LLOYDS BANKING GROUP PLC – 2021 Q1 INTERIM MANAGEMENT STATEMENT – PRESENTATION TRANSCRIPT
(amended in places to improve readability only)

Wednesday 28 April 2021 – 9.30am

LBG PRESENTERS:
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António Horta-Osório
Good morning, everyone. Thank you for joining our Q1 2021 results presentation. I will begin by providing a brief overview of Q1 performance before William will discuss our recent strategic progress and financials in more detail.

Turning to slide two of the presentation. We are now more than a year on from the start of the pandemic and whilst we are starting to see some positive signs, the significant impact on people, businesses and communities in the UK and around the world is clear to see.

The Group remains absolutely focused on supporting all of its customers and on Helping Britain Recover from the financial effects of the pandemic.

And we are continuing to support our customers and businesses across the group, for example, through payment holidays and Government-backed loans, whilst maintaining the excellent customer satisfaction scores we spoke to you about with our full year results, which are the highest in the last 10 years.

Our colleagues across the group continued to demonstrate extraordinary resilience and dedication, supporting our customers and communities in these very difficult circumstances, and I would like to thank them again for it.

And, in what continues to be a challenging environment, we have seen good momentum and encouraging franchise growth in the first quarter of 2021.

Both NIM and AIEAs are up versus Q4 2020 and are better than our expectations, with NII up 2 per cent when adjusted for the number of days. Whilst our continued cost discipline means total costs were down 2 per cent with operating costs down 1 per cent year on year.

Given our prudent, low risk business model and the success of the measures put in place by the Government, Regulators and the banking sector, the underlying asset quality of our different portfolios has remained strong with credit experience benign.

Although uncertainty remains, the UK economy is performing better than expected, on the back of a very successful vaccination program. As a result, we have seen an improvement to our economic outlook, predominately in unemployment and HPI expectations, which has resulted in an impairment release of £459 million, which, together with the positive behavior of the underlying asset quality, has produced an impairment credit in the income statement in Q1 of £323 million. William will talk more about this later.

Relating to the balance sheet, we have continued to take advantage of the strong mortgage markets with £6 billion open book growth during Q1. We have now seen growth for the third consecutive quarter in a market where economics have improved substantially.

Retail deposits were up more than £9 billion in the quarter, including current account growth of £5.6 billion, demonstrating the strength of the franchise.

Another area of strength has been our capital build and during the quarter our CET1 ratio increased to 16.7 per cent and our strong capital base remains significantly above both our ongoing internal capital target of circa 13.5 per cent and our regulatory capital requirement of around 11 per cent.

Regarding Strategic Review 2021 launched in February, we are already making good progress across a number of areas. Our clear execution outcomes for 2021, underpinned by long-term strategic vision, position the Group well for future success. William will further elaborate on this.

Finally, given the trends we have seen and reflecting the solid business momentum, we are today enhancing our overall guidance for 2021. I will now handover to William who will run you through the new guidance, the financials and the Strategic Review 2021 progress in more detail.

William Chalmers

Thank you Antonio and good morning everyone. I will run through the Q1 results, including a brief update on Strategic Review 2021, before opening up for Q&A.

Turning first to slide four with an overview on the financials. Net income of £3.7 billion is down 7 per cent year on year, given lower rates, but an increase of 2 per cent versus the last quarter of 2020. NII was flat quarter on quarter, but if adjusted for day count it would actually be up 2 per cent. In particular, both NIM and Average Interest Earning Assets were ahead of our expectations.

In a challenging environment, the Group continued to demonstrate cost discipline, with total costs down 2 per cent year on year. Pre-provision operating profit of £1.7 billion was down 12 per cent year on year, but up 21 per cent compared to Q4 given the increased income and lower costs.

Asset quality remains strong with underlying credit experience benign. The improved economic outlook has driven a provisions release of £459 million, resulting in a Q1 impairment credit of £323 million.

Statutory profit before tax of £1.9 billion was up significantly both year on year and versus Q4.

TNAV was stable compared to Q4 at 52.4 pence per share with profits offset by cash flow hedge reserve movements driven by the upward shift in interest rates in the quarter. Meanwhile, the Group's capital position remains very strong with a CET1 ratio of 16.7 per cent after 54 basis points of capital build in the quarter.

Now turning to slide 5 to look at our Strategic Review 2021 progress so far. As you know, in February we launched the next evolution of our strategy. Strategic Review 2021 is a combination of clear execution outcomes for the coming year, underpinned by long-term strategic vision and supported by significant strategic investments.

It is very early days, but in Q1 we have delivered progress against a number of our priorities.

In Helping Britain Recover, we have made meaningful progress across all five of our priority areas that are embedded in our business ambitions. Achievements to date include launching the Pay As You Grow and our Recovery Loan Scheme to support clients through the next stage of their recovery where required. We have also lent nearly £4 billion to first time buyers in the first quarter of 2021.

We joined as a founding member of the Net Zero Banking Alliance as part of our commitment to help accelerate the transition to a low carbon economy and to achieve our net zero by 2050 ambitions.

Our customer ambitions focus on further business alignment to help unlock coordinated growth opportunities across our core customer needs.

In Q1, we have built upon the Group connectivity of our Insurance & Wealth franchise by significantly increasing Schroders Personal Wealth introductions and by launching a new Halifax branded protection product, the latter increasing 'direct to site' volumes by 25 per cent year on year.

For our Commercial clients, we have launched new and exciting propositions, in line with our investment focus on increasing digitisation, while also building out product delivery functions. Examples of these are outlined on this slide.

Finally, as outlined at full year we are investing in our core capabilities to enable sustainable success in the new environment – technology, data, payments and our people. We are encouraged by the progress we are making and will provide further updates on these areas in more detail over the remainder of this year.

I will now turn to slide 6 and look at how the Group's customer franchise performed in Q1.

Open mortgage balances were up £6.0 billion in the quarter, building on the trends we saw in Q4. Given the continuing strength of activity levels we expect further open book growth in Q2, with a somewhat slower pace thereafter in H2.

As expected, given the continued social restrictions during the quarter, consumer finance balances were down £0.8 billion to £36.2 billion. Modest growth in motor was more than offset by the reduction in the credit card and unsecured loan books.

In Commercial, balances were broadly in line with December. A small pick-up in SME balances was partially offset by continued optimisation in large corporates.

Given the strong mortgage volumes seen to date and assuming a gradual pick-up in unsecured balances in H2, in line with our macro-economic assumptions, we now expect low single-digit percentage growth in average interest earning assets this year.

Once again, Retail deposits were a strong growth area, up more than £9 billion in the quarter, including current account growth of £5.6 billion. This continues to demonstrate the strength of the franchise in a still subdued environment.

In Commercial we have continued to see a small tick up in SME and Mid Corporates deposits, whilst large corporate balances have stayed relatively stable.

