess of its target solvency as we stand today. So we feel very comfortable about the capitalisation of the business today. Obviously falling interest rates puts a bit of pressure on that solvency, but as I said it is in excess of the target as we stand today.

We have got a significant equity hedge within the insurance business and that has proven to work very well in the context of the environment that we are in. That largely hedges out the capital impact of the falls in the equity markets that we have seen. So that proved to be a timely and effective remedy for some of the equity market volatility that we have seen, at least the capital position of the insurance business. Being exposed to credit spreads having said that, it is probably no news to everybody on this call, but credit spreads act as a below the line charge. We will have to see how credit markets perform over the course of the year, but there is some vulnerability to credit defaults, credit downgrades if that ends up happening over the course of the year. Both as a matter of solvency two and the FCR. But nonetheless we expect the capital position to be comfortable.

PRA guidance is a factor for sure, the Scottish Widows get sent a letter just like everybody else so we won't ignore that. But it is not necessarily determinative of where we will be. So I think overall in sum it is too early really to make a call on the position of Scottish Widows. It looks very well capitalised right now in excess of its solvency. The pressures to date have been relatively well withstood, but there is clearly the possibility of pressures over the course of the year in particular in the credit markets just like I guess for all of the insurers. So we will just have to see where we end up in the course of 2020.

Second question around pension funds. You saw the pension surplus on an actuarial basis increasing in the quarter for the first three months of this year. That is a function as you will have seen in our comments of significant of credit spread widening which in turn increases the discount rate and allowed the surplus to come up to above £5 billion which is a considerable mark-up upon where we were as of the end of the year. Some of that credit spread widening has abated and narrowed and therefore the discount rate with it. And we will see that so far at least, let's see where we end up at the Q2 date. But so far at least in quarter 2, you will have seen some of that surplus erode because of that change in direction of credit spreads. But nonetheless I would expect it to be a surplus position as ahead of where it was at the end of the year by some considerable margin.

In terms of the overall funding position, on that point it is too early to say. The funding analysis is being worked on right now by the consultants. They drew a year-end date as being the relevant date for the position of the fund. The position of the fund will be set as of the year-end, it won't be set as of the quarter. And we don't know what that is, the trustees don't know what that is, but again that funding date for the purposes of the financing of the pension fund going forward and the negotiation we are going to have with the trustees, that is a funding date as of the year-end and is not affected by the volatility that we are seeing since then.

#### **Toby Rougier**

William its Toby, can I make a couple of other comments? In terms of the triennial valuation and obviously since the last valuation we have made a substantial amount of deficit payment contributions. So those will go to reduce the deficit over that time. It is also worth noting that the pension funds themselves are substantially de-risked and have been de-risked for quite some time. So they are broadly hedged, certainly on an accounting basis for rates and inflation. And in terms of the asset side, I mean the portfolio has been de-risked for a while. So there is an allocation to equities, something like 5 per cent or so. So it has got a de-risk asset portfolio and with that substantial amounts of rates and inflation hedging. And since the last triennial valuation we have made some considerable deficit payment contributions.

#### **Jonathan Pierce**

**It is just that the deficits at the end of 2018, I know you don't give us a formal update in the accounts, but going through the trustee documents, the deficit to the end of 2018 were no different really to the end of 2016 despite the contributions over that period. I am really just trying to get a sense as to whether you think there is a possibility for a substantial reduction in contributions once this review is completed in the same way that Barclays saw a big reduction or just simply is it far too early to tell?**

#### **Toby Rougier**

I think it is too early to tell Jonathan.

#### **Question 6 – Martin Leitgeb, Goldman Sachs**

**Good afternoon, could I just ask on the standard variable book within mortgages, I was just wondering if you could shed a little bit of light on how this has behaved over the last couple of weeks? And now that the market is in a way frozen, do you see a take up in standard variable rates from essentially mortgages coming off the initial period or how do they get managed and is that an expectation that this could continue into the next couple of months?**

#### **William Chalmers**

Martin just to make sure I answer the question. Was it a question about the SVR or a question about the re-pricing or the pricing of mortgages that reached their term maturity on the fixed rate?

