LLOYDS BANKING GROUP PLC – 2021 HALF YEAR RESULTS – SELLSIDE ROUNDTABLE TRANSCRIPT
(amended in places to improve readability only)

Friday 30 July 2021 – 2.00pm

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William Chalmers
Thank you to everybody for joining. As usual we have a number of the senior finance team on the line with me. So depending on the nature of the question we will ask for their input which hopefully will be useful to you all. So again thank you for joining. You heard the results yesterday. I hope the Q&A session was helpful but perhaps without further ado we can start to take some questions.

Question 1 – Rohith Chandra-Rajan, Bank of America
Hi, good afternoon and thank you very much for doing this call. Please could I revisit a couple of the topics that were discussed in some detail yesterday - capital and mortgages. On capital, a couple of things, thinking about the capacity for additional shareholder distributions at year end. In terms of the Q2 CET1 ratio, after removing IFRS9 software, regulatory RWA inflation and the Embark acquisition, takes the CET1 ratio to 13.9 per cent proforma. We then obviously need to think about capital generation in the second half of the year, final dividend and dividend-linked pension contributions. I just wanted to check that those were all the pieces that we should be thinking about when we consider what capacity there may or may not be for additional distributions at the year end. That was the first question, please.

William Chalmers
Okay thank you Rohith. In terms of the building blocks for capital, we stated our 16.7 per cent position at the half year which is a strong position. We also talked yesterday about the software which is around 50 basis points, about the transitionals which is 78 basis points. But those transitionals can go either way at least that is what experience tells you, Rohith. That is to say, they can come out if the macroeconomics play out exactly as we forecast them. On the other hand, if the macroeconomics are better than we forecast them, then they can effectively de-risk the CET1 ratio and become a solid part of that going forward. So that is the second building block. As to the pensions point you made, we have made full payment of the fixed annual component of our new pensions contributions schedule (£800 million). Any further 'in year' cash distributions will obviously now primarily refer to the interim dividend payments. We would have an additional cash amount for that at the end of the year. Then as you say there is the profitability of the business going forward. There is Embark as an acquisition, for which 30 basis points will come out at the end of the year. Those are the building blocks. I will leave you to do the maths across that.

Rohith Chandra-Rajan
Okay, thank you. So the cash distribution linked-pension contribution is about what is paid in the year, not what is accrued and declared in the year. So as you said, the interim only?

William Chalmers
Yes it is a cash link and it is in year, Rohith. In this case it is the interim cash dividend. And the narrative of it or conclusion of it is that when we look at that capital position as I said yesterday, it is a very strong capital position, I expect that to continue to the end of the year and I expect that to give us choices as to what we then do with excess capital, whether that is buy backs or special dividends in the context of the environment at that time and at the discretion of the Board.

Jon Burgess
William, the pension component will relate to full year 2020 and the half year. It is a relatively small number, from a capital point of view, but it is both components.

Rohith Chandra-Rajan
Okay thanks very much for that Jon. And then staying on capital, the risk-weighted asset chart on slide 19 seems to imply quite a bit of optimisation next year. Is that still mainly focused on commercial and does it have any loan growth or revenue implications?

William Chalmers
Thank you Rohith. As I said yesterday, the optimisation process is a continual process of balance sheet management that we have in the context of trying to make sure that the balance sheet is as efficient as possible. In some context that is going to encompass low-returning assets in the non- or less- relationship areas of the business, often in commercial. In some cases that is going to be driven by capital efficient securitisation. In some cases, by better collateral management. In some cases, by re-rating of assets, and optimising other transactions. So it is a variety of different techniques that we use in optimisation. I would say it applies to the business as a whole Rohith, but inevitably, there is a concentration within commercial.

As to your question around income. Typically if you get rid of any asset that has a yield attached to it then there is going to be an income consequence, however modest that might be. But I would stress that these decisions are always taken in the context of economic value added, net present value type screens, which make it a very capital and value accretive transaction to do. So I don't anticipate significant revenue headwinds from the optimisation process either this year or next, but I do anticipate it continuing to be an important part of our balance sheet management in the interest of shareholders.

Rohith Chandra-Rajan
Okay so there may be some revenue impact but it is return positive?

William Chalmers
I would say it's a very modest revenue impact.

Rohith Chandra-Rajan
Okay and then a couple of quick questions on mortgages please. One of your peers this morning indicated that their end Q2 application spreads were about 20 basis points below their average Q2 completion spread. How does that compare to your experience? Also to touch on SVR again, you highlighted the attrition is running at 15 per cent. So SVR is now about 15 per cent of the book down from 20 per cent a year ago. I guess most of the other major UK lenders are some way below 10 per cent. So I was just wondering if there is a natural level that you think that gets to over time or if there is anything different about your SVR book that means it won't converge with peers over some period of time?

William Chalmers
In terms of the application spread, I noted the comments which you were referring to during the session this morning. I would say that our applications pricing in the course of the current period is well north of what they indicated during the session that they had. While it is below the completion margin during Q2, it is significantly less below what that party has indicated. I won't give you a precise number, just to stick to our stance from yesterday. But it is materially ahead of the application margins that were being indicated by that party you are referring to.