Now turning to income on slide 7. As I said earlier, Q1 NII of £2.7 billion was in line with Q4. Both net interest margin and average interest earning assets were ahead of our expectations. The Q1 margin of 249 basis points was up 3 basis points on Q4, benefitting from continued optimisation activity in the commercial book, strong customer inflows and liability management benefits. Lower structural hedge net interest income was largely offset by the strong mortgage book growth at attractive margins. The mortgage growth was also the primary driver of the AIEA growth in the quarter.

Following the increase in structural hedge capacity at the end of 2020, and in the context of favourable yield curve movements during the first quarter of 2021, we have both reinvested and increased the notional balance of the hedge by £21 billion to £207 billion.

The Group's structural hedge capacity has since been further increased to £225 billion, capturing a part of the deposit growth observed in 2020 and reflecting continued success in attracting current account balances. We continue to take a conservative view on eligible balances for the hedge.

Consistent with recent investment, the weighted average life of the hedge has increased to around 3.5 years, up from around 2.5 years in 2020.

Given the positive yield curve impact on reinvestment and the increase in hedge size since year-end, we now expect hedge earnings in 2021 to be stronger than previously estimated. The headwind we expect now is circa £300 million compared to 2020. Based on current market rates, we now do not expect to see a headwind from the hedge in 2022 and only a modest headwind in 2023.

With the benefit of the developments in Q1 and the improved yield curve environment, we have upgraded our guidance in this area. We now expect the net interest margin to be in excess of 245 basis points for 2021.

Other income across all divisions continues to be impacted by the lockdown restrictions in the UK, albeit up 6 per cent on Q4 given the non-recurrence of negative Insurance assumptions. We continue to expect other income to gradually recover in the second half of the year as activity returns. We also continue to invest in income diversification opportunities over the medium term.

Q1 operating lease depreciation was impacted by lower fleet volumes. The Q1 charge also included a circa £30 million benefit from the more resilient used car price outlook given recent trends.

I will now look at costs on the next slide. Our focus on efficiency and cost discipline continues to provide competitive advantage and remains fundamental to our business model.

In Q1 total costs were down 2 per cent, with a reduction in both operating costs of 1 per cent and remediation costs of 25 per cent versus Q1 2020. Looking forward on remediation costs, a quarterly run rate equivalent is likely to be somewhat higher than Q1.

Following the successful start to Strategic Review 2021, Q1 included £0.2 billion strategic investment spend, on track for our target of £0.9 billion in the year. Looking forward, we continue to expect full year costs to be lower than 2020 at circa £7.5 billion, despite Covid-related headwinds and expected increased variable remuneration costs.

Now turning to slide 9 to look at impairments. Asset quality remains strong and the observed credit experience in Q1 continues to be very stable. Retail credit experience remains benign and in line with pre-Covid levels. In Commercial we have seen a release in the quarter, given improved outcomes on restructuring cases, lower defaults and reduced balance sheet exposures.

Furthermore, the macro-economic outlook has improved since year end. The vaccine rollout in the UK and additional Government support announced in the Spring Budget result in positive shifts in our economic assumptions. This implies peak unemployment now 1 per cent lower at 7 per cent versus 8 per cent previously and HPI now expected to reduce by circa 1 per cent in 2021, versus circa 4 per cent previously, both compared to our Q4 base case.

The improvement in the macro-economic outlook has resulted in a £459 million provision release in Q1. Together, the benign underlying environment and macro improvement, results in a net credit of £323 million for impairment in our income statement.

Our total ECL provision of £6.2 billion remains around £2 billion higher than at the end of 2019. Given uncertainties continue, we have increased Covid related management judgements ECL by around £100 million to circa £1 billion, consistent with our approach at the year end. This includes the £400 million overlay we took in Q4, given the high level of uncertainty in the current environment, such as risk of virus mutations and the impact of the Coronavirus Job Retention Scheme when it is removed. It also includes circa £600 million held in Retail and Commercial, largely to recognise the absence of losses that we would have expected to see had support schemes not been in place during the pandemic.

The updated economic outlook has resulted in a modest reduction in coverage, which nonetheless remains conservative, and well above December 2019 levels, at 1.2 per cent of total lending and 27.1 per cent on stage 3 assets.

Given the updates this quarter, we now expect the full year 2021 net asset quality ratio to be below 25 basis points, although needless to say, uncertainty remains on the outlook.

Now turning to the next slide to look more closely at credit quality performance. Credit quality remains strong across the book, with both Retail and Commercial portfolios performing well. In Retail we continue to see low new to arrears levels across the business, at or below pre-crisis levels. Notably, this is despite the vast majority of payment holidays now ending.

95 per cent of all Retail payment holidays have now fully matured, with 94 per cent of these customers resuming payment. Of the remaining 6 per cent in arrears, roughly a half of those were already in arrears before the payment holiday was granted.

Within the Commercial portfolio, our exposure to the sectors most impacted by coronavirus continues to remain modest, at around 2 per cent of Group lending. Indeed, excluding Government-backed lending through the CBILS and BBLs programmes, which as you know is low risk exposure given the guarantee, we have actually seen a net reduction in drawn lending across the majority of key Coronavirus-impacted sectors compared to March 2020.

Circa 70 per cent of Commercial Banking exposure is at investment grade. The investment grade percentage of key Coronavirus-impacted sectors remains unchanged from the end of year position at 38 per cent. Meanwhile, across the portfolio, our new to Business Support Unit volumes remain in line with pre-crisis levels.

Looking forward, we do expect new to arrears levels to increase later in 2021, consistent with our economic outlook as support measures subside and unemployment increases. We are well provisioned for this.

I will now move on to slide 11 to look at below the line items. Restructuring costs in Q1 were up year on year, largely driven by increased severance costs and R&D technology costs. Volatility and other items are down, both year on year and compared to Q4, benefiting from positive insurance gains.

Both statutory profit before tax and statutory return on tangible equity are up year on year and compared to Q4, somewhat helped by the impairment credit.

Following the announcement in the Spring Budget that the corporation tax rate is to increase to 25 per cent from 2023, we will see a circa £1 billion P&L tax credit from the revaluation of our deferred tax asset at the point this change is enacted into law. This is expected to be in Q3 of this year.

Given the improved outlook for both NIM and AQR, we now expect 2021 full year statutory RoTE to be between 8 per cent and 10 per cent, excluding a circa 2.5 percentage point benefit from the tax credit I've just outlined.

Moving to RWAs and capital on slide 12. Risk weighted assets reduced £3.8 billion in the quarter, largely driven by continued optimisation in Commercial, with limited credit migration seen to date. In 2021 we continue to expect RWAs to be broadly stable on 2020. As we look forward into 2022, RWA inflation will impact from regulatory change, starting on the 1st January 2022.

Looking at capital, our CET1 ratio increased to 16.7 per cent with 54 basis points of capital build in the quarter, benefitting from 31 basis points of RWA reduction. Our strong capital base remains significantly above both our ongoing internal capital target of circa 13.5 per cent and our regulatory capital requirement of around 11 per cent.