#### **Martin Leitgeb**

**So if you have a standard two year mortgage which is due for re-financing at the end of the period, would you see essentially more people spending longer on the standard variable rate so potentially seeing a slower attrition of the standard variable rate book as we have seen over the last couple of quarters? Or essentially if anything comes up for re-financing, that will go in terms of mortgage and essentially what we have previously seen before I think around 13 per cent continues?**

#### **William Chalmers**

Well I will answer that and maybe Israel Santos who is on the line from Retail would like to add. But the SVR run-off has continued to be around 13 per cent mark in Q1 so that is the run-off of the SVR component the book hasn't materially altered. Again that is only as of the Q1 during which time we had relatively short periods of disruption. So with that proviso of the SVR attrition or run-up has been similar to what we have seen before. The numbers that we talked about in terms of the 30 to 40 basis points of margin impact, that does not really change that assumption just by way of background. I mean we are still working on the same basis. Having said that, it is the case that the term fixed that is coming off and then being refinanced by a new term fixed and of course by default other non-term fixed products is at more favourable rates than the term fixed product that is coming off, if that makes sense. So if we see a product that is a two year fixed, five year fixed coming off because its duration has lasted, the product that is replacing that whether it is fixed or as I say by default some other product, is a wider margin product than it is replacing.

#### **Martin Leitgeb**

**Just to follow up on cards. So if we just think about, it seems like the payment holidays could be used just to rebalance some borrowers that are more towards mortgages which is cheaper as opposed to some other elements within their personal debt. So I was just wondering how should we think about the credit card balances going forward? There was a**

**meaningful contraction in Q1, would you expect that to continue or would you expect that to level off at some point as things normalise hopefully?**

**William Chalmers**

It is a good question. I think we would expect that to somewhat level off over the course of the second quarter. You will assume a sort of base level of spending, but having said that I don't think we have reached that levelling off period by the end of March. So I would expect some continuing levelling off in terms of the unsecured assets to take place during the course of the second quarter. And in turn that is factored into our 30 to 40 basis points that we have been talking about. So once we get beyond that then I think you get to a level of spending. We've seen spending levels down as you know about 20 per cent and it maybe there is a little more to go. But once you get to a certain base level of spend then I think you start to see the asset composition levelling and I would expect to see that to start to happen over the course of the second quarter. But calling exactly what that is a little tricky right now.

**Question 7 – Chris Cant, Autonomous**

**I just wanted to follow up on a couple of other points that have been discussed. So IFRS 9 transitional, to your remarks that this is going to remain small and won't deviate. If I think about the Bank of England stress tests in the 2019 tests you toughed on a fully loaded and a transitional basis in the same year of that test and the gap was about 2 per cent at the trough. So has it increased roughly tenfold from the point it went into the test I guess? Why do you not expect this to be material in this crisis when it appears to be very material in the stress test? Is it something about the nature of the Covid stress or is it the quantum of loan losses? So if your guidance for this year to be less than four times 1Q, if that proves to be wrong by a factor of two, does this suddenly then blow out? What is in this that is different about what you are currently expecting versus the stress test in terms of how that changes?**

**And then on NIM, just trying to unpack the comments around overdrafts. So you have about £1.3 billion of overdrafts at the end of last year. I think pretty much all of the banks are going to be charging about 40 per cent on that. So is the 50 per cent reduction in chargeable balance is that 6 basis points and how we should think about it within your 30 to 40? You seem to suggest that we could do some simple maths to work that out, so that was my stab at it. And within the 30 to 40 what aspect leaves you to have such a range of uncertainty for a single quarter's margin, what bit of it is the thing driving the 10 basis points upper and lower bound of that?**

**William Chalmers**

The IFRS 9 charge in the ACS versus the IFRS 9 charge here and the impact upon transitionals, we see as being quite a different stress here versus the ACS. The ACS is different in a number of ways. In terms of the composition of it, it has got as you know very high rates which drive very sharp losses. It is a long longevity stress which goes on a number of years into the future. That has an impact on the overall amounts of stress and the impairment associated with it and obviously the sectors from which that stress is derived, in particular housing HPI and so forth. So it is a high rate situation which drives very high impairment level. It is a long duration situation which again drives both a high impairment level and drives the sources from which it comes.