On the SVR book, it is interesting. As you say, we are quoting 15 per cent SVR attrition during the course of the second quarter. That is a year on year number Rohith. We are watching it closely as to whether or not it reacts to increased home mover demand in the overall mortgage book. And the most recent evidence as of the last month or two, and Israel may care to comment further on this, is that it has been relatively more benign, i.e. it is running at lower than 15 per cent.

On your question as to the SVR book as a whole, as I said in my script yesterday, the 15 per cent is on an annualised basis but it is actually off the back of a smaller book, so the absolute loss of SVR that is incurred by that percentage is obviously falling with that. And in terms as to whether it is different to other SVR books, yes I think it is actually. I think it is probably smaller balances and lower pricing. If you look at the differential in our front book and back book pricing on SVR in particular, when we compare it to any of the rest of the market it is materially lower and is coming now off of relatively low balances on average. Israel may have the number to hand. So we feel pretty comfortable with the SVR book. We are watching it closely. Hopefully what I have just said is useful additional information. Israel please do add if there is anything you would like to?

Israel Santos
No I think that is it, thank you.

Rohith Chandra-Rajan
Okay thanks very much for all of that.

Question 2 – Omar Keenan, Credit Suisse
Good afternoon. Thanks for making the time for the sellside roundtable. I have two questions please. One on rate sensitivity and one on the customer migration to the new bank architecture. Firstly on rate sensitivity, I think the one year rate sensitivity was just over a billion at the full year stage. It might be a little bit early to discuss the impact of the Bank of England rate hikes, but I was wondering if you could perhaps give us some insights into how the management team are thinking about how rate sensitivity is evolving and how any behaviours might change or how the bank is being positioned for that and how we should think about rate sensitivity when it eventually happens?

And the second question that I had, is on the new bank architecture. I noted in the slides that 120,000 customer accounts have been migrated to the new bank architecture with Thought Machine. Can you perhaps share with us how important the project with Thought Machine is and do you envisage that one day all customers might be on this new bank architecture? And what it might mean for cost:income structurally going forward? Thank you.

Toby Rougier
On the hedge position, in terms of where we are, we gave you the current position. In terms of remaining maturities we have about £30 billion of maturities during the rest of 2021 and we have about £10 billion of unused capacity as well. And going forward in any one year we will have between £20 and £30 billion of maturities on the hedge. So we have plenty of capacity to invest if we see rates pick up at all. As you know, they have been relatively flat since the end of Q1. You have seen the investment that we have made in Q2, so we are continuing to invest. We are typically keeping the weighted average life of the hedge just slightly under what would be a neutral position for us. But if we do see rates pick up then we have the capacity to take advantage of that.

Carla Antunes da Silva
On the migration point, we highlighted there was a de-scoping of that exercise. If you recall we gave a target of 400,000 and we went for a smaller number in order to make sure that it was successful and to have the PCA customers migrated onto Thought Machine and that was very good. That was mid-June and we managed to get several million data points migrated safely and have them on cloud native technology for the period of five days. But it is still very early for us to be able to talk about what this means about cost saves and efficiency. What is clear, is that we are able to build a lot of our technology and our investment on cloud basis technology, which is what we are trying to do. As soon as we have any more to give you on data points we will come back to you, but for now it was the successful data points that gives us confidence to continue.

Omar Keenan
Thank you Carla.

Question 3 – Fahad Changazi, Mediobanca
I have a question on bulk annuities. Please could you comment on pricing in the bulk annuity market during the year given tighter corporate spreads? Did you manage to back annuities with liquid assets and corporate bonds? I just noted that new business income is low but it could be just down to volume. Thank you.

James Hillman
The lower volumes have certainly increased competition on pricing. Volumes are certainly down across the market in the first half of 2021. We have held our pricing discipline and as a result our volumes have been down. In answer to the second part of your question, we have been successful in sourcing illiquid assets to back annuities that we have written, whether that is individual annuities or the bulk business. And we have therefore been successful in using those to support the new annuity business and spreads on those illiquid assets have been perhaps a bit more resilient than even those on corporate bonds.

Fahad Changazi
Could I just follow-up on that question please. I noticed that you launched a new equity release product earlier in the year. What proportion of your new annuity assets are illiquid and are you happy with the mix or will you change that going forward? Thank you.

James Hillman
The proportion of annuity assets in illiquid is largely unchanged from where we were at the end of 2020, we disclosed that in our solvency and financial condition reports. So about 54 per cent. And in respect of the illiquid assets back in those, they are well diversified and we continue to want to run a well diversified portfolio for illiquids.

Fahad Changazi
Thank you.

Question 4 – Aman Rakkar, Barclays

Good afternoon everyone. I have a couple of questions. Can I come back to the commercial book – it's around your RWA guidance. I was wondering if you could tighten my understanding. In terms of the guidance for this year, you talk about less than £200 billion. Is there any chance that you could put a more precise number on that? And the reason I ask is, you are flagging £15 to £20 billion of regulatory RWA inflation next year. To take the midpoint of that that is £17 to £18 billion and then combined with a little bit of growth gets you to £20 billion. So we are looking at something like £220 billion of RWAs. If the offset to get back to £210 billion is commercial, we are looking at £8 to £10 billion pounds of commercial banking RWA optimisation which is around 10 per cent of the commercial RWA base. Is there any chance you can help me understand if I have got my numbers in the right ball park. And if that is the case, the idea that that doesn't potentially have a material revenue implication is something I am struggling with a little bit.