The CET1 ratio includes circa 50 basis points from the change in treatment of software intangibles. Following the PRA statement that they intend to repeal the revised treatment in 2021 and revert to the original full deduction, we expect this benefit to reverse out of CET1, potentially as early as Q2.

CET1 also continues to benefit from 91 basis points of IFRS 9 transitional relief compared to 115 basis points at December 2020. If our macro assumptions are correct, this relief will run off across 2021 and '22, albeit precise timing remains uncertain.

Even excluding both of these, CET1 remains strong at circa 15.3 per cent.

In the quarter we accrued 5 basis points in respect of dividends in line with the 2020 payout and consistent with regulatory guidance. As previously outlined, we will update the market on interim dividend payments with the half year results when we have received greater clarity on distributions from the Regulator. The Board remains committed to future capital returns and in 2021 intends to resume our progressive and sustainable ordinary dividend policy at a dividend higher than the 2020 level.

Finally moving to slide 13 to conclude. To summarise, we have supported customers since the start of the pandemic and we will continue to support them throughout the recovery period. We will deliver across our Helping Britain Recover focus areas and contribute to the transition to a more sustainable and inclusive society.

We have seen solid financial performance in Q1 as the business continues to deliver, with balance sheet momentum and income growth versus Q4. We have also continued to build our strong capital position, with a CET1 ratio of 16.7 per cent.

Strategic Review 2021 is underway and is delivering momentum on key initiatives. During the remainder of the year, we will continue to build opportunities across our core business areas of Retail, Insurance & Wealth and Commercial Banking. This will create sustainable shareholder value through revenue generation and diversification, disciplined growth and further efficiency gains, whilst delivering for our customers and for our colleagues.

All of these initiatives will support our trajectory to a medium term statutory RoTE in excess of our cost of equity.

Looking at our 2021 guidance. We now expect net interest margin to be in excess of 245 basis points. We continue to expect operating costs to reduce to circa £7.5 billion. We now expect the net asset quality ratio to be below 25 basis points. We continue to expect RWAs to be broadly stable on 2020.

Given these upgrades we now also expect statutory RoTE to be between 8 per cent and 10 per cent, excluding circa 2.5 percentage points benefit from the anticipated tax rate changes. With that I will conclude the financials.

Before we move to Q&A, as you know this is António's last set of results. I would like to take this opportunity to thank him on behalf of the Board and the Group. His contribution to our business over the last decade has been extraordinary. I personally have benefitted greatly from his experience and guidance during the time I have worked with him. More importantly, the Group has benefitted hugely from António's leadership, both in setting it up for success and in allowing it to make the contribution it does to the UK today. I'm sure I speak for all stakeholders in saying thank you and wishing António continued success as he moves onto his next role.

Thank you for listening, we will now open up for Q&A.

Question and Answer Session

Question 1 – Joseph Dickerson, Jefferies
Hi, good morning guys. I also echo, Antonio, William's sentiments, and wish you the best in your new role starting next week. I had just a couple of questions on the management overlay of £1 billion and the provisioning more generally.

First of all, what are the things you would need to see to start to release out of that £1 billion to a further extent? And then secondly, how sensitive is the underlying provisioning to house price changes? Because I note that in your base case, you've got about an 80 basis points decline this year. And I think the Land Registry is showing a growth of closer to 9 per cent. So I was trying to square that. So, that's provisions.

And then lastly on slide seven, you show a two basis point quarter on quarter benefit to NIM from "funding and capital." And I'm just wondering if there are still legacy instruments that you can call on the capital side to help continue to drive that sort of benefits in NIM in the near term?

William Chalmers
Thank you, Joe. With regards to the first of your questions, relating to the management overlay, as you point out, we have COVID-related management judgements in ECL of around a billion. That is composed of two components. One is the £400 million, what I call conditioning assumptions insurance overlay. The second is a further overlay of COVID management judgment related overlay of £600 million. And that relates to provisions that we have taken against both the retail and the commercial book to take account of losses that we would have expected to see, but for government furlough schemes and other forms of assistance in place.

As we look at that going forward, the £400 million first of all, we have conditioning assumptions, which essentially are setting the underpins for our base case based upon vaccine progress being in line with government expectations, based on reopening being in line with government guidance, and based on furlough and government support being in place as the plans have indicated, including the extensions that were talked about in the Budget. So our conditioning assumptions, there's a number of conditioning assumptions, but those are three of the most important. We've taken the £400 million conditioning assumptions management judgment to insure ourselves against any of those going wrong, whether it be by vaccine mutations, whether it be by a slower re-opening process than we had first forecast.

I think therefore, Joe, with respect to the £400 million, as we see those conditioning assumptions getting hopefully confirmed as we roll through the course of the summer, then we'll take another look at that £400 million management judgment in respect of those assumptions. With respect to the £600 million, as I said, that is a management judgment additional overlay that has been taken to account for provisions that we would have expected to see, but for the various assistance programs - payment holidays, and furlough being foremost amongst them.

Therefore, as we see the results of the furlough program as it rolls off during the course of the autumn, probably going into the third and fourth quarters of this year, possibly into next, we'll take another look at that £600 million and see whether or not our assumptions play out and consider the £600 million and its replacement accordingly.

With respect to HPI, we don't update them on a quarterly basis, but I'll just refer you back to the year-end sensitivities that we gave on HPI, which both showed HPI down. The sensitivity given there was if HPI fell by 10 per cent, the incremental impact would have been about £280 million or thereabouts. And it's not quite symmetrical if you look at it from the upside perspective, but it won't be too far off. So I would take a look at those assumptions as of year-end, as I say, bear in mind, we don't have a quarterly basis for those sensitivities.

And finally, with respect to funding and capital, Joe, we have, as you said, received some benefits. One point that I'd like to make there actually is that the funding benefits that we're enjoying are in part because of the strength of the retail deposit inflow that we've seen. You've seen £12 billion in this quarter, you saw £40 billion during the course of 2020, and that is allowing us to effectively fund the business relatively more cheaply than we have historically and indeed better than our expectations.

And so you're seeing some funding benefits flowing through from that. And we would expect that to likely continue through the course of 2021. As regards legacy instruments, there's always something further that you can do on legacy instruments, for sure. But we did undertake activity, as we pointed out, as of the tail end of last year. We are getting through that. There are always bits and pieces more that you could do, but I would expect those to gradually tail off over time.

Joseph Dickerson
Great. That's very helpful. Thank you.

Question 2 – Omar Keenan, Credit Suisse
Morning. Thank you very much for taking my questions. I just wanted to ask a question on the revision of the average interest earning asset guidance to low single digit growth. I was wondering perhaps if you could elaborate on your thinking here. Are we just seeing a temporary lift from the budget measures and mortgages that is helping 2021, or do

you think that there are other more permanent factors that have changed structurally, in the housing market for example, that might inform us beyond 2021?

