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LLOYDS BANKING GROUP PLC – 2020 Q3 IMS – SELLSIDE ROUNDTABLE - TRANSCRIPT
(amended in places to improve readability only)

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William Chalmers
Thank you everybody for joining this afternoon. We are happy to take questions in whatever order they come up. I think we pretty much said what we were hoping to say from an announcement point of view on Thursday, so maybe we will just go straight into questions.

Question 1 - Rohith Chandra-Rajan, Bank of America
Hi, good afternoon and thank you very much. A few things if that is okay, mainly clarifications so hopefully fairly quick. Firstly, just on the mortgage spreads. If you could clarify whether the spreads that you mentioned, so the 160 basis points on completions and 190 basis points on approvals, whether they're for new bank customers, or whether they include retentions as well?

And then the second one was, SVR attrition was 12 per cent at the half year, I just wondered if that had changed at all?

And then a couple of questions on the lockdown, but I don't know if you wanted to deal with those two first.

William Chalmers
Thanks Rohith, thanks for the question. On mortgage spreads, I mentioned two numbers when we spoke on Thursday. One is margins on completions, which includes new applications and retentions, and that is about the 160bps number that I mentioned, compared to previous front book maturity of more like 140bps. And then new business applications, that is about 190-200bps Rohith, so there is the distinction for you.

In terms of SVR attrition, as of the third quarter we are looking at about 13.6 per cent so it has ticked up slightly since the half year into the third quarter, not by very much, but just up slightly.

Rohith Chandra-Rajan
On the lockdown, a couple of things. It looks like the Government is trying to keep the housing market open. I was wondering if you anticipate any disruption that could impact the conversion of the strong Q3 approvals that you had into completions in Q4, Q1 or even a slowdown in new approvals?

William Chalmers
Good question. As you say, the Government is trying to keep the mortgage market open and obviously that is a very good thing. I mentioned on Thursday that we had a strong new pipeline. Much of that new pipeline is already in the form of applications obviously and we would expect those applications in the main to complete. It is possible I suppose that new business is a little bit slower off the back of lockdown measures. It is too early to tell really on that. But to the extent there is any inhibition around visiting houses and so forth, perhaps that has a marginal effect on the new pipeline. But that which is in the pipeline, that which is in application format, we would expect to largely complete and to, in turn, lead to continued decent mortgage volumes off the back of Q3 going into Q4 as earlier commented on.

Israel, feel free to add to that if there is anything I have missed.

Israel Santos
No, I think you have narrowed it down, so I think applications that are already in the pipes might be a little bit of delay but I wouldn't expect major delay heading into Q4, so I would expect a large volume of those to complete in time. The new applications I guess it all depends on the type of business. Because obviously you are dependent on whether people visit each other's homes to see homes. You are also dependent on valuations and availability of people to go and do valuations, for example, depending on the

property you are buying etc. So more of an impact in terms of new business, but obviously that would impact 2021 rather than 2020.

Rohith Chandra-Rajan

Okay, thank you very much, that is very clear and a final one, again just on lockdown and I appreciate this is very early to be asking you for a view on this, but you talked last week about the positives and negatives of the changes to localized lockdowns and the additional Government support post the end of Q3. I was wondering if you had an early view of what the national lockdown and the Government support that has been announced so far, to what degree that is already captured in the current provision models?

William Chalmers

Well maybe a starting point on that, Rohith, is just to recap on what we have in the current provisioning models and the IFRS9 modelling. The IFRS9 model that we have in the MES, as of the third quarter, which as you know is more or less consistent with what we had as of the half year, we kind of held the base case more or less steady, albeit they differ a little bit. That had within it localized lockdowns, by which it means really just that, i.e. a series of localized lockdowns in a patchwork type of way. It also had within it the ending of Government support as it was then announced as of the third quarter. So an earlier ending of Government support than we have in fact seen. If I put those two together, essentially the localized lockdowns I think have gone probably a step further than we would have anticipated in that Q3 macroeconomics. On the other hand, the Government support has also gone a step further than we would have anticipated in that MES, as of the third quarter. And the extensions of Coronavirus Job Scheme announced on Saturday after the implementation of the national lockdown kind of confirms that.

So as to the net impact, it is just a little too early for us to say and to be too categorical on it. But I think it is fair to say that both the extent of the lockdown and also the extent of the Government support, both of those have gone further and we will be looking at that closely in the context of Q4.

Rohith Chandra-Rajan

Thank you, I appreciate that, thank you very much.

Question 2 – James Invine, Societe Generale

Hi there, thanks for taking the question. I was just wondering if you could talk a little bit about how your underwriting process has actually changed in the Retail Bank. So clearly we now have some professions and jobs that are much more under threat in the leisure sector and so on. Are you specifically avoiding borrowers who have that as their profession?

And then also when somebody has had a payment holiday or they have been furloughed does that count against them in the credit scoring process please?

William Chalmers

I will make a couple of comments on that James and then hand over to Israel to add in one or two points as well. We have, as it won't surprise you James, been more cautious on the credit front since the Coronavirus crisis took hold. That is across all products in the sense that there has been introduction of somewhat tighter credit scores and somewhat tighter indebtedness limits likewise. Where we have particular products e.g. mortgages, we have tended to pull back on some of the high risk mortgages that we would normally offer. So for example mortgages that are above, certainly, 90 per cent, and to a degree 85 per cent LTV levels, we have pulled back on.