The second would just be around the costs commentary from yesterday and I think we might have had a go at probing this but I will have another go. On the variable compensation which has been reintroduced into the cost base this year, is there any chance you can help us understand what that might mean for costs in the subsequent year and beyond? I note the comment that we are rebuilding an element of costs that would have been in the 2022 cost base and everything else is on track. Should we be adding a £100 million pounds to the annual cost run-rate going forward? Anything you can add to help me understand about what the follow-through is on those variable costs please? Thank you.

William Chalmers

On the first of your two questions Aman, on RWAs, we won't be much more precise than we were yesterday. There are a couple of points that I will add which perhaps are helpful. One is when we said below £200 billion, we didn't mean £199 billion, we meant below £200 billion so you can assume that there is some degree of flexibility there.

Number two is that we are being quite conservative in terms of some of our approaches to the impact of CRD-IV and associated measures of, say, CCR as well, associated with measures to the early part of 2022. We don't want to get those wrong, so we are being somewhat conservative in those measures.

And then finally on the revenue concern that you have, there is for sure, a degree of optimisation in our numbers and that is why we have put it in the chart. But on the other hand it is to a degree spread around the business, but more importantly, it is also including a number of very de minimis actions from a revenue point of view. So whether it is appropriate collateral recognition, whether it is optimising transactions of counterparties in the market, whether it is recognition of CTS across the portfolio. There is quite a lot that can be done in optimisation, but it does not materially impact on revenues. And so I would answer your question on RWAs with those three points really. We have given you some rough numbers which have given us a little bit of room for scope, number one. Number two, there is a conservative approach to some of the numbers that we have given you to make sure that we don't get it wrong. And then thirdly, there are a number of techniques in optimisation that should be de minimis for revenue perspectives. But to be clear, optimisation is a part of the balance sheet plan next year, so I wouldn't want to dismiss that at all. But the revenue concerns that you have are not concerning us quite so much.

On the costs, I will ask Jon to add any IFRS2 comments that he would like to, but in essence yesterday what we stated was hopefully clear in the sense of what we have done for the incremental £100 million of variable pay, taking our guidance from circa £7.5 to £7.6 billion. That is an acceleration, and is not a one-off bonus for a better year. It is because we have seen better financial performance both in income and impairments, in the business. And so on the basis that income performance continues to persist going forward, then you are going to see that recurring into future periods. Now there is an IFRS2 point underneath it, relating to the amount that we effectively accrue in any given year, which perhaps Jon you want to add a bit of colour on?

Jon Burgess

Yes. So because the awards are in part via shares you recognise some of this year's bonus pot will come through in 2021 and some will come through in 2022. And the same way as in 2020 we have a zero bonus pot but we still have a charge of about a £100 million because that related to prior periods. So you do get that impact. To confirm what William has just said therefore, this isn't a spike up in terms of bonus-related costs that then dip back down. I would say it is a rebuilding up to the sorts of levels that you would expect to see on an ongoing basis. And in terms of publicly available information, in the 2018 report and accounts we talked about a bonus pot of over £450 million and in 2019 it was £300 million and in 2020 it was zero. So we are rebuilding back up to a level that will then be sustainable.

For 2021 the revised guidance talks about the £7.6 billion which is flat year on year, and that will be despite the very sharp rebuilding of variable pay, and therefore underpinning that, as you would expect to see from this Group, is quite a lot of significant savings still landing in year to mitigate that headwind. It is not in the same place as original guidance, but it is still flat year on year. Therefore there is a lot of underlying cost delivery still happening through the cost base in 2021.

Aman Rakkar
Thanks so much for that.

William Chalmers
Sorry Aman, just to go back to your first question briefly, the optimisation is not a new thing. The optimisation during the course of this year, we have done in the past. So the extent that your concern is around income effects as I say we have been doing plenty of optimisation over the course of this year and years prior to this which again has confirmed our comfort in any potential revenue impact around it.

Aman Rakkar
Thanks William. Can I just ask what your experience with RCF repayments are and your early stage experience on the other Government-guaranteed anniversary, are you seeing corporates repay?

William Chalmers
In terms of RCFs is that a credit question or an extension question, Aman?

Aman Rakkar
I guess RCFs would have been a credit repayment question and the other would be what are you seeing in terms of the other Government guaranteed stuff being extended or repaid?

William Chalmers
On RCFs, our overall experience has been very good. We saw at the beginning of the crisis, a significant drawdown on RCFs from many of our counterparties and you will have seen the information for the most affected Coronavirus impacted sectors in some of our disclosures over the course of the last year. We saw a significant drawdown mainly as a precautionary approach from commercial counterparties, in a way that is not dissimilar to the way in which some people approach payment holidays on the retail side.