On the related question just on the consumer unsecured balances and consumer behavior, which is quite a big topic of debate amongst investors, especially with high savings levels, I was hoping you could offer your thoughts here on any clues you've seen so far in the very short time that hospitality and non-essential retail has been open, that can help us think about what a modest recovery in the second half can look like? Thank you very much.

William Chalmers
Thanks Omar. With respect to AIEAs, as you say, we have experienced a decent Q1 in that respect; AIEAs went to £439.4 billion, as you saw, from £436.9 billion at the end of Q4. So an increase of roughly two and a half billion, that's obviously very welcome. It's driven by a number of factors, but principally the mortgage growth that we've seen in the course of the first quarter.

Looking forward to the remainder of 2021, first of all, we expect to see several elements of the AIEAs to continue into Q2 and beyond into H2, or 2021. Most obviously that's the mortgage market where we continue to see strength in Q2. And indeed, we would expect continued mortgage growth into H2 of 2021, because we think there are structural factors behind that growth in the mortgage market, in addition to some of the more cyclical factors that we're currently benefiting from.

Likewise, in the second half of H2, we would expect the opening up of the economy to lead to a gradual expansion of the unsecured balance, although clearly that will be activity dependent. And also depends upon the extent to which our customers choose to use deposits as opposed to going to credit. But overall, those are two positive factors for the growth in AIEAs in the second half of 2021.

I think looking forward beyond that, I wouldn't give any official guidance, but a couple of thoughts to put into the mix. First of all, as I said, we do think the mortgage market is driven by structural factors. It's driven, for example, by people's preference about where they live. It's also driven, I think it's fair to say, by low rates as well, and therefore mortgages being relatively more affordable than it might be in other circumstances.

Likewise, if you look at other areas of our balance sheet, we do expect the macro growth to continue in 2022. You'll have seen in our economics this morning that we expect 5 per cent growth in GDP in 2022, which is a better pattern of growth going forward. And we would expect some form of balance sheet expansion in our business to be reflected therefore, unsecured most obviously, as spend pattern start to pick up and the macro growth continues. And likewise, over time we'd expect that to feed through across all of the business lines.

So I think there are some factors that are structural by nature and certainly encouraged by macro-economic developments that we think are encouraging from an AIEAs growth perspective. But we have to see how that pans out over the course of this year. And we'll obviously be updating you accordingly.

You asked about spend. The spend trends are pretty encouraging so far. We have seen through the course of the first quarter, improvements from January through to March and those improvements are continuing in the context of April's figures. If we look back to the comparison with 2019, the spend figures for the second week in April to Wednesday the 21st, second or third week in April to Wednesday 21st, it shows increasing spend by about 21 per cent over 2019, but it's worth pointing out that that is a positive 27 per cent within debit card spend relative to 2019, negative 12 per cent versus 2019 credit card spend. We do expect that over time as airlines, hotels, travel, that sort of thing picks up, that this credit card spend is going to grow accordingly. And that's really what we're waiting for. So positive developments on the spend picture, Omar, and that's obviously encouraging.

Omar Keenan
That's great. Thank you very much.

Question 3 – Raul Sinha, JP Morgan
Good morning, Antonio and William. Antonio, thanks for everything over the past decade, especially the healthy debate, and I wish you the best in your next role. I've got two questions please.

António Horta-Osório
Thank you very much.

Raul Sinha
The first one is I was wondering if you can unpick a little bit of the NIM guidance upgrade today for us, to give us a sense of how much of your increased view on the NIM reflects the structural hedging changes that you've made, in terms of both increasing the size of the hedge and the capacity, versus how much relates to a more positive view of consumer spending in the second half of the year? I'm just trying to understand what are you assuming in terms of consumer spend in the second half of the year within the NIM guidance? And then I've got a second one, please, on the dividend.

William Chalmers
Sure. Shall I just take the first one first, and then we can go into the second one. The margin outlook. As you say, first of all, Q1 has been a relatively benign development on margin. We came from 246bps at the end of last year to 249bps at the end of this quarter. And that's been driven by headwinds which won't surprise you, including the structural hedge and unsecured balances, but also tailwinds, as outlined in my comments earlier, around commercial banking, around funding, as we discussed earlier, around some liability management capital benefits. Those benefits stay with us as we look forward. There are one or two other factors that come into play as we look forward.

From a tailwind perspective, the structural hedge headwind that we have previously seen, as I mentioned in my comments, that structural hedge drag has been reduced significantly by the yield curve improvements that we've seen during the first quarter. And that is clearly a benefit. In terms of the headwinds that we see, it’s interesting because they're actually very benign from a net interest income point of view, albeit a little dilutive from margin point of view. So for example, mortgages volume is benign from interest income point of view, but slightly dilutive to margin.

Likewise we see some expansion in commercial banking, both RCF and also trade finance balances. And finally expansion in unsecured, as I mentioned earlier, which more or less gets us back to where we ended the year in 2020 as we see it unfolding. But we're expanding unsecured at very high levels of the credit spectrum i.e., very cautious credit standards, which in turn is a slightly more dilutive measure than you might first think. So all of that gives us our guidance for margin in the remainder of 2021. And hopefully that's useful.

Consumer spend, I think we see that as unfolding along the lines I mentioned earlier on. Continuing to grow, in particular, I would expect the re-opening up measures, and in particular things like travel, hotels, airlines, that sort of thing, to lead to greater credit card expenditures over time. And obviously a part of that is going to stay on the balance sheet and a part of that is margin accretive. So hopefully that gives you some sense, Raul.

Raul Sinha
Got it. Thank you. I guess the second one is just around what we should be expecting in terms of the interim stage on the dividends. And I don't know if I'm reading too much into this, but it sounds like we might get more than the usual interim sort of update on the dividends. Are you expecting the PRA to talk about broader capital restrictions and should we expect that you might be able to address some of the stuff on capital distribution at the interim stage or should be waiting until the end of the year for this?

William Chalmers
Thanks for the question. As you know, we did the most that we could with respect to dividends in 2020, that was a regulator-determined standard. We do, as I’ve said a number of times before and it continues to be the case, recognize the importance of dividends, and capital distribution more generally, to shareholders. And we also obviously note our strong capital position in that respect, and that leads us to both intending to accrue dividends and also to pay an interim dividend in line with the position as we see it at the time.

To your question, we are waiting for the regulators to take a view on allowable dividends for the sector as a whole. We very much hope that the regulator will allow the Boards to make the judgments that they would like to make. And that the restrictions that have previously been in place are no longer seen to be necessary.

So our expectation is that by the time it gets to half year, we will have a better view on that. We're clearly looking to see what the PRA says. And then subject to that, we'll look at the interim dividend. Again, at the end of the year, we'll also look at the final dividends in the context of the macro, the outlook, the capital position, and clearly what the regulator says. But all in the context of, as I say, recognizing the importance of dividends and capital distributions to shareholders.