Likewise in other product areas, motor for example. We have tightened up the credit scores somewhat and tightened up indebtedness and affordability criteria, across the book. And then similar types of things in terms of cards where for example we have suspended proactive credit limit increases and we have somewhat tightened some of the credit that will be available to certain customers, and again, the same thing on the EPLs. So a number of both generic and product specific measures that we have taken, James.

On the payment holidays, as you know that's been something that has been relatively tightly looked at by the Regulator and we have obviously respected that. That in and of itself, in the context of IFRS9 modelling, has not been taken as a Significant Increase in Credit Risk(SICR) in terms of the staging of that credit. Likewise, we do not have a policy of somebody who has taken a credit holiday, thereby being somehow barred from the credit process going forward. But we are pretty mindful and pretty cautious around extension of further credit for somebody who is already on a payment holiday. And that is for prudential reasons, really for both the individual benefit in terms of avoiding them getting over-indebted, as well as our own in terms of fulfilling our responsible lending criteria. So that is where we are coming from on the payment holidays and as I said, it is intended to be both for the customers and for the Bank's benefit.

Israel, I should give you an opportunity to add anything about credit or payments holidays.

Israel Santos
I appreciate the opportunity but that is quite comprehensive William, thank you.

William Chalmers
James, hopefully that answers your questions.

James Invine
It does yes, thanks very much to both of you.

Question 3 – Fahed Kunwar, Redburn
Hi William, thanks for taking the questions. I have a few if you don't mind. On the hedge roll and on hedge in general, it looked like there was a £500 million step-up in the quarter from hedge income, I think it was £600 million at the first half and then it moved to £1.1 billion in the 9 months. That is a huge step-up and the yield did pick up quite a lot as well, at least on a net basis. Could I understand exactly what was happening there that resulted in an extra £500 million of income coming through in the third quarter?

And just to follow-up on that point, if you think ex-LIBOR you are making £1.5 billion, if a third is rolling off, do we assume, I understand from talking to you and others – Douglas and Ed – that it is not all high yielding stuff, but are we assuming a headwind of around at least £300-400 million from this roll of £60 billion that you were talking about next year? That was question one.

Question two was on other income. It used to be that you were forecasting 6, it kept coming in at £5.7-5.8 billion. Then Brexit happened and that took it down to kind of low 5's, and now COVID's happened, taking it down to 4. And we had a retail review in there as well. Should we assume, going back to £5.5 billion, the extra £200-300 million of the retail review is where we should get if the cyclical pressures are big or is it going to be kind of we declare a victory if we get to £4.5-4.6 billion? Is there a £1.5bn swing in the current run rate of other income, or do you think actually it is a lot less than that?

And my third question is on the sustainability of the gross mortgage lending and pricing, there were differing views on what was happening. It felt like your peers talked about the volume growth and the pricing being pro-cyclical i.e. being more about where we are in this cycle and that it probably wouldn't be sustained post Q3. I did feel like Antonio and yourself were saying and suggesting that it was a bit more structural than that. Can I get further thoughts on how you think about how the cyclicality of your current environment is helping the mortgage market, versus what is structural? Thank you.

William Chalmers
If I take the first one, first of all on the hedge. The hedge picture, for me the best way of looking at the hedge in times of pretty low LIBOR rates, is just to have a look at the overall income that the hedge generates. And we described that in the IMS for the third quarter, or rather for the nine months in totality, at £1.9 billion. And I think, for simplicity's sake, and the easiest way to look at it, some of the confusion around the hedge and the hedge contributions, is because sometimes people are quoting it net of LIBOR costs, and sum total of earnings less LIBOR, and sometimes people are quoting it on a gross basis. I think in times of very low LIBOR the easiest way to look at it is on a gross basis and just say, well the hedge earns us about £1.9 billion in the first nine months of 2020.

That I think then deals with your question about the apparent lumpiness in the first, second and third quarter of 2020. There wasn't really so much lumpiness. What did change was the underlying LIBOR reference space against which people were netting out hedge earnings. So I think that is what has given you the impression of lumpiness in the hedge profile which is less the case. It is rather more just a question of where LIBOR was in any given quarter and therefore, the net hedge earnings in excess of that.

When you look at the roll off going forward, as I said, if we have got £1.9 billion in the first three quarters, you might divide that by three quarters I guess, to a rough run-rate for the 2020 year as a whole, to give you a sense as to what the overall hedge earnings might be during that period. And then looking forward, we have, as I mentioned on the call on Thursday, deliberately adopted a strategy of short-dated hedging for many of the hedge maturities in the last year or so. And that is intended to give a degree of income protection, in the event, for example, that rates go lower. And also, to some extent at least, a degree of income where we have seen opportunities in the curve, as and when they occur.

That has all led to short-term hedging which has therefore gone on top of our regular hedge maturity programme. This means that as you look at the maturity next year and the associated roll-off with that, I wouldn't be inclined to take 60 out of 180 and assume that therefore it is one-third of the overall hedge income that comes off in that year. I think it is more appropriate, in a way, to take a look at the overall hedge earnings, take a look at the life of the hedge which I mentioned was 5-6 years. So that is the profile over which the life of the hedge can be measured, that 5-6 years for that roughly £2.4-ish billion type income.