Those RCFs then effectively repaid over the course of the year. The credit experience in relation to them was extremely benign. In fact you can see that in terms of the commercial charge, or indeed credit, we have seen over the course of this year. It has really been an unusually very benign state of affairs. So the RCFs drawdown seems to have come and gone. The credit experience was extremely benign. There is a little bit of an expectation we have going forward that commercial facilities might start to draw again as we go into the economic expansion. But I think RCF utilisation is clearly very different, with a much more positive outlook in mind and it will be for working capital or other purposes that RCFs may be drawn down. We are anticipating a little bit of that. We may see a little bit of that in the second half.

In terms of the Government guarantee facilities, it is very early stages, so I wouldn't want to be too categorical about it, but for the bounce back loans, our overall experience so far in terms of repayments has been better than our expectations. Having said that, a number of those counterparties and bounce back loans are moving to payment holidays which effectively give them a six month further non-repayment period. So we don't want to get too carried away with the early news. But as I say, the level of repayments has been better than expected. There is a chunk, not huge, but maybe 10% or thereabout going onto further payment holidays. So that will come to pass, or at least give us further information in the early part of next year. But hopefully at a time when cashflows are better, from a corporate cash point of view.

Then on CBILS, it is much too early to say, those we have been contacting and those due to repay within the CBILS area, again it has been very constructive so far Aman. Again better than our expectations, I think in CBILS we always expected it to be a lot better and indeed it has been.

Aman Rakkar
Thank you so much.

Question 5 – John Cronin, Goodbody
Hi William and team, thanks for taking my questions. Coming back to this excess deposit point. I'm just trying to understand how influential in terms of strategy, I'm thinking around the pivot to Wealth, the continued focus on developing that business. How influential is the excess deposits in terms of the strategic decisions around how the Group evolves in terms of its shape?

The second question is on emerging competition in mainstream banking. How worried are you in the context of the likes of Revolut, Starling, Monzo, JP Morgan, Goldman Sachs potentially entering the retail banking market and all calling out loud ambitions in that respect?

And then finally just on mortgages, and again a rather generic question, but I'm just curious about the bullish message you have sent out in terms of the structure of underpinning strong mortgage demand beyond the simplicity of just the stamp duty relief. Appreciate that and appreciate the reasons for that statement, but are you worried at all about a dip in home mover demand next year as economies reopen and given the return back to work in the UK and maybe people become a little less excited about wanting to move to a larger property? I am just curious about your thinking in broad terms, and how that might impact upon volumes and the home mover channel. Thank you.

William Chalmers
Thank you John. Just to take each of those three in turn. Excess deposits, it has been an interesting story as you said. We have now had £63 billion since the beginning of 2020. And that has continued right the way through into the second quarter as you saw. So that pattern very much remains a part of what we have seen, with a further £24 billion coming on in the first half. Even if you allow for a bit of that coming from the commercial bank, which is related to stamp duty deposits being made into their accounts, for example, and one or two end at quarter type periods. You are still seeing circa £20 billion increase in H1 in retail which has nothing to do with those factors. So it is sustained growth and very significant growth in deposits.

That is great, it comes off the back of both increased average balances and also increased customer numbers which is great to see. I think as we move forward we always have an ambition to ensure a complete waterfront of the Wealth offering. And indeed that is what the acquisition of Embark allows us to do. That is an ambition that frankly, precedes anything to do with the crisis or the deposit inflows associated with the crisis. Having said that, it is clearly more relevant in the context of the higher level of balances that we are seeing today, and indeed, possibly sustained customer behaviour which suggests that there may be a higher level of savings going forward. And so giving customers a full choice as to where they choose to put their savings is absolutely key. In that context it is compounded by the sustained low interest rate environment that we are likely to be in. Whatever the short term volatility might be, it is going to be relatively speaking a low interest rate environment.

And so in short, the strategic thinking proceeds the crisis. Having said that, the excess deposit position that we find ourselves in makes the acquisition of Embark and the completion of the wealth management offering, all the more compelling. And I would hope that we are able to give our customers a full and compelling product set which will be better for their long-term fortunes, and indeed ultimately better for the bank as it seeks to build other income streams in a low rate environment.

On your question around new entrants, Revolut, Starling, JPM and so forth. I mentioned yesterday that in a sense, the fact that these banks are setting up is an endorsement of the fact that it is a pretty attractive banking market to come into. It is a vindication of where we choose to allocate our capital. Having said that, what do they have to offer? The key question for us is what do they have to offer versus what we have to offer. We aim to keep our customer proposition across the spectrum whether that is retail, SME, or commercial. Now the likes of Revolut and Starling and indeed JPM at this stage are clearly extremely small. By maintaining our product proposition and doing everything we can to not just keep pace, but exceed what they have to offer, we would hope to keep it that way. I think ultimately what it does, is it lays down the gauntlet at some level in terms of product and service. It gives us something to make sure that we are competing effectively against. And I think that is the most important thing. That in turn is why some of the investments that we make in, for example Strategic Review 2021, our focus on digitalisation of the SME and the commercial bank, are particularly important in the context of maintaining our competitive position. As long as we are able to do that, we will be fine, but it is going to take continued attention and investments from our side, and that is what we will do.