Raul Sinha
Understood. Thanks so much.

William Chalmers
Thanks, Raul.

Question 4: Jonathan Pierce, Numis
Hello everybody. And again, to repeat good wishes to Antonio, good set numbers to leave on, these. And the two questions I've got focus on, firstly to start on the structural hedge, which I suppose to a degree is where the improvement in margin guidance is coming from, and then I've got a question on operating lease depreciation.

On the hedge, maybe to give us a bit of color on how you scale the approved capacity of the hedge. You've said that there's £225 billion approved capacity today, but that's only reflecting part of the liability growth over the last year. So do you do what I think NatWest does, and look at the last 12 months average deposit base? So over the next 6-12 months, we'll get some further rolling through of that averaging effect and the improved capacity will just naturally increase further? So I'm just trying to get a sense as to what the capacity of this hedge could move to, based on the spot deposit base today. That would be helpful.

And the second question on operating lease depreciation, for the last few quarters now, ex-the profits on the car sales, we've been running at an annualized, probably £700-750 million a year, and that's a lot lower than the billion pound number we'd got used to historically. Is that a sensible base now to be thinking of, driven almost purely by the size of the Lex fleet, and hence rate for operating lease deprecation being closer to £700 million going forward? Thank you.

William Chalmers
Thanks. If I take the first of those questions first around scaling of the hedge, when we look at the hedge, it's interesting, of course, in the last five quarters, our hedgeable deposits have moved from around £200 billion to around £254 billion. So an increase of roughly £55 billion over the course of that time. At the same time, our hedge capacity has gone from around £190 billion to around £225 billion. And so effectively, the cushion has increased by circa £20 billion during that time. Now normally we'd expect to run with about a £10 billion cushion, i.e. the difference between hedge capacity and hedgeable deposits. Right now, because of the growth last year, we're running with a cushion that’s actually tripled from that to around £30 billion or so, and we are waiting to see how those deposits behave over the course of a macro economic expansion.

And the watch word right now is just to look at those balances and to be cautious about how they might respond in the context of a macro economic expansion, and therefore significantly increase the buffer. That gives us the opportunity, if those deposits end up being sticky, and we do expect that some of them will be, to accommodate the hedge accordingly during the remainder of this year, but we're kind of waiting to see, Jonathan, as we see how 2021 unfolds.

The second point is around hedge deployment, which is that obviously when we increase the capacity of the hedges, as we have just done to £225 billion, it takes us a little bit of time to deploy that in the course of the year. So we will see the benefits of that increased hedge capacity as we deploy the hedge over the course of the year. It will be gradually deployed into the market in an orderly way, and therefore our headwind, or reduced headwind, gives you some sense of how we expect to see that play out.

The second of your questions, on operating lease depreciation. As I mentioned in my comments, operating lease depreciation has seen a benefit of around £30 million this quarter from improved used car prices. As we look forward, I would take the Q1 operating lease depreciation, take that £30 million, which I mentioned in my comments, and just adjust accordingly. And you'll see, relative to previous years, an improved performance, as you say. And that is partly because the size of the fleet is going down. And it's also partly because, as I said, we've taken a cautious view on used car prices. We're not seeing that unfold in as negative a way as we had expected. And therefore that is coming back on to the operating lease depreciation in any given quarter, including Q1.

Jonathan Pierce
Okay. That's really helpful, both of those answers. Thank you. Can I ask a very quick follow-up on the hedge because I think this is quite important. These new deposits that are getting deployed, because a lot of them are current accounts, can I just confirm that you're still comfortable putting those out up to 10 years forward because you have got such a big cushion? You're quite happy to still be deploying those at 10 years, is that right?

William Chalmers
Well, I think I would see it quite differently, actually, Jonathan. As I said, in the last five quarters, we've basically seen deposit inflows of close to £55 billion. We have increased hedge capacity, but only increased it by £35 billion, and thereby significantly increased the cushion that we have of deposit flows over hedge capacity. And so actually I think we're taking a very prudent and

cautious view with respect to the movement or potential movement of current accounts. And as I say, that's expressed by the increase in buffer that I just talked through.

So when we look at the hedge, we typically deploy the hedge, by way of background, at around the five-year part of the curve. That's typically where we go, that's consistent with our asset size and consistent with roughly moving towards a neutral position from a hedge perspective. But I think we are being extremely prudent with respect to the rate at which we deploy the deposits and indeed leaving ourselves a lot of room for even a very, very substantial macro expansion before we need to worry about the hedge size.

Antonio Horta-Osorio
And, Jonathan, just to build on what William just said, so you will see we are still below the weighted average life. That's where a 100 per cent hedge position would be. And as William just said, we are mostly investing these additional deposits, these current account balances, on the five years, because of the reasons William explained, but also because we do believe that there's a significant probability that the curve will steepen further, while we think from the comments that you are hearing from the different central banks around the world, that they will not move short term rates. And therefore, there is a significant probability that the curve steepen further. And we think that also for this reason, the five years is the right way to invest these additional balances.

Jonathan Pierce
Okay, really helpful. Thank you.

William Chalmers
It's perhaps also worth mentioning in response to your question, we have around £40 billion of maturity this year in the hedge. So again, we’ve taken an incredibly prudent position vis-a-vis the cushion of the hedge, i.e. eligible deposits have increased much faster than our hedge capacity. That’s number one, and number two, in addition to that, we have £40 billion of maturities in the hedge this year. So it's a really quite substantial buffer.

Jonathan Pierce
Okay. That's great. Thanks a lot.

William Chalmers
Thank you, Jonathan.

Question 5: Robin Down, HSBC
Good morning. I have to confess, Jonathan's asked most of the questions I was going to ask in terms of that structural hedge. But can I just clarify then, on the £300 million, you're assuming there that you deploy the hedge up to its kind of full capacity to £225 billion? I mean, it looked like a tough quarter to deploy that sort of amount in the first quarter, but is that what you're assuming there?

And just sort of linked on the margin side, I just wonder if you could talk a little bit more about the commercial banking side and the sort of optimization that's going on there? I can see it was around 2 basis points in the first quarter, just how much more you've got to go on that front?

And if I could be really cheeky, I appreciate we're only in April 2021, but I think you're signaling that the drag on the structural hedge in 2022 is going to be kind of minimal. That’s obviously one of the major negatives in terms of the margin development. I'm just wondering if you could talk a little bit about how you see margins developing then in 2022, because I think with the rising consumer credit balances, I'm assuming we've got further deployment of the structural hedge coming through, is there any reason why we shouldn't be looking for a relatively stable margin picture in 2022 versus 2021?

William Chalmers
Thanks Robin. So first of all, in terms of the deployment of the hedge and our guidance around the £300 million headwind in 2021, we are assuming that we gradually apply that hedge capacity over the course of the year. So that takes into account, just normal deployment over the course of the year, as opposed to doing it all upfront.