Now, that therefore, is going to give you a fair guidance to 2021. If you look beyond 2021, as I mentioned in the Call on Thursday, it is actually a pretty lumpy hedge profile. And if you were to use that on a kind of proforma or proportionate basis for 2022 and 2023 for example, you would probably be over-estimating the run-offs because of the lumpiness of that hedge profile. And the reason for that is because back when Brexit came about, and the curve first flattened, the team, led by Toby, pulled off of rolling the hedge over into maturity, into the curve at that point. And therefore the volume of the hedges that were taken on as of 2016 and therefore mature out of 2022 and 2023 is less than you would typically think. And that is what I mean by the lumpy hedge profile going forward, and why, whilst it is probably fair enough to take the average life and the overall hedge earnings for 2021; I would caution against doing that for 2022 and 2023.

Fahed Kunwar
Could I quickly follow-up on that, that was very helpful. You made one point, £1.9 billion gross which is running at about £2.4-2.5bn annual. Divide that by 6, you are looking at about a £400 million drag, so about a 10 bps drag next year. I appreciate your comments looking forward, but we should think that the structural hedge is about a 10 bps drag next year?

William Chalmers
Yeah, I mean I won't be overly precise until we get to the end of this year, beginning of next for Q4 results. But I think again if you are looking at the 5-6 year span, if you are looking at the £2.4 billion in earnings that we take in 2020 and you are dividing one by the other, for 2021 at least you won't be too far off.

Fahed Kunwar
Okay that is very helpful. Thank you.

William Chalmers
Now the important point to make there is that as we look at that run-off - somebody I am sure will come back to say something on the call perhaps - some of that is obviously being offset by the benefits of the mortgage writing that we are doing right now. And in due course we can talk a bit more about that. But when you look at that overall hedge profile, I think it is just important to bear in mind the other moving pieces in the net interest income line before you draw conclusions about what the effect is. I know your question is only on the hedge, but I thought I'd just mention that first.

Fahed Kunwar
I guess what you are saying is the hedge is the deposit income, but obviously then your front book is well ahead of your back book and if that carries on, that offsets a lot of the £400 million odd drag you are talking about?

William Chalmers
That's it. So then moving on to the second of your three questions, on OOI. You mentioned that a number of years back there was a £5.7-5.6 billion type run-rate in this area. And I think if you had looked at the beginning of 2019 you would have come to a similar type of conclusion. The challenge is that, as you say, the time has passed since then to a degree, some of the business areas, particularly within Commercial, have been hit by lower levels of activity. I think you might say the same about some aspects of insurance. And also, as I have tried to point out a few times, you would also say that the first half of 2019 benefitted from a number of one-offs, whether that was change in asset manager, or whether that was longevity, that type of thing. Those one-offs in the first half of 2019 were quite material in my view.

So I think what you are looking at now is an Other Income picture which for the time being at least is impacted by an absence of beneficial one-offs, in slightly the same way. In fact, in Q3, at least, the picture as you know is hit by, one which is the Asset Management Review, which if you add that back in, it is more like £1,070 million or thereabouts, the Q3 Other Income. I think that the revitalisation of that Other Income line is really contingent upon two things. If you look at what is not in Other Income in Q3, then it is a pretty long list in some respects. So, what is not in there is much market activity, being a UK provider we just haven't seen that much unlike some of the investments banks who have more of a US exposure. What is not in there also on the Commercial side is new GTB transaction banking mandates. That again is at a relatively subdued level. Within Retail, I mentioned it on Thursday, what is not in there, is an awful lot of travel and car expenditure. So while debit cards for example have come back, credit cards haven't really come back in the same way, it is still tracking about 20 per cent below where we were pre-Covid. And as you know travel has been hit particularly hard within that.

Then on Insurance, what is in the Oher Income or what is not in the Other Income, not that much protection income because branches have been slower in terms of new mortgage generation, and therefore the protection with that has been slower than we would like it to be. Not that many new workplace mandates, off the back of those mandates being placed more infrequently. GI got hit by August weather and I am slightly reluctant to call that as I think GI will always be hit by things like that in some respects. But GI was noticeably hit by August weather in a way that is more extreme than we would expect to see in a run rate. And then annuities, we saw basically an absence of annuity writing, certainly in Bulk and to a degree in Individual. Therefore many of the engines that we would expect to see supplying that Other Income line, were either turned off or pretty muted during that time.

And then finally, and you have heard me say this a number of times, but we are making some fairly ongoing consistent and significant investments in the Other Income lines across the spectrum, retail, commercial banking and insurance. The platform within insurance, cash management in commercial banking, and package bank accounts in retail. And I would hope that brings it back. But to bring it to a conclusion here, while I would expect to see OOI therefore grow over time, I do expect that growth to be relatively gradual. I won't put a number on it until we give you guidance for the full year, but it is going to be step by step, and in periods of low activity like we are in right now, we are going to feel that from an Other Income point of view. I do think, having said that, we have reached a floor and so I hope that it is relatively speaking starting to recover from here. But how quickly that is, is subject to the points I have just made.

Finally your third question, on the sustainability of mortgage pricing. Two points I would make. We believe that mortgage pricing is a function of a number of things. Supply side constraints. Most of the nation's mortgage providers have had a hard time trying to meet the demand that is in the pipeline right now. Israel may want to comment more on that in a second. We also think it is a function of demand and that demand goes to stamp duty holidays for sure, goes to pent up demand for sure. But we also think it goes to something structural around people changing their lifestyles. So we do believe that there is something underlying there as well, which in turn will lead to a continued pattern of mortgage growth even after the more temporary benefits drop away.

The other point which I think is important here is to view it in the round. We are in an environment of low rates. We are in an environment where much pricing in various areas of both retail and commercial banking is under pressure. Ultimately the UK is a relatively well structured market, and therefore I think mortgage pricing is in part reflecting that. That means that in a low rate environment, I would expect other factors to compensate and at the moment mortgage pricing has taken some of that strain.