On the mortgage demand question, as said and I think others are more or less in the same boat when I listen to their commentary. We do see sustained volumes going forward. There is no doubt that those volumes recently have been augmented by cyclical factors and the stamp duty holiday is the best example of that. But nonetheless the structural support factors, whether it is lifestyle, rates or relatively low unemployment, even in the context of our macroeconomics expectations, those factors we think are going to give structural support. It may be that it shifts around between home mover, first time buyers, remortgage and different components of the housing market and that is fine. But I think we do see that level of structural support continuing in the second half of this year, indeed going into next.

The one point that I would look out for that would change that narrative - we don't foresee it, but it would change that narrative - is if unemployment or rates tick up above the types of levels that we are talking about. But that is not our base case at the moment.

John Cronin
Okay, thank you.

Question 6 – Chris Cant, Autonomous
Good afternoon, thanks for taking my questions. I have one on remediation and restructuring costs please, and then a couple on ratios. Consensus has your combined restructuring and remediation costs dropping to about £600-700 million in 2022/23. But if I think about remediation and the items you have called out in the first half it feels like you have a sort

of £350 million or so base run-rate for legacy conduct items. And then we have got to allow on top of that, something for the HBOS Reading costs which you flagged are significant. And I appreciate we don't know on the timing, but I am just trying to think on the round here. If I think about the restructuring and I look at the split of that you have in there, tech R&D, you have got regulatory change spending in there as well. You have got things like severance which I guess will persist on some level. So again, it feels like you have got a base number which is quite high into next year. And I think you have flagged the Embark capital impact, but some restructuring charges from that flowing through as well. So again that feels like it might be five, six hundred million. It looks to me like the combined costs for restructuring and remediation might be getting on to double where consensus is in 2022/23. Is that about right, please?

And then on ratios, on the asset quality ratio. It has been a while since you have commented on this. I am just interested where your thinking is on the normalised cost of risk for the business going forward. I think in the past, you have said 35 basis points, but just cognisant of the shift towards mortgages and the fact that maybe the book's performed better than you expected during the real world stress we have just had.

And finally on NIM. This is really just a point for my understanding. But now that your loans deposit ratio is dipping below 100 per cent, I am just thinking about your comments about deposits growing, being positive for the NIM. So I guess any earnings you have got on surplus liquidity are included in the numerator for your NIM, but there is nothing in the denominator based on how you calculate it. So for other banks, excess liquidity growth is a NIM drag, but in your case it seems like it might actually be coming through as a NIM positive now the loan to deposit ratio is dipping. Is that right, and then if liquidity declines over time, that is going to be a headwind? I appreciate that doesn't change NII, I am just trying to understand the calculation of the ratio there. Thank you.

Jon Burgess
You heard William's response on remediation charge yesterday in terms of peeling back from the £425 million, stripping out the general insurance related fine of £90 million, £150 million relating to HBOS Reading which left about a hundred and eighty of other stuff. In relation to the other stuff, again William said there was an element of forward recognising of costs, in particular operational costs in relation to that. So frankly, the run-rate in relation to the other legacy items isn't really £180 million in a six month period Chris, it is lower than that. We have talked loosely in the past about a £200-300 million range in terms of a normal run-rate. I think that continues to be sensible guidance in terms of normal run-rate from where we are today, because we are not encountering new items. The costs that we are incurring are all about existing legacy issues that are just multi-year programmes in terms of resolving and fixing. So the £200-300 million on an ongoing basis is fine. In the short-term, what you need to do is put something on top of that for HBOS Reading.

Now in our results announcement, we have been clear that in the future there could be further significant charges, but that we are not able to reliably estimate those charges whilst we are providing for them today. So that in itself gives you the nature of the problem. It is very hard to give you a lot of guidance in terms of what to assume and over what period. We certainly are looking over the rest of this year into the end of 2022, so you are talking about 2023 guidance. That feels a long way off Chris, but over the next eighteen months, I guess you need to put a figure in and we have obviously provided £150 million at the half year and we have sort of signalled that half of that roughly was cost-related and half of it was redress-related. The cost should drop away but the redress as you know will continue, or is likely to continue, and may continue at the same or an elevated rate. But again you are just going to have a do a bit of a judgement call on that.

So those are the dynamics in terms of remediation. I will pause just for a second, have we got William back.

William Chalmers
Jon I am back yes, but I was listening to you speak then. You are doing a great job so carry on, otherwise I am happy to take over.

Jon Burgess
The second question was around restructuring costs this year and into next year. In 2020 the restructuring costs were about £521 million and we said they would be slightly higher than that in 2021. I think consensus is in a sensible place. It does imply as William called out in his narrative yesterday that the run-rate in the second half of the year will pick up relative to the first half. And so H2 will be higher than H1 and will land somewhere close to consensus. And Embark does add a little bit on top of that probably, which wasn't in our thinking at the start of this year. But it is not a huge number so is probably a little bit higher than where consensus currently sits. As we then delve into 2022 we obviously pause because we are not really going there in terms of guidance. But hopefully that gives a clarity in terms of 2021.