And there are other factors as well which are perhaps a bit less relevant to the IFRS 9 point, but nonetheless worth mentioning, things like conduct for example. And of course there is perfect foresight there as well. In this situation obviously we will see what happens over the coming quarters, but in this situation there is an enormous Government response both the fiscal and the monetary level. There is a strong expectation of some sort of recovery in the course of 2021. As said ours is probably a more modest recovery than most other commentators have for 2021, but nonetheless we see a 3 per cent recovery during that time. And so you get that rebound affect and therefore this stress today is frankly not as bad and not as acute and not as lasting as the ACS stress. And that then drives quite a different position into impairment charges. And so the transitional relief associated with it. So that is a big part of it Chris I think.

On your question around NIM, the NIM you asked two particular points, one is just the calculations, the maths around the overdrafts and the reduction in chargeable balances and what component of the overall 30 to 40 basis points that leads to, I will leave the maths to you in that respect. But then you also asked a second question which is around the uncertainty of the 30 to 40 basis points that we gave and why there was such a wide range. That is intended to give you some idea of the sensitivity of the margin into Q2 and I am afraid it is down to, frankly quite a lot of dependencies. What we have done is give you a sense as to the inputs into that sensitivity, the rates impact, that is unlikely to change within the quarter. The mix change within Retail, how much of an impact does it have on unsecured and the new mortgage markets. The commercial banking component of that, how much do commercial bank clients draw down on RCFs as an example. How much of the interest free overdraft taken up? Is there any impact on the natural progression of the book churn as we discussed two seconds ago?

So three uncertainties. Where do swap rates go? How much do corporates draw down or not? How much spending is there? How does that drive the unsecured balance? How do overdrafts perform? These things are our view if you like. We thought it only

appropriate to give you a range of the type that we did in the context of what is a highly uncertain environment for a number of different factors. And so that hopefully answers your question Chris. I mean we have a view as to where this all comes out but it is contingent upon many, many inputs. And to be anything more precise than that is really spurious accuracy.

#### **Chris Cant**

**There is nothing, no sort of one fact you are particularly uncertain about this, just a combination of everything? On IFRS 9, if I can just round that out. I understand the scenario is not quite the same, but it sounds to me like basically this is just a quantum of loss issues, i.e. if this does turn out to be a meaningfully worse stress than you are currently expecting it to be, then actually this could be a material part of the capital structure on a transitional basis. It is just a question of the severity of the stress basically?**

#### **William Chalmers**

I think the nub of it, you have got it Chris. I mean the duration and the severity of the ACS stress is above what we would expect to see here. And as I said, the best example of that is what happens in the course of 2021 as an example. This is a short, sharp downturn as I said, we are seeing 7.5 per cent down in Q2. We are seeing unemployment rates over 7 per cent in Q2. And so it is a sharp downturn, but it is one that is marked by a change in direction as of 2021. So that is a big part of it.

In terms of the overall impact or importance in our capital structure, the one point in our capital structure that is probably worth making is if you look at the capital position we have got 14.2 per cent CET1 which is as you know is pretty much 300 basis points in excess of the regulatory requirement of about 11.3 per cent. When we add on the recent increase in ECLs, we have got another £5.2 billion in ECL stock on the balance sheet which is a provision against those assets. We have got a pre-provision profit which is whatever you guys think it is going to be in the course of Q2, Q3, Q4, it was roughly £2 billion in Q1. So that gives a further cushion. We have got a PVA which is now £750 million or thereabouts of a cushion going forward. So you need to add all of these things up before worrying too much about the capital structure. And certainly in our view at least that combination of six billion on top of the regulatory requirements, £5.2 billion of ECL, £750 million of PVA, whatever you think our pre-provision profitability is going to be. You know hopefully it is kind of cushion upon cushion, upon cushion in our view and should give you some assurance about what is important in our capital structure and what isn't. And if you view it in that context, I am not sure if transitionals are ever going to be especially important.