Israel, would you care to add on any of that?

Israel Santos
So the only bit I would add on, and I think you made the right point in terms of some of our competitors struggling with the volumes. And I think that is reflected in the very strong Q3 apps margin. So if there was any bit I would say may fall away, I suspect it is that piece to the extent that that margin is particularly high, as competitors find greater back office capacity, that 190 number that you quoted maybe the one. The 160 number is, I think, definitely a sustainable number that we have seen for quite a period of time.

Fahed Kunwar
That's great. Thank you both, very helpful. Cheers.

Question 4 – Aman Rakkar, Barclays
Afternoon William, hi Israel. Just a quick one on costs, well actually I guess more on strategy. Just interested in to what extent we are in a position to make strategic decisions about the business. Obviously we have got fairly material senior leadership change in the organisation. Just interested in to what extent work is going on around re-profiling the cost base or potentially doing anything on RWAs. The kind of thing that perhaps we would have expected as part of GSR4 if it was to be announced in February. Or is it simply a case of actually there is a bit too much uncertainty right now, we have got to wait for this transition to come through before those kind of decisions can really be made.

William Chalmers
In a way there are two questions in there really. One is about costs in particular and the second is about how we are doing on strategic decision making and our work on what I guess is GSR4/SR21. I will take the second one first. The SR21 strategic planning process very much goes on as it always does. So there has been no relent on that. What we are doing, we would expect to normally bring the next stage of SR21 strategic planning to a head at the same time as the previous one is winding down. And that is exactly what we are doing this year. So as we speak right now, there is an awful lot of work going on to culminate before Christmas in the next piece of the strategic work going forward. The reason that can continue is that the executives despite obviously the change in Chairman and change of Antonio the Chief Executive, is actually pretty stable beneath that and has been around a long time. I am by far the newest member I suppose. But that stability helps and also the clarity of direction and strategy helps as well. So everybody actually knows what it is they're supposed to be doing. And when we think about our next leg of GSR,

we pretty much know that 4 or 5 strands have to be in that group strategic review, we are therefore going ahead planning them, figuring out where we want to invest, what we want to do. When the new Chief Executive comes in they will obviously have their say on that. I have no doubt they will also have their nuance on that. But I would expect that 75 per cent or thereabouts is pretty much in the same place. Therefore, from that perspective at least, we can get on fairly much with business as usual despite the management transition that we are seeing.

The second or the first of your two questions related to costs. And to take that as an example, there are a number of areas we are looking at in relation to GSR planning for the next stage. Costs is, as ever, one of them. To an extent it is embedded in other aspects of the GSR planning programme. But to give you some idea on costs, it's really two or three points that I would make. One is, as you know, it is a focus area and an area in which Lloyds has an outstanding track record. And that very much continues on a day to day basis. I think then, there are perhaps two or three strands below that. One is just the BAU management on costs that we do no matter what. It is strategic, it is also tactical, it is long-term and also day to day. So we look at suppliers, we look at organization design. We look at automation, we look at our external Consultant costs, and we are very rigorous and thorough about the way in which we address those and attack those and that is kind of the BAU management piece.

Secondly, there is a question that is based around the opportunities provided by Coronavirus, which is hard to say anything good about frankly. But the opportunities provided by Coronavirus and what do we mean by that? We mean how do we look at the cost base going forward, what does that mean to distribution, what does it mean for our internal ways of working? What does it mean for much of the way in which we address our customer base, from front to back? What Coronavirus has essentially done there in the way that we look at it from a cost point of view, is it has effectively accelerated much of what we were expecting to see anyway. And so, what we are seeing on a cost base point of view is not so much novel ideas, but rather, an accelerated opportunity to realise some of those ideas. They won't all become apparent in 2021, they will take time to play out, but the point is that the visibility of those ideas is becoming clearer by virtual of the Coronavirus situation.

And then finally there is a strategic layer that rises above the management, rises above Coronavirus and looking at that I think that is much more technology oriented around what can we do with the Cloud, what is our long-term distribution plan? What do we do that is really core, versus not core? Those types of things which are more around the strategic pattern, and again, those will take clearly some time to play out.

As a final comment, I think all of this is in the context of wanting to very much maintain a focus on investment, and it's also with the observation that some of these types of cost jumps that we would hope to take over the next few years, are going to require investment. Some of those you will see straight away. I mentioned the slightly heightened restructuring charge in Q4. That is in part because of a) a severance and b) property acceleration. We are looking at the estate and are accelerating some of the closing of properties. But the point here is some of those cost jumps are going to require investment and you will see that from time to time.

Aman Rakkar
Thanks for that. Just one additional follow-up question then. Around your property footprint then in terms of that commercial real estate opportunity, are you able to help us think about what proportion of your cost base you are currently spending on your corporate commercial real estate, your kind of Lloyds commercial real estate. And just to kind of maybe get a sense of what opportunity there might be in the medium term if you rationalise that?

William Chalmers
I won't give you the precise number on that amount, but maybe Douglas is happy to pick up with you on it offline. Two points that are maybe worth making. One is I think the distribution, there are two elements to that cost base from an estate point of view. One is the distribution network, two is the actual head office functions. And by head office I mean there are a lot of head offices within Lloyds. Just as I guess there are with all of the UK main banks. The first of those two, the pure distribution function, the cost savings from closing one branch or two branches are, we have always thought relatively modest, Israel may want to comment on that further. They are certainly there, but they are not necessarily significant. We think that it may also be the case that actually once you get beyond a certain level, i.e., more of a critical mass in the branch network, then you may be able to access more of a fixed cost base and the cost savings may get more material. So that is an area we are looking at to see what the permutations might be, without committing to anything.

