LLOYDS BANKING GROUP PLC – 2022 Q1 INTERIM MANAGEMENT STATEMENT – SELLSIDE ROUNDTABLE TRANSCRIPT
(amended in places to improve readability only)

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LBG:
William Chalmers, Chief Financial Officer
Carla Antunes da Silva, Group Strategy, Corporate Development & Investor Relations Director
Jon Burgess, Group Financial Controller
Douglas Radcliffe, Group Investor Relations Director
Sergio Afonso, Corporate Treasury Director

William Chalmers
Welcome to everybody for today's call. Thank you very much for taking the time to join. I think we pretty much said what we were hoping to say on Wednesday of last week in terms of our thoughts around the numbers. So we might go straight into Q&A. If we could ask you just to stick to two questions per person, at least at the outset so that we can get through whoever would like to participate that would be helpful.

So perhaps with that I can just hand over to operator and the colleagues on the line to start the Q&A.

Question 1 – Benjamin Toms, RBC
Morning and thank you for taking my question. You mentioned during your presentation that you took a £100 million provision top up for potential cost of living squeeze. And that one of the indicators that you look at is subscription levels. Is it possible to give some colour on what other indicators you track internally other than unemployment I guess that help inform you that the consumer is about to feel a squeeze? Thank you.

William Chalmers
Thanks for the question. First of all in terms of the overall cost of living adjustment that we made in the course of the results, as you know we had an underlying charge of £150 million at Q1 and then we put on top of that an aggregate economics charge of £27 million resulting in a £177 million charge for Q1. That £27 million is indeed an aggregate and so, if you like, is the combination of some gives and some takes in the context of the economics changes that we made as of Q1. But within that, there was just shy of £100 million overlay that we put in place for essentially two buckets. One is the lower demographic segments of our unsecured portfolio. As you know, our unsecured portfolio is a prime portfolio but within that there is a spread and so an adjustment was made for potential defaults at least from some of the lower demographics within that.

And then the second was in relation to potentially exposed sectors of our commercial business. Within that manufacturing and agriculture are examples where price rises have been experienced and therefore we want to ensure that we are prepared for any eventualities or for potential adverse shock to those sectors. And that was the second component of the overall charge.

So that was what was behind the cost of living adjustment within the MES part of the charge. It is worth saying that it is the second time we have done that. So as you will be aware as of the end of last year we also ran a severe scenario for a more inflationary outcome and that resulted in an adjustment to our severe ECL which then netted down based upon our 10 per cent weighting, also came through in the year end ECL. If you combine those two there is a total cost of living charge, if you call it that, of around £160 million when you combine both of those two components.

Then in terms of your question around the indicators that we look at, I was just trying to give some sense of what we are seeing within the customer base and one of those data points as you suggest was subscription payments that we have seen stopped essentially since the summer of last year. We have seen about 1.2 million, just over 1.2 million subscription payments stopped since the summer of last year. That is things like video streaming services, gym membership, more discretionary type expenditures. I think it is the combination of two things, one being post Coronavirus adjustments to the way in which people live their lives. The second being largely anticipatory based upon our default experience, which as you know has been very benign, but from an anticipatory stance potentially, pulling down a little bit on discretionary expenditures.

That is one example and where else do we see it? We see it in what consumers spend money on. So for example we have seen, and not surprisingly, during Q1 average monthly spend on food, energy and fuel bills around £60 higher than it was two years ago as another example of the data that we have access to and gives us some insight as to what is going on within the customer base. But I also mentioned when we look at our card expenditure for example, spending on cards, and credit cards that it is, around 7 per cent higher than it was at Q1 2019. Spending on debit is around 8 per cent higher over the same period. Within that component we are seeing increased travel expenditure.

So my point is that we have access to a variety of pieces of data that inform us about how consumer trends are developing. It is not all going one way. We are seeing increased spends, we are seeing increased travel as said in the unsecured book. And so it is important to keep this in context. For sure we are seeing inflationary trends and for sure that will impact on consumers in various ways. But we are also seeing some of the contra trends in other areas of our business.

Benjamin Toms
Thank you.

Question 2 – Omar Keenan, Credit Suisse
Hello good afternoon, thanks for making the time for the call. Just a quick question around how the debates around setting guidance internally is thought about in terms of the Bank of England base rate but also somewhat related to the asset quality picture and hear your point of view that the asset quality environment still looks like it is quite benign. But if I look at market expectations therefore, the Bank of England base rate going above 2 per cent at some point. So, the NIM guidance I guess was revived for 1.25 per cent, I think, at the end of the year. How are you thinking about the difference between that and what the market seems to be saying?