#### **Question 8 – Aman Rakkar, Barclays**

**On the stress test, I note your comments on the call around RWA procyclicality so mortgages protected by Through The Cycle approach. You have got a downside Loss Given Default assumption on your other Retail and then corporate on Foundation IRB is less rate sensitive. Sorry to keep going back to the Bank of England stress test point, but in that stress test you see about 15 per cent risk weight inflation, for a different stress event which I totally understand, but can you help us understand where exactly does that stress, so that RWA procyclicality, where does it manifest in the stress test please? I know the mortgage book incurs outside losses for high rates, but that is presumably not an RWA issue given it is through the cycle. So could you help us understand where that comes through in the stress test?**

**And another one is on Government guaranteed lending. Forgive me if you have already addressed this in another form. Basically do you envisage that being a big part of the balance sheet going forward? Could you help us understand the fee that you guys pay to the Government for lending under that scheme? And I guess on the CBILS stuff, some idea on the average net interest margin relative to your current net interest margin? You know is that a mix shift we should factor in going forward?**

#### **William Chalmers**

Just to start off on the procyclicality point, I will make a couple of comments on that on how we see the current position and then a couple of comments in terms of the ACS. I think we may also have Andrew Edwards on the line from Risk actually who may want to add to some of the comments I will make. But the way that we see the procyclicality situation so far is that we have seen as you know a little bit of RWA inflation in Q1, that took the assets from the RWA from about £203 billion to £209 billion or thereabouts. That in turn was nothing to do with procyclicality so that was a combination of securitisation regulation, CCR, CVA basically market driven changes. Threshold driven changes i.e., the inflation of our CET1 base which in turn allows us to risk weight more of the insurance company.

So those were all, nothing to do with procyclicality, but kind of happened in the RWA base in Q1. As we look at this situation any procyclicality or otherwise very much depends upon the extent of the downturn and obviously the severity of the downturn as well. The models that we have as outlined and I will be brief on this as I know you know a lot of it from the call on Thursday and possibly before that. But the mortgage model is predominantly through the cycle model. Some of the Retail models are more point in time and the commercial banking models are more hybrid including as you mentioned in your question the Foundation IRB point. What



happens to RWAs going forward will depend in part on client demand, but on the procyclicality issue at least, blunted by those comments both by the mortgage model comment that I made and also by the Foundation IRB model point that I made.

When you compare that to the ACS what you are seeing in the ACS is a more prolonged and a more severe downturn which is blunted and shortened in this case by Government action by nature of the crisis and so forth. That in turn, if you compare it to the ACS, shows you lower corporate defaults in significant part. It also shows you lower secured defaults albeit that is blunted by the through the cycle point that I mentioned earlier on. That lower level of corporate defaults then mitigates in terms of procyclicality of the asset base.

So on that particular point, Andrew you may want to add one or two points comparing the ACS to the current situation viz a viz procyclicality but I will hand over to you.

#### **Andrew Edwards**

Yes, no I will just reiterate really what you said William. I think and it goes back to through the answer that you gave to the previous question as well. I think the nature of the set of economic assumptions that underpin the ACS and the impact therefore obviously that can have on specific parts of the portfolios clearly is very different from the type of scenario we are looking at, at the moment. And therefore that drives quite a material difference as you would expect in the level of procyclicality that you see. And as William has highlighted we do believe that the structure of our portfolio and the different parts of portfolio we have and different capital treatments that we have mean that we are just much less sensitive, much less procyclical than you might otherwise think.

#### **William Chalmers**

It doesn't mean that we don't see any migration from a risk point of view, it doesn't mean that we don't see any procyclicality. As I said on Thursday and reiterated today, we don't see any significance to the overall picture as we see it today and based on our outlook.

The second of your questions in terms of loans, I will ask Alan Brindley to comment a bit more on the CBILS pricing and CBILS schemes. The extent of Government guaranteed lending on the balance sheet, I would not expect it to be particularly significant over time. That very much depends upon how long this situation lasts for. But if you see the balance sheet as of March of lending, customer lending that is, about £443 billion, it is hard to see the Government programmes adding a material amount to that overall customer lending position. We will have to see how that goes and in particular I think it will be linked to the duration of this crisis. If we see some sort of easing up in conditions as of autumn, then I think we are really looking at a total stock of Government lending which will be pretty immaterial relative to the whole balance sheet. But clearly if it goes on beyond that then the amounts might start to accrue.

The types of levels of lending that we are seeing so far in the case of the CBILS, it is the sort of low, one-ish billion type level. That will rise quite quickly off the back of the Bounce Back Loan Scheme that was announced this morning. But again it will rise to the levels of sort of low single digit billions would be my expectation. Which in turn you can see some context there. And then I think among all that is said with the caveat that we will have to see how long this crisis lasts for.