William Chalmers
On restructuring Jon, just to pause, exactly as you said. At the full year we looked back at 2020 with the £521 million and said that we expected it to be slightly up in 2021 looking forward. And I got the question what does slightly up mean and said 10-20 per cent up for the 2021 full year number. The first half year run-rate is below that and as you rightly said just now, the second half will tick up to be in line with the indication, plus a little bit from Embark, but not too much, given the fact that it is only just being acquired right at the end of the year as you indicated.

Jon Burgess
Next question was around the through-the-cycle and AQR guidance which we previously said was mid-thirties despite probably 5, 6, 7 years of sub 30 basis points AQR. I am not sure that we are providing an update on that number William but I will leave that one with you if that is all right?

William Chalmers
Yes happy to, thank you Jon. In respect of 2021, Chris, as you know, we said less than 10 basis points. Based upon the underlying, it is a very benign experience right now, and at the moment we see nothing that suggests that that experience is going to change as we go into the second half. Our macro assumptions if you benchmark them against other people's expectations for economic performance, are on the conservative side. And therefore, it may be that the impairment outcome for the remainder of 2021 and indeed going into 2022 is a little bit better than we had expected or that we are building in currently.

I think, Chris, at the moment we do see this sustained performance on asset quality as being more sustained than necessarily just the back half of 2021. If you had talked to our CRO or any of the senior colleagues around the group in that area, I think you would develop a picture of a pretty benign credit environment that perhaps extends beyond that. I don't want to be giving 2022 guidance but at this point it would surprise me frankly if we ended up with 35 basis points in 2022, I think the outlook appears to be better than that as we stand today.

Jon Burgess
And I think your final question, Chris, was around the way in which we calculate our NIM and average-interest earning assets. You may be technically right, but I think it is pretty marginal. We called out some positivity in terms of deposits in the first half of this year relative to the second half of last year. That is in part just because of the timing delays of all the bank base rate change repricing that happened. Some of that only landed in the second half of last year. And so you get a full period impact this year. We have also said there is limited more that we can do in terms of repricing, but there has been some, and that has been both in the retail and the commercial space, both some actions taken in the second half of last year, and also first quarter of this year. So that has also helped a little bit in terms of momentum. And we have had a little bit of a tailwind from some slightly more expensive maturities that have landed in the period. So it has helped a wee bit, but I don't think it is a big part of our margin story.

William Chalmers
Well Chris, apologies for dropping out at the beginning of, or just as you asked your question. I know Jon covered the remediation piece particularly in relation to HBOS Reading. I am sure I am just going to repeat much of what Jon said, but given that it is an important area, maybe I'll just reiterate the points there. And again I apologise if this is repeating what Jon said as I had another power cut to deal with.

The £425 million in H1 as you saw and as you heard from my comments yesterday, as you look forward, what of that is going to continue and what of that is going to drop out? As I am sure Jon will have said, £90 million of that drops out for the FCA GI fine number one. Number two, of the £150 million in HBOS Reading, the way that we are looking at it is, half of that was forward operational cost and about half of that was redress. Forward operational cost relates to 2022 as well as the second half of 2021, that component drops away. But I think the redress may tick up a bit, and so although we don't frankly know with any certainty, if you keep that amount in as a rough guide for the second half it is as good as any other number that I think you could use.

Thirdly, the £185 million, as Jon said, has been in part relating to other look forward, and so drops out. There is underneath the £185 million, a lower level of run-rate, which is in relation to now very legacy items i.e. from a long time ago. Whether that is HBOS Reading, GI, or other elements of that piece. I would not take that full £185 million, but rather take a sub component of it, two thirds, something like that, again maybe a rough run-rate.

I hope gives you an idea, but again I would stress it is difficult to be any more precise than I have been at this point and the indications that I have given you are just that, rough indications, and there may be a bit of ebb and flow. But two things are important. One is that these are all now very legacy and if you look at conduct issues accruing since as far back as 2012, there is really not much new stuff accruing. It doesn't make it any less painful today but it does mean that the forward look is over time materially better. And number two, I was asked the question yesterday, are these items, in particular HBOS Reading, likely to be in any sense challenging from a capital distribution point of view. I hope that the scale of the answer that I have given you and no

doubt Jon gave you a few minutes ago, gives you the ability to put that into proportion, and to see that it does not rise to the level of materiality that it changes the picture on capital distribution.

Chris Cant
Understood, thank you.

Question 7 – Robert Noble, Deutsche Bank
Just a follow-up on the conduct issue. There is a difference between the level of materiality of charges that will impact your ability to return capital and the amount of capital returns built into consensus, so is it possible that these fines could get into billions, or if it stays in hundreds of millions then I don't think it challenges either perspective?

William Chalmers
I would be very clear on that Rob. No - hopefully the indications I just gave you around the £425 million and what components of that you might repeat or not in the course of the half going forward give you a clear answer to that. Reading through the lines of what I was saying earlier on HBOS Reading for example, we saw £150 million in the context of H1. The operational cost component of that drops out, redress may tick up a bit, if you stick in a further £150 million. We can't say with any certainty whether that is precisely right or not, but it is as good a number as any. I hope that gives you an idea as to the answer to your question. This is not in the billions of pounds clearly, this is in the low hundreds of millions of pounds. It is paced out over quarters in the way I have just described. But that breakdown of the £425 million in H1 I hope gave you as clear a picture as we can at this stage as to what you might see repeat and equally what you might not see repeat.