William Chalmers
Thanks for the question Omar. When we look at the overall economic picture, which obviously seeps through into the Bank base rate guidance, we look at it in the round might be the first point to start. So we will look at the various different ingredients of the economic picture, GDP, unemployment, HPI, CRE, inflation and of course bank base rates. And that is a picture as said in the round. Based upon our expectation of a slowing GDP over the course of this year albeit still clearly in positive territory, 3.5 per cent 2022. Likewise relatively modest unemployment, HPI that is moderating throughout the year. CRE likewise. Essentially what we are saying is what do we think the bank base rate is, that is both an input to those outcomes and also an output from those determinations. We do recognise, and you are right to point out, that we are behind market from a level point of view both in terms of the base rate and also, although we don’t disclose it, I suspect in terms of the swap curves that we are using as well for the purposes of our analysis and indeed the performance of the business and the guidance that we set off the back of that.

So I think in both of those two components we are behind. You know what is behind that as said, both 2022 economic forecast in the round, but also the period beyond that. And what do we think it is going to take in order for the bank to, if you like, calm the inflationary period down. Well we think it is going to be a combination of interest rate rises somewhat along the lines of what we have said. But also somewhat of an automatic stabiliser effect which is to say as these inflationary adjustments speed through into the economy, they themselves will slow the pace of GDP and ultimately inflation down off the back of that. We have also got things like energy prices expected to come out in the course of next year as an inflationary factor. It is all of those components that lead us to make bank base rate forecasts and to make swap rate forecasts. As said, at the moment we are behind market expectations on that point.

But our objective here is just to be transparent and just to show you what it is that we build our analysis on. What are the foundations, what are the building blocks? And then to say this is the performance of the business that comes out of that and this is the guidance that we can give off the back of that. But you know our building blocks and you know our sensitivities, and therefore if you or the market wants to take a different point of view, what we are trying to do is give you as many tools as possible in order to facilitate that analysis.

Similar sorts of points on asset quality environment that I would make, but if we look at our asset quality guidance for the course of this year which as you know is c.20 basis points. We also look at the performance of the underlying book to date. You might say well, absent any discontinuity in the economic performance, we seem to be trending on a favourable line relative to that guidance of c.20 basis points. I think that is probably true based on what we have seen in Q1.

I think we then get to the question as to what will we do with the Coronavirus adjustments or the Coronavirus overlays that we have put in place. And I think we will have to see how that goes over the course of the second quarter. But we are clearly gathering evidence of the fact that Coronavirus, touch wood, is not coming back in a vaccine resistant form at least for now. The longer that goes on, the longer that will feed into our considerations for what we do with those adjustments.

So I guess on the impairment charge again similar types of economics that feed into it Omar with the proviso that what we have seen in Q1 seems to be on the benign side of our guidance number one. And of course we are aware of the fact that we need to consider the overlays as we go through the year number two.

Omar Keenan
Thank you.

Question 3 – Aman Rakkar, Barclays Capital
Hi William. A couple of questions please. First on deposit beta's if I may. Seen around 9 basis points of pass through at the beginning of April, which I guess could be interpreted in one of two ways. Either it is a 40 per cent pass through on the last 25 basis points rate hike or its 15 basis points on the kind of cumulative 65 basis points. I guess the inference that would be drawn would actually be quite different depending on what the answer is there. So, when you think about it, prospective rate hikes going forward is the right reference point a 15 per cent that we have experienced thus far or is 40 per cent the right number?

If I can tag to that also the extent to which rising deposit betas kind of impact asset margins. Do you think about those at the same time i.e. you have enjoyed a richer deposit tailwind in Q1, allowed you to compete more aggressively in the asset market, and then maybe as that normalises maybe mortgage margins go up from here?

The second was just a broader question on net interest income in 2023 actually. Again, this tailwind that we are enjoying this year from rate hikes. Given your current rate assumption of 125 basis points, do you think net interest income can actually grow again in 2023 versus 2022? In particular, I am looking at the mortgage margin, negative mortgage margin churn which might be quite hard to offset next year. Any thoughts you have on that would be amazing. Thank you.