On the Head Office costs, again I won't give you a number on it, but that is a reasonably substantial part of the cost base in the way in which we work. I wouldn't want to overplay it, but it is certainly a cost basis worth addressing.

Israel, feel free to add to any of that?

Israel Santos

The only thing I would add on the branches and you have made the point is obviously we have got different size branches across the country and so some of the bigger branches that we have in City centres are still quite limited from a footfall point of view and so they are the ones that from a cost saving point of view would give you the biggest opportunity of closing down those ones. Obviously the smaller branches that you have in more far flung locations will by their nature offer you a smaller opportunity because their staffing levels in those branches are smaller and the space is smaller. So I think the point you made is well made.

Aman Rakkar

Thank you. Appreciate that.

Question 5 – Chris Cant, Autonomous

Good afternoon, thanks for hosting the session as ever. If I could come back on the hedge point please. I think you were saying, firstly, the expected churn next year is a bit less than £60 billion. But then also, that the churn in 2022 and I don't know if you said 2023 as well, would be lower than 2021. And I think you said that's because you have been putting on long dated swaps post Brexit when you filled up the hedge. If I look back on your disclosure, 2016 hedge was £110-120 billion size. By the end of 2018 you were up at £180 billion. And most of that happened during 2017, but the average duration you reported on the hedge throughout 2016 and 2017 was three years. I am trying to understand how you would have been putting on swaps during that period post-Brexit which would only be maturing in 2023 or 2024 or 2025 without the average duration changing. How, am I misunderstanding something about the nature of your disclosures there? I am just struggling to understand the specific rationale you gave as to why the proportion of the hedge maturing into 2022 would decline?

And then as a broader point, on the importance of this for your strategy looking forwards, I think about your 3Q P&L, cleaning up for the asset management review and annualising, you had about a £3.5 billion net income number for the third quarter specifically. And that is on obviously a fairly normalized cost of risk below 2019 levels. If I think about the structural hedge within that, if annualising at £2 billion of NII, so net of tax, just up £1.5 billion. So that is £3.5 billion, that £1.5 billion is the structural hedge. And over 4-5 years that £1.5 billion is going to disappear, assuming the curve stays as flat as it is. So when I think about your longer term targets and returns expectations, do you think you can grow the other bit of net income, the £2 billion that is not structural hedge, can you grow that sufficiently to offset this pressure, or should we just expect bottom line net income, even on normalised cost of risk, to be lower in 4-5 years time? Thank you.

William Chalmers

Thanks for the question. On the first question, I am not sure whether you heard me exactly correctly earlier on, it doesn't sound like you did. But just to give you some idea there. What I was essentially saying was the effective churn for 2021 was along the lines as discussed. Again the £1.9 billion for the three quarters, annualising that and then taking a 5-6 year time frame off the back of that, would give you your 2021. More or less, not exactly, but more or less. We will give you more detail at the end of the full year reporting period. I put 2022 and 2023, again I am not sure whether or not you heard exactly what I was saying, but the combination of the volume of hedges that we put on, plus the rates at which those were put on, leaves us to give you a sense for 2022 and 2023 hedge attrition, if you are going to use that same calculus, you are going to get it wrong. I am not going to get into the finer details of the hedge profile in much more intricate terms than that really. I was referring to 2022 and 2023 earlier on, and we have much milder, hedge run-off during those two years. And of course, by definition, that is a result of the amount of hedges and the rates of hedges that we put on in earlier periods. So again feel free to look at disclosure of previous years and have a chat with Douglas about exactly what went on and when. But that is the reason why it is lower in 2022 and 2023. And that is probably all I can say for now on it.

On the P&L, again on that I will leave you to do the calculations as you wish in respect of that. You have a sense I think as to the makeup, the building blocks around that net interest income. I have given you a pretty good sense I hope as to Other Income. I told you what we are trying to do about both in the context of net interest income, we talked a lot about mortgages, and we talked about the dependency of unsecured across cars, across motor, across UPLs, on activity and the pace at which those will come back. Again I have given some views on those. When you get to Other Income, I think I have been relatively clear about what we are trying to do both from an organic and from an investment point of view within that. And then it is really up to you. The one point I would make though Chris, when you look at all of this is I think you do at some point have to step back and decide whether the market is a rational market, a well-ordered market that allows large-scale incumbents to make a decent return, or not. That is your call as much as it is ours. But I think you have probably heard my views before on that.

Chris Cant

Understood. On the 2022-2023 point, maybe I need to follow-up with Douglas. But it does seem to imply that your historical hedge disclosures were incorrect.

William Chalmers
I have said all I can say. Please go into the detail with Douglas on it, I am not going to say any more.

Chris Chant
Okay, thank you.

Question 6 – Robin Down, HSBC
Hi, afternoon William. I don't want to labour the structural hedge point. But essentially what I think you are saying is that of the £60 billion that rolls off next year, £30 billion we can kind of largely ignore, it is the other £30 billion that was perhaps put on pre-Q3 that actually has an impact. But what I really wanted to try and get an insight into how you are thinking, we have also got that £30 billion that is going to roll-off and if the yield curve stays where it is, is going to be reinvested at very low levels. But going the other way, if I understand correctly the way you are trying to think about things, if we look at the mortgage book and assume it has an average life of kind of three and a half or four years, and again maybe 50 basis point spread uplift from that. That will broadly offset the impact, plus or minus, £50 million of the structural hedge in 2021. Is that how you are broadly thinking about it, is that how you get some comfort in terms of margins?