Robert Noble
Okay great, I think that will give some people some confidence. Can I ask a couple of other things. Have you given any numbers on the revenues and costs that come with Embark next year, I think it is something like 4 per cent other income growth in consensus. Can it materially change the top line in any way?

William Chalmers
I think on other income growth, the best way to look at other income as a whole is the commentary that we discussed yesterday, which is that we are seeing a sustained better picture in other income. If you look at the other income in Q2 versus Q1, it is up around £150 million or so. You can decompose that part through the equities business and a little bit of insurance assumptions. But there is a component of that which is increasing levels of activity in retail and insurance. And that is feeding through into an other income run-rate that as Raul's question indicated yesterday, is looking more like £1.2 billion versus our lockdown run-rate of £1.1 billion. Now I think as I said yesterday, there is more to go for there as the economy opens up because that £1.2 billion which we are kind of getting to in Q2 is off the back of an only partially opened economy. So we should see some better dividend from increased levels of activity as we go forward. And again that would be consistent with the £350-400 million that we lost in three quarters over the course of 2020.

So a) activity is getting us closer back to £1.2 billion, b) I think there is a bit more to go for in activity c) coming to your question, Rob, there is clearly augmentation from organic initiatives in the context of packaged bank accounts in retail or CM&P cash management payments in Commercial, or the mobile protection product within Insurance. These are going to augment other income gradually over time. The specific point on Embark, we will effectively acquire Embark as of the end of this year. Next year we will have a combination of Embark revenues, the very beginnings of the benefits of the revenues synergies from Lloyds. But at the same time, we are going to have offsetting restructuring and integration costs as well as those costs of Embark itself. So I wouldn't be looking too much for a return on a net or PBT basis for Embark. What you will see is a contribution to other income from the Embark revenues plus the very beginnings of the LBG synergies. But as I say, if you look at the PBT contribution of Embark after having netted off restructuring and integration synergies, that contribution in 2022 will be very modest.

Robert Noble
That is great. Just one last question. The insurance company, did it pay a dividend after H1 or is there an intention to start the dividend again this year or next year? And what is the solvency position in that business?

William Chalmers
Yes, it is a good question Rob. We didn't pay a dividend in H1 from the insurance company up to the bank. Having said that, the solvency position of the insurance company has improved over that time and it is now standing about 162 per cent which you may remember that as of the end of the year was about 151. So it has significantly improved over the course of that time both as a function of better 15 year rates, number one, and as a function of organic business generation. Against that, it has paid the GI FCA fine. But that 162 per cent solvency is after having paid that GI FCA fine.

I don't think we are looking for a dividend at the half year, but I think if that solvency position is sustained at the end of the year then depending upon the other outlook factors that we see within insurance, and obviously subject to discussion with the insurance Board, we might be having a dividend discussion. And clearly if rates strengthen at all that will just strengthen the point.

Robert Noble
Right thank you very much.

Question 8 – Fahad Changazi, Mediobanca
Hello again, just a follow-up on insurance. Could you give an update on the ambitions for protection insurance? You briefly mentioned it, but I think it was put back due to the pandemic - are you still looking to increase market share there? And with Embark it looks like you are focused more on the asset-gathering side of insurance. But could you see yourself getting more ambitious in the bulk annuity market? Thanks.

William Chalmers
Yes thank you Fahad. I will make a couple of points on that and then I will invite James to add. I think on protection, as a general matter, Fahad, yes is the short answer, we are absolutely looking to grow into that with the business. We have an existing presence within the protection market which we think there is much more to go for. If you go back a number of years, probably ten, fifteen years or so, Lloyds would have been more successful in protection at that time. We have since then gone through a cycle where we have wanted to make sure that we are behaving in the best possible way with respect to conduct and that we are doing so with the best possible protection products. And we now believe that we are making progress on those fronts. We still have decent protection share but it is high single digits in terms of market share and we believe that we really ought to be able to go well above that - at least double it and maybe more, maybe triple it. That is in the context of our product range through intermediaries, independently, but also obviously in conjunction with the mortgage product, and it is also in the context of consumers who I think post pandemic, are increasingly oriented around protection as a product. And so we are making a lot of effort right now to enhance the branch and mortgage-led proposition. We are making a lot of effort to enhance the mobile proposition. And the early signs in both of those areas are very favourable. It will take a little bit of time for that to grow, but it is certainly a growth initiative.

On bulks I think James may have alluded to it earlier on in the call, but on bulks we have not really been much of a participant in H1, particularly not in Q2, simply because pricing has not been acceptable from our perspective. We have a pretty disciplined approach to bulks. We do think the market is going to open up a bit more off the back of rate increases and trustees getting more active in terms of management, and we do think that is going to create opportunities for us. And so I think that we will grow in a disciplined way in bulks, would be my short answer. James you may want to add to any part of that?

James Hillman
Limited addition to what you said William, we will preserve our pricing discipline. Certainly bulks as people know is relatively capital demanding for insurance businesses. So it needs to meet our hurdle rates; providing it makes those right returns, it remains an attractive market in the context of the spreads that we can achieve either on corporate bonds or on illiquid assets. So we will retain our pricing discipline and clearly market size and the growth in the market which has been depressed over the first half of the year will also dictate the extent to which we will grow that business.