William Chalmers
Thanks Aman. I am sure somewhere in that mix you violated our two questions rule by the way but nonetheless I will try to get to all of them as we go through. First of all the deposit margin, it is obviously an important topic and I recognise it kind of grew in importance over the course of last week. I guess a couple of points that I would make in respect of that. One is how do we think about deposit margins? Three considerations which we put into the mix, one is what is the liquidity position of the business, so to what extent do we need funding based upon where we are. And as you know our loans deposit ratio of 94 per cent means that at the moment, we have a very liquid business. It is not 94 per cent by design, it is 94 per cent significantly because of the deposit inflows that we have had; c.£70 billion in the period since 2019. So, that isn't necessary a level that we would choose to run the business at were all other things equal. That's number one.

Number two, how is the competition shaping up? As you know the competition has been relatively muted in terms of deposit pass on over the course of the period since December. But that is a relevant factor and it then leads into the third factor which is making sure that we deliver for our customers as, frankly, the imperative of the business, both in value and in service. It is both of those two things; we seek to deliver great trusted products and we also seek to deliver value to our customers.

Each of those three has its part to play. At the end of the day we don't have a business without customers so we need to pay close attention to that. In terms of how should you think about it, is it a question of the average over the three base rate changes that we have had or is it a question of a crescendo up over time? I think in reality it is probably a bit of both, which I know is not necessarily the most helpful answer to your question, but I think you have probably seen not quite the average over time but equally not quite a crescendo up either. And so some mix between the two of them, then I am sure differing by not just different businesses, i.e. different competitors, but also within competitors. You have probably seen different liability pass-on in their different business areas. Indeed we have been relatively selective in terms of where we have chosen to pass it on and where we haven't, based upon our own franchise objectives amongst other things.

I think as we go forward, I said on Wednesday and I reiterate again, we feel that we are probably on the benign side of our overall assumptions from a pass on perspective at the moment. Having said that I would expect us to gradually build up towards those assumption levels over the course of future base rate changes. I wouldn't change that comment really from what I made on Wednesday. I think that is where we were, and I think that is where we continue to be.

To your question Aman there around how we think about the overall margin, do we think about the asset and liability sides together? Yes I think it is a very simple answer to that. As you know I have certainly always seen a proponent of looking at two things hand in hand and I have always maintained that when we have seen swap levels go down, temporarily at least, putting pressure on the liability margin, you have had to look at the asset side over the course of that time and indeed that is what we saw in 2020 and 2021. Now we are seeing a reverse of that, and it plays out. There is no doubt that it is playing out in a very kind of dynamic way, that is to say it is the same swap curve movement that simultaneously causes the mortgage compression that it allows you to make extra earnings on the structural hedge. It is the very same movement on the very same day that is causing the same thing. So you have to look at them together. Now having said that, we do look at the mortgage pricing in and of its own right. We also look at our market share in of themselves and we seek to be over time a strong, the number one, mortgage player. That doesn't mean that we are always in the market at the same time in exactly the same way. That means that over time we seek to be the number one mortgage player and that is what we will do. As said, with mortgage pricing moving around at any given moment, we would naturally seek to adjust our market share in line with what we think is both fair to the customer and also delivering reasonable returns from a bank point of view.

So, in short and in answer to your question on the asset margin, liability margin point, yes we would look at them in the round. It has been a dynamic, certainly I have been a strong proponent of, and I think it continues to be the case today. I do think, and this probably reiterates the point made on Wednesday, we need to see a period of swap stability before we can really judge what true equilibrium mortgage margins are. As you know, the swap curve moves significantly on a daily basis right now. You can't reliably say what an equilibrium mortgage margin is on that basis. Therefore, you know I am not predicting where it will end up, all I am saying is that you need that stability in order to have a period when you can actually determine what an equilibrium mortgage margin looks like.

Now you had a second question which I haven't gotten to, but it was around NII in 2023 and how we see the direction of that in the context of our base rate expectations and so forth. As you know we are not giving forecasts for 2023 NII and we did make a series of disclosures on 24th February which hopefully allow people to build in some sense of what we expect to see. I guess I would make a couple of observations around the margin, but I will put a bit of volume commentary on it as well. These are more directional comments, if you like, on what we expect to influence margin going forward beyond 2022. You have got a couple of tailwinds in there. You have got bank base rate changes for example, you have got the gradual deployment of the hedge into a higher rate environment. I think we have got about £39 billion of maturities, £40 billion of maturities in the hedge in 2023. That in turn is going to be put to work in a higher rate environment. Alongside of that, you have got increased unsecured volumes, with it there are expectation at least, increased unsecured volumes on the balance sheet which in turn are going to drive the margin. Against that, you have got the mortgage maturities, as you point out, relatively high yielding mortgages, re-financing into most likely lower margin business. Again, we can't tell quite what that margin is going to be but it is likely to be lower based on what we can see right now.