The second question, I just wonder if I can come back on the cost side, and I appreciate it is Q3 and you don't want to give any 2021 guidance, I have heard what you said earlier in terms of going to GSR4. But just in terms of broad profile for 2021, in the last couple of years I assume you hit the target for this year, we are kind of seeing 3-4 per cent cost decline ex-remediation coming through. Is there any particular reason why you would dissuade us from pencilling in a similar level of cost guidance for 2021? I am assuming that you are going to be quite tight on expenses and obviously there are some opportunities as you mentioned earlier in terms of Covid, coming through. So is there any particular reason why we shouldn't be plugging in on anything other than the 3-4 per cent in this early stage and I expect you will update us at full year?

William Chalmers
I think on the structural hedge point, I probably should stay away from being too precise in terms of exactly what was added on when, but it is generally the case, as you say, that of that £60 billion, a fair chunk of that was short term hedging that has been put on in the context of trying to protect the business during the period of pretty low rates. So that is the context, and as you say, some of that £60 billion therefore is regular or rather, better, hedge margin. Some of it is frankly lower hedge margin, on that third point you mentioned.

On the second of the two points within that area that you mentioned. I think Robin and please correct me if I am wrong, your question is to what extent is mortgages effectively offsetting structural hedge loss in earnings. I think there, I will probably make two points. One is as you look at the near term, well let me take a step back actually. The Q3 margin story is very much about liability-led improvements actually, rather than asset side improvements. So it was that deposit repricing that went on across the business that benefitted spreads. Obviously there are other offsets, but clearly you saw it in Q3. As you look forward into Q4 it is actually the asset side that takes over, and it takes over because of that mortgage pricing that I mentioned earlier on, per my answer to Chris's question just now, that I think is part of the kind of rational market adjustment that we are seeing.

So that mortgage pricing being relatively positive is the story for Q4 and obviously because the balances get built up it starts to become more of a story for next year. It does offset, but to be clear, I think it offsets more in the near term, because we have got relatively modest hedge reductions in Q4. I mentioned about £10 billion in the call on Thursday. And so that offsets a decent chunk of those hedge reductions in the near term. As you see the full weight of the hedge maturing during the course of 2021, even though we are adding mortgages on a reasonable clip right now, as Israel's comments mentioned earlier on. The level of that offset as a proportion of the hedge earnings that are lost becomes a little bit less. Simply because the mortgages can't work fast enough, or can't come on in enough scale quickly enough, to fully offset that hedge tail-off. It is an offset, it is still very helpful and it is still material, but proportionally it becomes less the further you get into 2021. And that gives you a sense of the dynamics, Robin, around that.

On the cost point, I will be careful because, as you rightly say, that is a function of 2021 guidance. So I won't go into that in any great detail, other than to say that when you look at Q3 in 2020, as you know we made a fair bit of progress there. And we made it despite the fact that there are Coronavirus-related headwinds including for example, no role reduction activity that we had, including for example some of the Coronavirus-related cleaning costs that we have seen. Coronavirus does some things that cut costs, e.g. reduced travel. But there is no doubt that it is a net negative. For this year that all leads us to the continued commitment to less than £7.6 billion and we stand by that and will deliver that. As we go into 2021, we are obviously looking at that now, and I won't give any guidance around that now. All I am saying is that there is a combination of headwinds and tailwinds that we will see in the course of 2021. The headwinds again, Coronavirus comes into play, customers' financial difficulties come into play.

Dealing with banks loan legacies likewise come into play. And in 2020 we have had lower compensation costs in line with the business, that will come into play. At the same time we will also see some tailwinds from previous investments that we have made. And I have no doubt that we as an organisation will continue to be very committed on cost reductions and we will get there and will give you much further detail on exactly how that will fare when it comes to Q4. But as I said, it is going to be a combination of headwinds and tailwinds to be taken into account.

Robin Down
Thank you.

Question 7 – Martin Leitgeb, Goldman Sachs
Good afternoon. Just a question on how to think about unsecured balances going forward, in particular credit card balances, and obviously a lot has changed in terms of reported a few days ago. I was just wondering do you see a risk that customers could again use mortgage payment holidays, which now look like being extended, to reduce further unsecured debt, particularly card debt and kind of re-shuffle their own debt stack? Is there a risk that we see a further step down in the next quarter in those balances?

And then second question, just on M&A. Again over the weekend there was some news flow that one of the larger retailers was considering putting its banking arm up for sale. Could you just give us your view on M&A in the UK banking sector, would you expect the markets to consolidate just given revenue pressure which was discussed over the last 60 minutes? Would you expect Lloyds to be an active participant in such a consolidation and if so, what kind of product areas would you be most excited about, in terms of purchase opportunity? Thank you.