Secondly, in terms of the CB optimization question, there's a couple of different things going on there. One is, we have a business here which is very strong, but we also want to manage it to appropriate return standards. And so as a result, there are clearly going to be some relationships where it's going to be harder for us to earn a sensible return from a shareholder point of view, than others. And so with respect to those assets, those relationships, we just seek to manage them in a sensible and appropriate way. And that's really what we mean by optimization.

There is also a pattern that is partly responsible for some of the margin developments, which is around lower forms of demand, particularly in the RCF area. And as you know, that was a feature of our 2020 results in margin development. And that contributes a little bit here. And then finally, the demand from a commercial point of view is relatively muted in some cases because of the government assistance programs. And so that has some margin substitution effect in terms of what we're seeing within CB. In terms of 2022, I won't go into guidance on the margin per se, but I think you'd probably have all of the factors that will make a difference during that time.

The hedge headwind is, as I said, neutral during 2022, we don't expect a hedge headwind during that time. And that's because of the yield curve developments that we have seen. There'll be other factors that play in the margin in 2022, which include obviously continued mortgage growth. on one hand, and also include unsecured expansion I would expect, off the back of an improving macro, as a further element. Those elements will play out in the context of margin development, Robin. So I wouldn't go beyond that, but you probably have the ingredients to get to the conclusion.

Robin Down
Sorry, just to come back on the commercial banking side. So some of it was due to the RCF. I guess, we're hopefully at the end of that, but how much more optimization do you think there is to go for in the next couple of quarters?

William Chalmers
I think there is a little. I think it is best seen in the context of the inputs to the margin guidance for the remainder of the year, Robin. And that is to say, as I said earlier on, tailwinds, we have a removal of what we previously expected as a significant structural hedge drag. That seems to be going away following on from the benign yield curve development. We have headwinds from size of the mortgage volumes, to a degree also from the return of some activity on the commercial banking front including things like trade finance balances and so forth. So on a net basis, if you look at the commercial banking influence on the margin over the remainder of 2021, it's more actually from expansion than it is actually from contraction. And so that hopefully answers your question.

Question 6: Alvaro Ruiz De Alda, Morgan Stanley
Good morning. This is Alvaro from Credit Research at Morgan Stanley. Thank you very much for your time. I have a question about a legacy Tier one. It was for a 12 per cent USD bond. As you know, it would be expensive funding after the end of the year. Considering the very high cost of leaving this useless debt outstanding, are you expecting to use a regulatory par call in early 2022? Thank you.

William Chalmers
Thanks. Alvaro, I might just refer you to the treasury team to get an answer for that question, I'm not entirely surprised you ask it, but I'll refer you to the treasury team.

Alvaro Ruiz De Alda
Thank you very much.

Question 6: Aman Rakkar, Barclays
Good morning, gents. Antonio, just wishing you the best of luck with your new role. Just a couple of questions. First of all, can I ask around mortgages please, I'm just interested in anything you can tell us about the Q2 pipeline. When I look at some of the system-level data, it looks like applications were not far off in Q1 versus what they were in Q4. Is there any reason why we couldn't see a similar mortgage volume print in Q2? Is there anything about your relative risk appetite? Were you taking share in Q1, anything you can give us in terms of color there? And could you update us on your pricing experience currently? So I know we've seen some narrowing in spreads through the course of Q1. It'd be interesting what we should be expecting in terms of completions in Q2. That'd be good.

Another one on consumer credit, if I could actually, just around your expectations for the growing balances in the second half of the year. I guess, particularly on credit cards, what your experience was on repayment rates? And what your assumptions were regarding the rebuild of those balances in the second half of the year, as well as seeing the recovery and spending - I guess we probably need to see repayment rates not too elevated? Would be good to get your thoughts there.

And then just finally, on other operating income, I was just interested in if you had any kind of updated views on what to expect from that line through the course of this year, given we're kind of one quarter further down the line.

William Chalmers

Thanks Aman. Picking up on mortgages first of all, we feel pretty good about volumes in Q2 and the market continues to be very solid. We continue to see very attractive volumes at frankly, very attractive prices. So I think that we'll enjoy the benefits in Q2 of both secular and cyclical drivers. It may be that as stamp duty turns off in Q3, then the cyclical driver component of that starts to weaken, but we still expect the structural drivers to remain in place. So we feel pretty good about mortgage volumes in Q2, and indeed beyond. But as I say, an accentuated growth in Q2 in particular.

Pricing, Q1 completions have been around 190bps, so that's been very attractive, and frankly pretty much in line with our Q4 experience. There has been a little bit of narrowing of prices in the course of the quarter. New business applications are around 175bps to give you some idea, but both the completions in Q1 and the new business applications margin, both of those two, are at significantly attractive margins versus the roll-off that we have seen for the same fixed rate assets. So from a volume and from a pricing point of view, it looks very favorable.

Consumer credit, I mentioned earlier on that we're seeing significant expansion in spend. At the moment, at least in March, that has been driven by debit cards. Credit is coming back, but it's coming back at a slower pace than debit. We do expect that to evolve over the course of the next quarter or so, particularly as restrictions come off and bigger ticket items, including, I mentioned earlier on, travel, but not just travel, consumer durables likewise, come into play, that in turn start to boost credit spend above and beyond where it is today. And so that will help, but I think you're right to raise the question of repayment rates. Repayment rates so far have been a little higher than we've seen them historically. And obviously the significance of repayments will influence the extent to which credit spend then stays on the balance sheet.

At the moment, we do expect our unsecured asset to increase over the course of H2 and we expect, roughly speaking, credit cards, for example, to get back to more or less where we started at the beginning of 2020. So it's a bit of de-leveraging in the first half, then a bit of re leveraging during the course of the second half.

But I would stress on that two points, one is our risk appetite around the whole area of consumer credit is very low. We're being very cautious on risk appetite, and so that is driving, to an extent, our volumes. If we end up getting into a better macro space, our risk appetite adjusts accordingly, and that in turn may impact balances, but for now it's a very cautious set of standards that we're applying.

The second point is that even if we see a little bit of delay in unsecured expansion versus what we might have thought by virtue of repayments, then I think it's a question of when it comes. It simply gets delayed rather than necessarily put off entirely.

Your third question on OOI, the OOI performance in Q1 has been pretty –

Antonio Horta-Osorio

Just before you go on, William. Aman, just about the mortgage volumes about what's happening on the mortgage markets. I mean, you might recall that we are saying this already since Q3, but we continue. And now it's three quarters that we've continued to see a structural shift in the mortgage markets whereby people are spending much more time at home. I do believe we will continue to work at least partially from home for the future. And that is a structural change and therefore many people that have the capacity to do so have been moving into larger homes, outside cities, with gardens, if possible. So you are seeing as much of very high volumes of mortgages of first-time buyers, as you are also seeing from home movers and this is the third quarter in a row that we see those shifts continuing.