So those are the tailwinds and headwinds if you like. We do experience the benefit of some of those tailwinds, in particular bank base rate changes now. Whereas some of the headwinds, in particular the mortgage rollover is slower to come into the margin over time. So, you should build that into your thinking about how you see this evolving. Ultimately the pace of that margin development and the pace of the associated net interest income is going to depend upon how the bank base rate moves. How the pass through actions, how the asset margins in particular mortgages develop. And then overlaid on top of that economic activity which is going to develop and lead activity across the balance sheet, particularly on the asset side.

So I think without being more concrete than that, hopefully that gives you a sense of the drivers, what we expect to see going forward on margin and net interest income.

Aman Rakkar
Thank you so much William.

Question 4 - Chris Cant, Autonomous
Good afternoon, thanks for taking my questions. I had one on base rate and then one on PMAs please. So on base rate you said you expect a base rate hike in May and then one in the later part of the year. I was just wondering if you could give us a bit more of a specific expectation on your second rate hike assumption so obviously we can all make our own assumptions about the pass the base rate, but just trying to understand how much of the year you are factoring in an additional rate hike within your revised NIM guidance. That would be a helpful data point please, just when is the second rate hike you are assuming?

On PMAs and the potential release there, if I think about where you were at the year-end, obviously there was no excess expected loss deduction, but when I look at your full year Pillar III it doesn't look like there is that much of a difference between your specific credit risk impairment and your regulatory expected loss. I guess we may enter a world where you have got these PMAs being released but we might not see the full effect of that in capital because you might see an expected loss deduction coming back. I don't know whether I am barking up the wrong tree there, but I would just be interested in your thoughts on how a release of PMAs would interact with that deduction, if at all, because it looks like it might come back and it is hard for us to take a view because obviously you have put through model changes in the first quarter and we don't have a full Pillar III yet, and I am not sure your Q1 Pillar III will actually give us the answer when we get it. But I can't see what your updated EL would be so I guess the expected loss spat out of the updated models will now be higher because you have put in higher PDs. So potentially that gap is now even smaller than it was at full year. Just interested in your thoughts, do we actually see that expected loss deduction come back if you start releasing those PMAs? Thanks.

William Chalmers
Yeah sure. Chris as your question on the first one was around base rate change in 2022 or 2023, not that it matters terribly much on either, but where was your question coming from?

Chris Cant
In 2022, so I think you said you expect one in May and one in the later part of the year. So, I just wondered what you meant by the later part of the year, is that like November or September?

William Chalmers
No, it is the third quarter, so the expectation for a further shift from what we might see tomorrow I guess it is, is that we would see it in the third quarter. I forget the exact dates of the meetings within that third quarter but I think it is towards the end of that third quarter. So hopefully that is clear. From that particular point of view there is also a further change which actually you will see, the easiest way to see it I think it is set out in our quarterly forecasts on the RNS. You will see there a third quarter jump from 1 per cent second quarter to 1.25 per cent third quarter. Actually as I speak, I think it is more like the middle of that third quarter than it is the end of that third quarter in terms of timing. So hopefully that gives you what you need.

In terms of the expected loss ECL point, you are right to look at that, it is obviously an important driver of the extent of capital release. Just to clarify a little around that, as you say there is this dynamic whereby at the moment our ECL is ahead of our expected loss deduction and so we don't have excess expected loss. That is the case because the ECL is where it is and therefore if we release ECL we get capital benefit at the moment. If the releases are coming at a different point in time when the ECL is actually below or let's say in line with the expected loss, then the capital dynamics from that is different because the expected loss becomes a peak capital requirement, if you like, rather than the ECL.

So, in answer to your question, how did the potential releases of the COVID overlay impact capital release or not, it really depends on the timing of when those releases occur. If you were to do them today, you have a situation where the ECL is ahead of the expected loss and therefore you will get capital benefits. If you do it let's say much further down the year, depending upon how the ECL develops clearly, that might or might not be the case. Therefore you may see some diminished capital benefit from those releases.