William Chalmers
Sure, thanks. Mortgage payment holidays, you have probably seen the announcement out today from the FCA, which suggests that payments holidays will be back in the mix again after we had expected them to close effectively as of 31 October. I think what is going on there, it won't surprise you, is the FCA wanting to act in sympathy with the broader lockdown and the other measures that the Government are taking, and asking the sector to reconsider the holiday position. At the moment at least, that is directed towards those customers who have either not had payment holidays before, or had only a three month payment holiday before, in which case they can ask for an incremental three months, taking a total allowance up to six. So stepping back, as you know from our disclosures at 3Q, our payment holidays experience has generally been pretty good. We have now got 82 per cent repaying, 15 per cent extended with about 4 per cent arrears across the book. Some of those arrears were either in arrears when they started, or arrears at one down. So some of them will clear themselves as a result. I think looking forward, and this is only an expectation, so take it with a degree of caution. I guess logically I would have expected that the individuals that were taking payments holidays in the first instance were those that were either seeking to take precautionary measures, and I think the repayment statistics suggest a fair number of those payments holidays were doing just that. Or they were payment holidays for customers who had frankly perhaps suffered greater difficulties. So those who would be asking for payments holidays at this stage, who have not already had them, I would just be interested to see what kind of sub-segment that is, and what the characteristics of that demographic is. But I do think Martin, to your point, do we expect more payment holidays to come as a result of this change? I think logically yes. But as I said, it comes in the context of the payments holidays we have already had are very largely repaying, number one. Number two, I would just be interested to see what the credit characteristics of those people who did not ask for payment holidays first time around, but are asking for them now. What those are will be interesting. And I guess my inference is, I would expect that pool to be perhaps slightly smaller than we saw the first time around.

On the second of your question, M&A and consolidation. We saw the stories in the press just like you did and I wouldn't want to comment on any particular situation, but I would say that where we are, in a market with very attractive pricing that we can secure on an organic basis without engaging on M&A, then that is what we are going to do, because we can write it to our own standards, we can write it under our own controls and our own systems, there are no integration issues etc. And so when we look at opportunities like that, we certainly compare it to our own organic opportunity and at the moment our own organic opportunity is strong. So that is the compare and contrast. I think the other point that you alluded to Martin which I would agree with, is that all of this is a sign of consolidating market which logically over time ought to favour the large scale incumbent players. And many institutions I think are just finding it frankly less easy to make the returns, and are therefore pointing out, which over time like I say I would hope would benefit us.

Martin Leitgeb
Thank you very much.

Question 8 – Andrew Coombs, Citi
Afternoon, a couple from me and just building on some of the points you have already raised. The first is the commentary that Antonio provided with the quarterly call about a rational and orderly mortgage market. He did make the point about

stamp duty, but also suggested function and customer behaviour, the structural shift there and the banks were pricing up to reflect the drag that we were seeing elsewhere. Last week NatWest gave somewhat more conservative guidance I would say, saying they felt that the phenomenon was more something in Q4 and Q1, and post stamp duty we might see some more pressure in the mortgage market again. So perhaps I could just ask you to revisit those comments and thoughts?

And then second, kind of attached to that, is if you have got a rational and orderly mortgage market, then they counterbalance this pressure you are seeing elsewhere. The old return on tangible equity targets, statutory return targets, going back in my mind now to GSR3, but I think it was 14 per cent. How realistic is it to get even close to that in this low rate environment? Thank you.

William Chalmers
Thanks Andrew, thanks for the question. On the mortgages, I won't obviously comment on what others have said, but from our perspective, as your question alluded to Andrew, we see a mix of factors in there. I mentioned a little bit earlier on and will ask Israel to comment as well, but a mix of factors includes some temporary phenomenon I think without a doubt. Those are stamp duty holidays. Those are the pent up demands from the first lockdown. Those also include supply-side constraints. Many large players have been having trouble, frankly, meeting the supply side. We took some effort earlier on in the year to employ a few more people in that area, so that we hope we are doing better than most. Those are examples of measures that may be more transitory. I think, having said that, there are some structural measures; the rate environment is clearly one of them. The move of people from one lifestyle to another is clearly another, including things like working from home dynamics and so forth. And so we do think there are some longer lasting structural dynamics in there, which lend themselves to support. I have no doubt there will be variations in pricing for sure, that lend themselves to support for perhaps a little bit longer than the very near term.

Before moving on, Israel is there anything further that you would add to that?

Israel Santos
No I think that is absolutely right. I read with interest obviously what was said by NatWest on Friday. I can understand to a degree what they were talking about. They are putting a date of stamp duty ending as being the end of this good position. I am more in the camp of the customer behaviour changes are real. We can see it happening on a week by week basis, that transition of customers from city to country, from smaller dwellings to bigger dwellings, from city living to outside space. We are seeing that now in life, so I believe that is real. There is a question mark over whether the stamp duty holiday may be extended, who knows, it's a question mark given the latest news. And I think the price rationality point is a relevant one. If we think back to pricing in the last few years, we haven't been active participants in that market because we haven't felt the market has been rational. And the market is acting rationally, and given other pressures, I suspect or hope that that would be what continues.

William Chalmers
Thanks Israel, and then Andrew on your second question around RoTEs. As you said there was an RoTE ambition in the last GSR of 14 per cent. When we look forward now, we are obviously in an environment of low rates and it looks like we are going to be there for a period of time. I do think earning very attractive RoTEs in a low rate environment is obviously much tougher from a bank's point of view. Having said that, consistent with my earlier comments, I think it is a rational market, which ultimately large scale cost advantage players who run the businesses well, should be able to earn a respectful return in the medium term. But could be, particularly with the news on Saturday, that we are in for a couple of years of kind of transitional returns in that respect. But again a respectful return in the medium term I think is a reasonable ambition for a large scale player in this market.