And so on top of the stamp duty impact that William mentioned to you, I strongly believe this is going to be a structural shift, which we'll continue to watch as time goes by, because people are obviously spending more time at home. They want to invest more in their home and that is going to continue in my opinion.

William Chalmers

And Aman, you asked on OOI. OOI has seen a pretty solid quarter during Q1. That is to say it's consistent with our lockdown run rate of about £1.1 billion. I think that it is also a pretty straightforward quarter. There's not much to draw your attention to in terms of one-off items either way. The £1,135 million therefore, I would expect, to be completed during the course of Q2 and beyond as a base.

And then, we believe that during 2020, we lost around £300 to £400 million of effectively lockdown-related shortfalls in activity across all of the businesses - across retail, by way of interchange, across commercial, by way of transaction banking, across insurance by way of new business. And indeed even to a degree across our equities business.

Therefore, as we emerge out of lockdown, we would expect that £300-400 million to start to return to the business and start to gradually build back in on top of that £1.1 billion number that I mentioned. That in turn will be augmented by our investment. So again, over time on a gradual basis and again, across all of our business areas.

So I think, Aman, we see £1.1 billion as a lockdown base, we think over the course of three quarters in total, we lost around £300-400 million. We expect that to gradually come back in and gradually be augmented by the benefits of investments across our business. Those in respect of SR21 and those that are longer term. And the pace of that Aman, it won't surprise you, is going to be activity dependent.

Aman Rakkar

Okay. Thanks. Can I just get a couple of points of clarification. That other income commentary is really helpful. I mean, it looks like it's pointing to a number that's kind of around probably 4.8, 4.9 for the full year 2021. And then hopefully we can kind of grow that in 2022. So please correct me if you think I've interpreted that incorrectly. And I guess just coming back to the consumer credit point, did you say that you would expect credit cards to end the year in line with 2020? And if so, given that it's down 6-ish percent in Q1, are we talking about hopefully flat in Q2 and then maybe a kind of 6 per cent growth in H2? Is that the kind of run rate that we should be looking for in 2022?

William Chalmers

First of all, on OOI, it's going to be activity dependent. We've got the engines of growth there, which basically are twofold, activity returning coming out of lockdown and the benefits of our investments over time, both are going to be gradual, both are going to be activity dependent. So, I wouldn't go further than that and giving you much guidance I'm afraid, Aman.

In terms of cards, again, I wouldn't be too precise because it will be very activity dependent. I do think overall, the outlook is, broadly speaking, for a bit of de-leveraging in H1, a bit of re leveraging in H2, more or less getting you back to more or less where you started. But again, that could be faster if we see a rapid macro and an increase in credit usage, it could be a little slower if the repayments of the big deposit base end up being people's preference over taking credit. And if it is a lot slower, as I said, that's a question of time. It's not a question of the unsecured business not benefitting from that. It's simply a question of a slight delay in such. So again, I wouldn't be too precise, Aman, but hopefully that's helpful.

Question 7: Fahed Kunwar, Redburn

Thanks for the questions and thanks, Antonio, for your help over the last 10 years and good luck at Credit Suisse. I had a couple of questions, just clarifications on the hedge actually. The hedge duration increased really markedly in the quarter. Am I right in assuming that links to your earlier comment, that essentially you're hedging current accounts and assuming a 10 year duration? So the reason we can expect that duration to continue to increase, is if you decide to keep on hedging more current account balances, at longer duration?

And the second question I had on the hedge is a bit more high-level. I think a couple of years ago hedge income was about sub-10 per cent of group revenues. It is now sitting at about 15 per cent. If you were to deploy the capacity you suggest, it probably goes higher than that. Do you think about a revenue cap on the hedge in a sense, that at some point if rates stay low and deposits keep growing, which you've seen in other countries with low rates, the hedge income becomes a bigger and bigger portion of income? How do you think about that dynamic or is it just purely mechanical, linking it to the growth in deposits?

And my second question was around your impairment guidance. And if I think about your lower than 25bps guidance, just taking the high end of that, that's about 40 basis points a quarter thereon which seems very high. Is that potentially linked to the fact that actually on commercial defaults, you see them as artificially low right now? And do you think actually commercial defaults would increase to normalized levels in the second half of the year? And that's just purely on the fact that, not looking at the economic provision releases, in your actual on the ground defaults, there are big commercial write-backs? And so is that a factor in you thinking that actually impairments get up to higher levels as we go through the year from the charge we had in Q1? Thank you.

António Horta-Osório
I will start with your question in terms of structural hedge and then William can add points on the structural hedge and answer the second question. And what I would say is following. If you look, because you were asking about a potential cap on revenues, the way I think we should look at this is the following.

We have a policy like most banks have, of hedging all interest rate risks in the balance sheet back to three month LIBOR. And let me just say LIBOR, because you know, the fact is that we are moving from LIBOR to the other benchmark, but the point is, as a bank, you should provide on both sides of the balance sheet, whatever your customers want. So if they deposit current accounts, which have no maturity, that is one thing. If they deposit with you at six months, whatever they want, you should satisfy their needs in the same way.

On the other side of the balance sheet, we provide mortgages which have 30 year maturities or may have lower maturities. So you should do what the customers want on both sides of the balance sheet. But then in order to properly manage the risks of the bank, you should convert everything to, for example, three months LIBOR in both sides of the balance sheet.

Having said that, so what is happening with our structural hedge is not anything financial. We have to assess what is the average life of the current account balances. We have been gaining market share of current account balances, as you and I, and we together have been discussing for the last years, we have constantly been gaining market share of current account balances in the UK.

And therefore what we have to do is to, in order to have the balance sheet hedged, we have to estimate what's the behavior life of those balances, because they are the only part of our liabilities and equities which don't have a pre-determined duration or maturity. And we believe, as we have told you along the way, that current accounts should be 10 years maturity, which is five years duration, and other rate-insensitive balances, five, which is two and a half.

So the fact that the revenue proportion of the current account balances is increasing, I would say it's a very good thing, because it only reflects the fantastic work that the commercial teams have been doing with our multi-brand model, where we continue to attract balances which are basically paid zero. So they are convenience and trust balances, and we are just reinvesting those balances at a conservative average maturity, as William explained in the previous question. So that there is no reason at all to have a gap. This is our most valuable franchise on the liability side, it is the current account balances, that I repeat, represents the trust of our customers in our brands, and that is convenience balances, not price-driven balances.

William Chalmers
Fahed, just add one or two points to that, and then answer your question on impairments. The hedging strategy, as I mentioned earlier on in my comments on one of the earlier questions, has basically been moving from about two years to five years.

So if you think about the duration with which we are deploying the hedge, that gives you a sense. Previously when the curve was very flat, there was essentially no transformation margin. We were investing at relatively short ends in order to ensure that we maintained some degree of optionality, should interest rates change. When interest rates did change, there was clearly value at that point in investing slightly longer on the curve. And we've typically moved to around five years.