Chris without forecasting the precise track of our ECL over the course of the year it is hard to be more precise than that but hopefully that gives you an idea that it is timing dependent, that at the moment we are in a position whereby the release of that COVID overlay would indeed lead to a capital benefit because of the status that we are in. If we see any change over the course of the year in the expected loss and or the ECL, that dynamic could change.

Chris Cant
That is helpful. In terms of the model changes you have put through in the first quarter am I right in thinking that does just mechanically drive up your regulatory EL even though it hasn't resulted in an EL deduction in the first quarter but just logically it would appear to result in a higher EL? I am not actually sure how much of an overlap there is between your ECL models and your RWA models. Implicitly, there must be some connectivity there because you talked about how we had seen some stage migration because of these changes around the definition of default and things which had impacted your staging but didn't result in a change in ECL, but there was obviously some feed in there and you re-categorised PMAs. But I think the higher mortgage risk rates, presumably that does mechanically come with a high EL, but I am not sure how much of a fact that is?

William Chalmers
We haven't disclosed the exact amount, but the point you are making is right, that is to say the probability of default which ultimately leads or is a contributory factor to the EL is indeed embedded in the RWAs and so when you see an uplift in RWAs, it is driven by those same factors which in turn drives an uplift in EL as of the first of January. So that one change leads to the other if you like. Having said that, it didn't change the overall ECL EL dynamic, and so my point earlier on about capital release if the COVID releases will happen now stands. Then we just have to see how those two factors develop over the course of the year.

Chris Cant
Okay thank you.

Question 5 – Jonathan Pierce, Numis

Hello there. I have got two questions both on capital development I suppose over the course of this year. The first one is just to check on the intangibles that didn't look like there was much of a move at all in the first quarter. Just checking really that the statement you gave to us on this call a couple of months ago now that you would be looking to do I don't know, £1.5-£1.6 billion of software capitalisation in 2022 still stands and it really is a case that we are only two months since you set out the strategic plan that cost is going to come later this year.

The second question on the insurance company. I don't know whether you are willing to give us an update on how you are thinking regards Solvency II, either how the Solvency II ratio has moved since the start of the year, I guess it could be fairly appreciable. And how you are thinking about surplus capital there, particularly given some of the recent comments from the regulator on the approach to regulatory capital and insurance companies? Thanks a lot.

William Chalmers

Thanks Jonathan. On the question as to intangibles, there has been no change since the year-end as you point out, it has only been a matter of weeks I guess. But the plans are very much the same. You know all of that is contingent upon us rolling out the strategic plans at quite a pace over the course of the year. We will update on that over the course of this year, half year and beyond. But based upon those developments within the strategic plan, indeed the intangible plans haven't changed. My only slight hesitation is that it does depend upon us interlocking an awful lot of plans over the course of the year and therefore will we be able to achieve the pace that we set out to? Yes I think in all probability we will, but we will make sure that you are updated on that over the course of the year. So as said, no change on the intangibles point.

On the insurance company, you are right to point it out because obviously the developments, particularly at the long end of the curves do have an effect on insurance solvency. I don't think we disclose it on a quarterly basis but I think we do it on a half yearly basis. But it is probably safe to say that the insurance solvency today is markedly ahead of where it was when we disclosed on 24th February. That in turn, even if just for the transitionals which of course have to come out of the solvency adjustment in line with the rising rate environment that we have seen because the matching adjustments are lower. Even after you net out for that, we are still seeing a very significant booster solvency within the insurance company. We will take a view on that over the course of Q2 and indeed what it implies for the potential dividend I should say from the insurance company up to the group. But I think it is safe to say that position has been benefited by the rising long end rates. In turn it has given rise to a potential insurance dividend that is probably above our expectations at the beginning of this year and we will figure out how do we want to pace that in terms of bringing out the insurance company to the group over the course of the half year and again at the end of the year depending upon how rates evolve.

Jonathan Pierce

So the end of last year when you said the proforma for Embark and the proposed dividend etc. I think you were about 29 percentage points ahead of the 140 per cent Solvency II target that you have talked to before. It sounds like, even when we take everything into account surrounding regulatory changes and so on and so forth, we are north of that now. And you would be happy to, I don't know, maybe upstream quite a lot of that over the course of 2022?