On the Retail side, the pricing of the Bounce Back loans was about 2.5 per cent. As you know that doesn't incur a credit loss because of the guarantee. So that 2.5 per cent deals with effectively administration costs up front and then any costs that we may incur at the backend in terms of addressing any customer issues that may arise out of lending that subsequently runs into problems.

CBILS pricing, Alan would you mind adding on that one?

#### **Alan Brindley**

So I guess the key point that you made William is we see it as largely substituting and we don't see it as particularly material in the context of the Group's balance sheet. Now our pricing approach doesn't change in terms of pricing against expected RWA and given the Government guarantee, obviously that gives us a significant benefit in terms of the risk weight. And to your point there is also the fee that we pay the Government which bizarrely depends on the number of employees that the business has and there is a difference between less than 250 and more than 250. And obviously the tenure of the loan as well. So we would expect on average between 50 and 100 basis points in terms of that guarantee and obviously that is priced into the customer rate that I talked about. But equally then gives the benefit obviously of covering the interest free period and the capital repayment holiday. So again we don't see it as material in terms of the overall pricing dynamic. There is a variability of potentially 30 basis points on the loan, but as I say not material in the scheme of things.

**Question 9 – Joe Dickerson, Jefferies**

**On the mortgage front and the LIBOR versus base rate, does the 30 to 40 basis point contraction in the second quarter assume a convergence of LIBOR and base rate?**

**William Chalmers**

Yes, effectively it does. On the basis that we haven't priced into that 30 to 40 basis point a sustained difference between LIBOR and base, it is an easier for answering it. So effectively yes we do see a convergence over time and I think the last few days at least we have seen some evidence of that. But yes is the short answer to your question.

**Question 10 – Gary Greenwood, Shore Capital**

**I just wanted to understand pricing dynamics and how they might evolve going forward? Obviously the interest rates environment moved against all banks, lower for longer putting the squeeze on margins that maybe wasn't expected earlier in the year. So I was wondering how you think the industry will respond to that, whether you expect to see prices firming coming out the other side of the Covid situation and just how you see that developing?**

**William Chalmers**

That question can be addressed both to Retail and the Commercial side. Addressing the Retail side first of all. I think we are already seeing some signs of that. The mortgage pricing for example has been sustainably higher since the beginning, actually since the end of last year in terms of front book mortgage pricing versus the mortgage product that is coming off term. And that I think is a function of a change in position really from some of the major competitors. You could argue that that that is going to be attenuated by TFS money, cheap funding from Government sources. That is possible. But we have got less sense of that this time around and I think it is partly because a number of institutions brought themselves to a somewhat difficult position in terms of refinancing Government funding. Therefore it is not obvious that that Government funding is going to drive down mortgage spreads in quite the way that it did maybe a few years ago.

Whether we see that pricing dynamic in other areas, in theory I think we should see it, there will be less capital available, funding markets will be pricing more tightly going forward and we have seen some evidence of that again in the first couple of months of this year. So you have got less capital and more expensive funding. You have got somewhat more constrained competition. And as I say we have seen some early signs of pricing taking account of all of that. But having said that, as the question alluded to earlier on, I think during the course of this year we have to see how the situation develops, how the health situation develops, but also the political situation around that develops. And therefore how markets are allowed to respond to that. It may be that there is a period during which time banks have to respect that environment and that in turn limits the normal pricing dynamics that you might see.

On the commercial side, I think again there is some evidence of that starting to tighten up pricing. We have seen some evidence in pricing dialogues and discussions on for example liquidity facilities whereby newer liquidity facilities are taking account of the type of funding environment going forward relative to those same positions on a historic basis.

So Gary I think it is you know, there are a number of factors that play here, but they are generally leading to tighter pricing conditions subject to as I have said the overall environmental factors which we obviously have to keep an eye on.