It is the case that as we deploy the increased capacity in the hedge, then that average life that is currently 3.4 years will increase a little in response to that. It will increase to something that is closer to its neutral position, which is around four and a half, five years or so. So you can expect to see, as the deployment of the additional capacity within the hedge, which as Antonio said, reflects the success of the current account product and the success of the savings product and the success of the commercial deposit gathering exercise, you can expect to see the weighted average maturity of the hedge move out a little, but it won't be more than about the one year, 18 months type indication that I've just given you. And that is on the assumption that we fully deploy the hedge and move to what we call neutral position.

It is worth bearing in mind in all of that, Fahed, as I said earlier on, we have increased the hedge cushion, the difference between the hedge capacity and eligible deposits from £10 to £30 billion over the course of the last five quarters, number one; and number two it is worth bearing in mind that there are £44 billion of maturities still coming on over the course of this year. So that together gives you about £70 billion of cushion or so, either not hedged or alternatively maturities during the course of this year.

The impairment question that you had, the impairment language is very deliberately less than 25 basis points, Fahed. And I would just ask you to look closely at that language as you think about what it means. As we stand today, that impairment language is off the back of the assumptions that our macro assumptions holds steady. i.e., you look at our macro assumptions, that set of macro assumptions is a slightly more adverse environment versus business as usual. 7 per cent unemployment is not a through-thecycle unemployment charge. We still see a bit of HPI deterioration this year, even though frankly, current performance make that look increasingly unlikely, but we'll see how it unfolds.

But the point being that we are giving you guidance of less than 25 basis points, that is on the assumption that the macro that we have portrayed is indeed what unfolds. If it is a little better than what unfolds, then that's why we chosen the language less than 25 basis points. I think that's useful to thinking about how we're looking at the AQR guidance, Fahed.

Fahed Kunwar
That’s great. Could I just ask one question on the commercial side and just looking at the actual on the ground business - restructuring, defaults, bankruptcies, they are at all-time lows right now, and I'm assuming that's a big function of government support mechanisms. How do you see that evolving as the government's support mechanisms go out? Do they go back up to normalized levels or do you think actually there's something else in the commercial book, which is rendering the charges and defaults as low as they are?

William Chalmers
I think there are two or three things that are going on in the commercial book. Generally speaking, we're in a benign underlying credit environment across retail and across commercial, and that’s why you’ve seen us take the £323 million credit today. That's obviously compounded by the economic outlook and the release that is inspired off of that, as the second input into that credit. I think when you look at commercial in particular, there's two or three things going on. One is that benign outlook without a doubt, and that is benefiting the performance of the commercial book as a whole.

Second, particular restructuring cases are performing better than we had expected. And so you're seeing specific write backs in terms of some of the cases that we have on the books. Third, you're also seeing, as we discussed earlier on, a reduction in balances within the commercial area in certain cases because of our own optimisation strategy, and that in turn is also leading to a more benign overall commercial banking outlook.

It's worth mentioning that during the course of Q1, we only had one material movement into Stage 3 in the entire commercial banking portfolio. And that gives you an idea as to just how benign commercial banking position is right now. We do expect, as I mentioned in my comments earlier on, that in line with our macro assumptions, arrears rates are going to tick up as we go through the course of the year, the withdrawal of the furlough scheme may well be an ingredient to that. But I think the important point as you look at it is that we are already provisioned for that development. That's what IFRS9 provisioning is about. And despite the credit that we've enjoyed today, we remain very well positioned for the macro that we’re forecasting.

Fahed Kunwar
That’s very helpful. Thank you both for the detailed answers. Cheers.

Question 8: Rob Noble, Deutsche Bank
Good morning, both. Just a couple of questions on capital, how did the Stage 1 and 2 write back, how did they impact capital at the moment, given the current level of transitional relief? I think you previously said, William, that half of the relief unwinds for this year, I assume that’s a lot lower now given your guidance.

And then secondly, in the past you've taken the majority of pension contributions in H1, how much have you taken, how much is there still left to do this year to impact capital?

And then lastly, Antonio, good luck with the new job. As you're leaving, is there anything that you think Lloyds should do that it isn't doing currently that you think could enhance the business going forward? Thanks.

Antonio Horta-Osorio
Thanks. I'm just going to tell you that there are lots of things that we can continue to do and do better. I personally think that in life you should always try to do better and it is always possible to do better. And as you saw, when we launched Strategic Review 2021 in February, there's a very clear plan with milestones. Everybody's involved, everybody's committed and with this single idea of, it's always possible to do better, and we should always try to do better. So I look forward to seeing Lloyds go from strength to strength.

William Chalmers
In relation to your first question, your first two questions, actually. One, Stage 1 and 2 write backs. As you see those write backs, the transitionals associated with those write backs adjust accordingly, is a short answer.

In terms of what we saw in Q1, as the statements imply, we currently have about 91 basis points of transitionals left on the books, that's around 70 basis points of dynamic, and around 20 basis points or thereabouts of static.

Looking forward, those transitionals will potentially roll off consistent with our macro-economic assumptions. So as Stage 2 assets migrate to Stage three, then our transitionals roll off in that context, with obviously no net capital impact in that transition.

The dynamic that we've seen in Q1 is interesting because essentially the transitionals that we previously had there in the capital base, we had thought on our old macro assumptions, would then come out of the capital base as Stage Two moved to Stage Three. What we've seen in Q1 is that actually the macroeconomics has not turned out the way that we expected it, it turned out a little better than we expected. So instead of the transitionals running off into Stage Three and coming out of the capital base, they're actually effectively de-risked within the capital base because the Stage 2 is moving back into Stage 1. So that transitional element is a de-risked component of our capital.

Over the course of the remainder of this year, if we see our macroeconomics unfolds as we expect them to, then we're looking at around a third of that total of 91 getting used up over the course of 2021. But again, I would stress that that is contingent on the macro unfolding in the way that we expect it to. And there's a lot of uncertainties.

Finally, on your pension point, we have a Q1 contribution on pensions, which is consistent with our previous contribution schedule. Going forward, that will adjust to the new contribution schedule. But what it means is that we have provided slightly more than half of the fixed contribution of £800 million in Q1, which obviously means that we front end loaded the pension contributions for the fixed contribution over the total of this year.

Antonio Horta-Osorio
Well, I just want to say it's my last investor call here at Lloyds. It has been a real pleasure to have this interaction with you over the past 10 years. It was really great to share performance with you, listen to your points of view, have debates, having challenge, very helpful to us. You as shareholders and the people you represent, you are the owners of the bank. And it was very clear for me and the management team it was our absolute duty to deliver to all stakeholders, including yourselves and the clients you represent. So I look forward to keeping in touch with you in my next job, and wish you all the best. Thank you.

FORWARD LOOKING STATEMENTS

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