Fahad Changazi
Great, thank you.

Question 9 – Gary Greenwood, Shore Capital
Hi, thanks for taking the questions. I have got three if I can. So first of all on your return on tangible equity guidance. I think you said 10 per cent for the full year excluding the tax benefit which would be another 2.5 per cent. So take 12.5 per cent and apply that to your tangible book value roughly at the half year to imply about 7p of earnings for the full year. But you have already done 5.1p in the first half, and I appreciate there is somewhat arguably one-off benefits from the tax and provision releases in there, but it does feel that less than 2p for the second half would be a very conservative number. So just interested in your thoughts on that.

And I guess sort of linked to that is on the provisioning guidance, the less than 10 basis points. I mean, again, anything near 10 basis points would feel very, very conservative. I heard NatWest this morning talking about net provision releases for the full year. So I was wondering what the likelihood is that you could actually see a net provision release for the full year also as well as the first half.

And then the last one just on costs. So you were at a sub-50 per cent cost:income ratio I think in 2019, that bumped up to 55 per cent last year, it feels likely it is going to stay at that sort of level this year. What do you think the likelihood is of getting that ratio back down below 50 per cent in the next two or three years would be, is that a realistic target? Thank you.

William Chalmers

Thank you Gary. Maybe just a couple of comments on that. On the first question around the RoTE at 10 per cent excluding tax, I won't comment on the earnings per share implications of that. Safe to say that if you look at the first half we have obviously benefited from a couple of things. One is the impairments line which as you can see has been a £656 million net credit so that helps. And the second is the tax line, which as you know was subject to a £970 million credit in the half. And so those items are benefits for the first half, that will change in the second half. The tax credit for sure, and let me come back to the impairments point in answer to your second question. But just bear that in mind as to how we look forward into the second half. If you take away from those two, we see building earning streams going forward, building income in the context of the costs that we have articulated as of the guidance, but hopefully those comments give you a sense as to what we might expect from the second half.

Now coming back to your provisions point, I think as we stand today and as per my comments earlier on, there is an absence of any underlying concerns, i.e. the fact that it is a very benign underlying picture number one. And number two that we see nothing ahead of us that really changes that picture. That does suggest that less than 10 basis points really does have an underline below the 'less than'. I think we have to see how it develops in the course of H2, we have been deliberately cautious and you can see that our macroeconomic assumptions reflect that as well. I would say that this question manifests itself in two ways. I think our base case economics are pretty cautious and if the base case economics end up being better than we are putting forward as of our H1 results, then you see a better impairment picture for sure. In the context of much of yesterday's discussion you also see a better asset growth picture. And because part of that asset growth is going to be unsecured, you may also see a better unsecured margin picture as well. So that then contributes to the Group margin. So there are a number of things that hinge off the economics. And I think we are being conservative in our economic forecasts. If it turns out that way, there are a number of lines within the P&L and the balance sheet that will turn to the better to reflect that.

Coming back to your impairments point. I think you are right Gary, we are being deliberately cautious in terms of the impairments guidance that we are giving. It is in the context of our base case economics. Everything that we are seeing to date suggests that we will be at the lower end of the types of numbers that we are indicating. So hopefully that gives you a bit of a sense.

Costs; less than 50 per cent cost:income ratio is certainly our ambition to build towards. I think it might take us eighteen months or so to get there. We might be looking at 2023 before we necessarily get to that type of number. But it is certainly our ambition to head in that direction.

Gary Greenwood

That's great, thank you very much for your answers.

Question 10 – Aman Rakkar, Barclays

Great brilliant, thanks very much for this. I just wanted to get a sense on operating lease depreciation, obviously another really low print for another quarter. How sustainable is that number, and do we need to continue seeing car price appreciation to sustain these levels?

William Chalmers

Thanks for the question Aman. It is a low print in H1 of £271 million. If we look forward for the full year we are seeing a second half that is not terribly different to H1 and that is sustained really by two factors. One is continued used car prices that are in decent shape. And number two, Lex volumes that continue to come off slightly. I think looking forward into the years beyond that we are currently forecasting some normalisation in used car prices, Aman, which in turn should lead it to tick up a little bit. I don't think we see it as getting back to 2020 levels, but we do see it ticking up a little bit from 2021 levels.

So hopefully that gives you a bit of a picture. I think the only way in which it stays at 2021 levels is if we see continued improvements in used car prices, as your question indicated. But again even if we don't, I don't think we see ourselves going back to 2020. It will most likely be somewhere in between.

Israel Santos

Sorry William, it's Israel, just one add. September could be an important month obviously, because of new plate registration in terms of new cars coming into the market. So you are right in terms of your sentiment of used car prices staying as strong as they are today. September, with potentially an influx of new cars, you may well find that some of that strength dissipates into Q4.

William Chalmers

Once again thanks to everybody for taking the time and joining the call. I hope it has been useful. Apologies for my couple of interruptions there, but again I hope it has been a useful call for everybody. Thanks very much indeed guys.

END

FORWARD LOOKING STATEMENTS

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