**Question 11 – Jennifer Cook, Exane BNP**

**I have one question in relation to your £13 billion POCI portfolio. I was just wondering how much that contributed to the mortgage ECL in the quarter? And the reason I am asking is because I think you used a lifetime PD assessment on that book. So it would be relatively less insulated than say the other mortgages under payment holidays so I was just wondering how much would that contribute to the ECL build?**

**William Chalmers**

We don't disclose that at the Q1 Jennifer. It is a part of the business which we obviously pay attention to, but we don't disclose that exact number in terms of the overall contribution to the ECL. If any of my colleagues on the line would like to add to that then please go ahead. But other than that it just falls into comments and considerations around the nature of the heritage book that we have and the risk factors around that which we give some colour on in the presentation as to the LTV as to the run-off and the fact that they are now averaging around sort of 43 percentage from an LTV perspective with a very large proportion of that below the 80 per cent LTV mark. So those are more risk comments rather than necessarily the allocation of the ECL but that is just because we haven't disclosed the portion of the ECL that goes onto that particular part of the book Jennifer.

**Jennifer Cook**

**Okay and would I be right in my thinking that if you were to take impairments against that book that does impact your revenue outlook as well?**

**William Chalmers**

Well again I will hand over to my colleagues on that. I don't think we necessarily have any particular comment on that point. Jon if you would like to make any comment, please go ahead. I don't think in the short that it does Jennifer but while that would be my answer I would like to confirm that with one of my colleagues.

**Jon Burgess**

Not that I am aware, not materially so, no.

**Jennifer Cook**

**Okay I was just wondering as it would be treated effectively similar to Stage 3 where it would generally have some impact, but I appreciate it is a small portfolio in the context of the book.**

**Question 12 – Rohith Chandra-Rajan, Bank of America**

**I wonder if I could just ask a couple on volumes. I guess looking at the mortgage book, it was down two billion in the quarter, but the industry net lending was up close to £9 billion. And as you commented earlier spreads have improved compared to what we had seen last year. So I was wondering if there was any particular seasonality in the book that is different from the industry as a whole?**

**And secondly one of your peers was talking about mortgage lending, gross new lending being down 50 to 60 per cent in April versus the Q1 run-rate. I wondered if that is consistent with what you were seeing?**

**And just a clarification really just in terms of the mid-markets book which looks like there has been a £24 billion reclassification from mid-markets to the corporate book. I was just wondering what the reason behind that was?**

**William Chalmers**

In terms of volumes versus the industry, no particular trend to call out there. You know our stance I think in terms of the appetite for building mortgage volume versus margin pricing. I don't think that has changed over the course of the last few quarters.

In terms of seasonality of the books, no particular highlights that I would point out. In terms of mortgage lending, we have certainly seen the new mortgage lending come off very substantially during the course of April. We saw some continued completion for stuff that was already in the pipeline in the course of March and April. But in a sense that is completion of stuff that was already pre-booked. As to new mortgage products, much lower than we would have seen over time and 50 per cent is low end of what I would expect to see, I would have thought it would have been more than that. If you look at it as newly originated mortgages or newly completed mortgage as opposed to following on from what is effectively March legacy business.

And as for markets re-classification. I think the re-classification is right it is just a new way of presenting new information. Douglas you may or may not want to add to that, but it is simply a new way of presenting the information on the balance sheet which hopefully is useful.

**Douglas Radcliffe**

It also reflects the way the business is run.

**Rohith Chandra-Rajan**

**What is different about that £24 billion because it leaves you with very little markets of £4 or £5 billion?**

**Alan Brindley**

Essentially the mid-market book is now shown within large corporates that is how it is managed. The mid-corporate portfolio which is businesses that turnover up to £100 billion is managed as part of the SME portfolio. We have just shown it separately so that you can see SME on its own essentially. So to Douglas' point, that is how the book is now run.

**Israel Santos**

And Rohith sorry it is Israel, just one on seasonality. If you look at Q1 of this year and Q1 of last year you can see something quite similar. So driven a little bit by our maturities and when we focus in terms of new business, you see 2019 trends and 2020 trends in the first quarter are broadly similar.

**Rohith Chandra-Rajan**

Okay I was just wondering why those are so different to the market when you are 20 per cent of the market?

**Israel Santos**

We pop in and out of the market as required Rohith.

**William Chalmers**

Alright. Well thanks very much indeed for joining. I hope it was a useful session for everybody and we will call it a day. Thanks very much indeed.

## FORWARD LOOKING STATEMENTS

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