William Chalmers

Well the Group policy is to ensure that capital is managed centrally. We don't like to leave excess capital in the various different operating businesses of the Group and that is a capital management philosophy because we feel that it should be allocated in the appropriate way based upon board decisions. Therefore, in principle where we see excess capital above and beyond the target capital levels of any given area we will seek to distribute, to dividend that up to the Group so that we can then allocate it in the appropriate way including capital distributions to shareholders.

Jonathan Pierce

Okay that is very helpful, thanks a lot.

Question 6 – Andrew Coombs, Citi

Afternoon. I wanted to come back to the point about the mortgage rollovers. You have extensively talked about how inelastic the market was in the back half of 2020 during COVID pandemic, how those mortgages which were written at a very high spread are now going to roll off and present a headwind in the second half and into next year. Just so we can think about that in a bit more detail, I know at the time if I go back you were talking about application spreads at 190 basis points plus. You obviously provide, aside the mortgage book, both fixed acquisition, fixed retention in your slides. Could you do two things, one is provide us an idea of exactly how much gross mortgages not net new mortgages were written during that period?

And the second is to provide an idea of how much was written at two years versus five years as well please?

William Chalmers
Thanks Andrew. Just maybe one or two comments on that. In terms of the overall front book versus back book spread, we effectively switched over in Q4 between the front book margin and the Q4 of last year that is in terms of pricing of which new business versus old business was written. We have seen in conjunction with that yields that were written in the 2020-2021 period, you will have seen them on a quarterly basis as we disclosed them, but typically quite attractive and typically in the sort of upper ranges of the 150 basis points to 200 basis points range. We are then seeing completion margins in Q1 of this year of 85 basis points and I mentioned application margins have been below completion margins and you will see that come through over the course of Q2.

In terms of the gross book written in Q1, I don't think we disclosed that number. I mean as you know we disclosed 2021 new business in totality of £90 billion. I don't think we go beyond that to disclose gross and net and really Andrew, that is just competitive/sensitivity reasons, nothing more than that. Hopefully you will get a bit of a sense from it though by overall levels within the market by the £90 billion that we do disclose and by the expected book size that we have and the turnover that is implied by that which should help you to build into it.

In terms of spreads between two year and five year it stays at roughly 50:50. That hasn't changed much and where it does change it is kind of 48:52, it is that type of change rather than any more profound than that. So hopefully that answers the question on term that you had there Andrew.

Andrew Coombs
It does indeed on the newly written business. I guess just thinking about going backwards in time the book that was rolling off in 2020, would that have been a similar 50:50 split between two year and five year? Is that where we can try and back up on what it would have been.

William Chalmers
Yeah it has been more or less that for a while Andrew, that is not a new development.

Andrew Coombs
Okay thank you.

Question 7 – Robert Noble, Deutsche Bank
Afternoon William. I just wanted to ask on the consumer book. I think nearly all of the large cap banks describe themselves as prime so maybe Barclays and obviously you are the largest lender in unsecured. Is there anything we can see that shows that or even if you can tell us in terms of, I don't know, distribution, weighted credit scores or income declines or anything like that or anything you can point us to that we can compare the unsecured books of all of you? Thanks.

William Chalmers
Thanks Rob. The best way to get an outside in look at this is to look at credit agency data which in turn will give you some disclosure. Then I think more particularly look at securitisation data as well. So you will see our securitisation data freely available and you will see within that default rates and the like, charge off rates and so forth. And you will be able to compare that against other providers in the market. You mentioned Barclays there as an example. I think that should lend testimony to the experience that we have had on the unsecured book and indeed allows us to feel that prime is the right description for it. We can't comment on where others are but certainly prime is the way that we describe our book and in that respect feel comfortable on that basis.

Robert Noble
Are the securitisations reflective of the whole book or are they a cross section at the top would be my only question?

William Chalmers
A cross section of the whole book would be the way I describe it. So you will see in that securitisation data performance pretty much how the book is performing. I think that is the best insight into the performance you will see. The other data point that you might look at is our overall stage one, stage two, stage three data within that. So you will see within our stage three for example, we have actually gone down to a £286 million stage three within the cards book versus Q4 of £292 million in the cards book, and those are pretty low numbers. Again, if you look at Penarth you will see that backed up. If you look at credit scores through agency data you should see that backed up. But at the end of the day the stage one, stage two and three data is what you have on an outcomes basis to back it up.

Robert Noble
Alright lovely, thank you very much.