Question 9 – John Cronin, Goodbody
Hi there and thanks for taking my questions. The first one is M&A and I am not going to ask on any specific opportunities of course, but would you have a resistance to bulking up further in unsecured personal lending for example? Or would you see it as a potential attractive segment from an earnings perspective given the other income pressures?

And secondly, how do you think about the scope in a longer-term context for recycling some of your excess deposits into Wealth and how might that influence your view on fees, if at all?

And if I can stick in a third one. Just on mortgage pricing again, let's just challenge that on the rationality of the market. I mean we heard you speak positively about the returns from a products RoTE again early last week. How worried are you that HSBC or Nationwide or others could just force the market down again in a bid to build stock share?

William Chalmers
Thanks, John. On the first of those three questions, M&A in the unsecured personal lending market. The way that we look at M&A of this type is that where there are value added opportunities that we can undertake without undue risk and at a reasonable

price, which obviously goes into the definition of value added I guess, then we will look at them. And we will see whether or not there is real value to be added there. And it has to be a focus on that because the capability add is obviously limited, at least in most of those types of areas. So I don't think we are actively looking at M&A in that space. Having said that, we will act in the best interests of shareholder value, and we will look at opportunities out there as and when they come along with that framework in mind. Tesco's last year was quite a good example of the way in which we would look at that. I do think that in that particular area of unsecured personal lending, we would be pretty careful right now. We have got a book within our own area, of credit cards for example, which is a premium book. We have taken great care to grow it responsibly. And we think that we are appropriately positioned as we go into this environment. We don't want to extend ourselves in that respect. We don't want to go beyond parameters that we feel very comfortable with. So anything that comes along on unsecured personal lending, as I said, we will view it with shareholder value creation in mind, but we will view it fairly carefully given the environment that we are in.

The second of the two areas, recycling excess deposits into Wealth, and that is interesting, as you know, we are up about £35 billion in deposits so far this year. A chunk of those in Commercial, a significant chunk of those in Retail, about £20 billion in Retail, of that £35 billion. There is no doubt that in a lower interest rate environment, that money ultimately is going to look for earning slightly greater returns, or should do anyway over the medium term. We would see ultimately the area of Wealth as an area that we would look to build in. We have got the Schroders Personal Wealth combination joint venture there, which is as you know, kicking off right now. That is a key area of growth going forward. That is for a certain demographic and is part of the strategy. I think we will look to build that Wealth proposition out over time. And therefore those deposits that we have seen across the business obviously most recently evidenced by the £35 billion in growth. We do see it as natural for them to potentially go into Wealth areas. We will look to build up that offering to customers, John. We will also be very mindful of building it in the right way. That is to say, in customer interests, a full and clear eye on any conduct constraints. But that movement of money and making sure that we serve our customers' interests is certainly on our agenda.

And then finally on mortgage pricing. It is hard in a way to add much more to what we have already said. I think HSBC and Nationwide will obviously do what they want to do. I would underline the fact that they are in the market today, and yet pricing is where it is today. And so, ultimately HSBC and perhaps even Nationwide still have to earn an acceptable return within those businesses. And I would hope that they are mindful of that. But as I said before, mortgage prices go up and down, but we do think there are some reasons as to why it should be stronger for longer given the circumstances that we are in.

John Cronin
Thank you

Question 10 – Chris Cant, Autonomous
Hello again, thank you for taking another. I just wanted to follow-up on these comments around rational mortgage pricing. So again, thinking about what NatWest have said in the past and recently. They thought 80-100 bp spreads were consistent with a mid to high teens return on the products. They indicated that Q3 completion spreads would be north of 30 per cent returns. Given that things have widened since then, we are probably up closer to 40 per cent returns on mortgages. Do you think that is rational, sort of 40 per cent or 30 per cent plus, if we revert back to kind of Q3 levels? Do you think the market will actually sustain that? And when you talked about consolidating markets, if I think back to the period where most of the challenger banks sprang up, it was a period of wider mortgage pricing. Do you not see a risk that we see a return to new entrants to the market if there are 30 – 40 per cent returns on offer? Thank you.

William Chalmers
Yes that is a fair question Chris, obviously the debate we have just been having. Without adding too much to the points from earlier on, I suppose that the points maybe worth highlighting are that it is less a function of looking at any particular narrow product line, although clearly one would look at that. But also worthwhile just stepping back and saying, what are these institutions earning on a broader basis? And in a zero or low rates environment, one has to look at what are the institutions earnings, for example, off of the float recorded by deposits, there would have once been a liability margin there. Less so today as you know. What are businesses earning elsewhere? There is a lot of impairments going on so returns are suffering off the back of that. So I think that the rationality of the pricing is for the product line in isolation, sure. But it is also for the institution as a whole. And I think we are probably not the only ones who would look at it in that way. Most institutions would say, well how am I getting a decent return out of this business. And mortgage pricing, I think, would be partly set in reflection of that.

Second point is there has been an expansion of mortgage pricing typically in downturns and that has lasted for a number of years. It was certainly the case during the financial crisis and was also the case in the crisis before that. It is not to say that it doesn't then go through a further competitive cycle in due course but it is to say that mortgage pricing expanding is a function of banking downturns which we have seen before, and that is partly what we are seeing today, I think.

And finally, as I said earlier on, we will see a bit of volatility. I think we see structural reasons why it may stick around as I said before, stronger for longer. We will just have to see how that fares, but that is our view.

Chris Cant
Thanks.

William Chalmers
Thanks very much indeed to everybody for showing up and thanks very much indeed for questions. We look forward to staying in touch as we go through the next few weeks.

END

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