Question 8 – Perlie Mong, KBW
Hi, just a bit of a broader question. I appreciate that obviously it has only been nine weeks since the strategic update and you will obviously provide more updates on that in the half year. But when I think about some of your priorities, growing market share in cards, mass affluent fee income from businesses or even Citra Living, they seem to be a strategy that you would imagine is more appropriate for a more healthy economic backdrop. So just wondering if you could give some colour on the discussions you might be having at a management level. The environment actually is not that bad right now in terms of the various indicators, so just wondering if everything is on track? Some colour around that would be really helpful. Thank you.

William Chalmers
Thanks, it is a fair question. We are building a strategic plan at a time when frankly the economics are looking a little tougher over the course of 2022 than they did this time last year. Having said that, there are some counter occurrences to what we are seeing, in particular as I mentioned earlier on the development of the Coronavirus impact, which appears to be lessening, and that is helpful. But I think the main point that I would highlight is that the strategic initiatives themselves are not contingent upon some sort of loosening of risk appetite or loosening of credit standards within the business. Indeed if you look at them, they are really about accepting that the credit standards that we have maintained until now, very much stay in place. In certain cases we are ensuring that those credit standards are brought up to speed with economic developments that we have seen, as you can imagine. But rather building upon, in the case of customer propositions for example, the customer and intermediary journeys that we have. In the case of customer relationships, building upon the holistic relationship that we have, which in turn will allow us to better assess the credit metrics against any given customer. Likewise, developing mass affluent which is at the end of the day at least as much a liability driven product and to the extent that it is a credit driven product, will go towards the higher credit quality customers within our customer base and indeed outside of that. Within SME it is about digitisation of process rather than anything around credit expansion. Indeed, it will probably lessen the emphasis on lending and increase it on ancillary products. And then within CIC, the large corporates area of the activity, again it is not about loosening of credit standards, it is about improving delivery of process, ensuring that we are relevant to customers in markets that matter but not typically credit markets.

And so I think you are right to make the observation that we are building our strategy into a fairly more challenging economic environment. But on the other hand, the strategy is not a strategy that hinges upon credit risk appetite, in fact, if anything, it is quite different to that. It is about building and diversifying away from net interest income into other operating income which often enough is liability driven and in many cases doesn't require a significant increase in credit risk appetite.

Perlie Mong
Okay that is helpful, thank you.

Question 9 – Fahad Changazi, Mediobanca
Hello William, could I ask for a bit more colour on the recent changes made by the treasury on Solvency II and just because you are more forthcoming than insurers, how are they versus your expectations? We get a lower risk margin but we have a reassessment on the fundamental spread, the matching adjustments, left pocket, right pocket. And regarding increasing flexibility on the management adjustment assets, do you expect to change your proportional liquids back in liabilities or are you happy with current levels? Thank you.

William Chalmers
Thanks Fahad. I will be relatively brief because I think this regulatory change is at an early stage and there is quite a lot of debate about what exactly will come out of this. But I think as we look at the potential Solvency II changes, the overall comment that I would make is that it probably falls short of some insurers expectations as to what might come out of the Solvency II changes. I think there was a lot of expectation that it would significantly free up the market for long-term investments and do so in significant part by regulatory capital changes. To an extent that has been arrived at per the comments you just made. But I think overall it probably falls short of some insurers expectations. I don't think we have built any big plans on it to be honest, and I will come to why that is in a second. But I think if you look at the net effect of the overall changes that is probably where it falls out.

In terms of particularity the lower risk margin, you are right. Matching adjustment comments, you are right too. From our perspective, two comments made, one is our insurance strategy is not especially dependent upon the build out of the bulks component and therefore the overall effect of the Solvency II changes will be limited because our strategy in significant part is built on other things. So where are we investing significantly in our strategy? Protection is a good example, workplace pensions is a good example, home insurance journeys is a good example. Building in the combination of our, particularly retail and insurance businesses, is a further example. These are not really dependent upon the Solvency II changes that you are referring to. Overall, as I said, we will be a beneficiary just like anybody else from these changes, but as an overall industry comment I think they probably fall a little bit short of what the insurance industry might have expected.

Fahad Changazi
Okay that's great. That's helpful, thank you.

Question 10 – Raul Sinha, JP Morgan
Afternoon William, I was just trying to understand given all these model changes that you have seen on the mortgage book, if you have got any sense of the sensitivity of mortgage RWAs and negative house price inflation. I think historically we have seen some point in time models that claim to have higher HPI assumptions. So I am just trying to understand whether these recent changes would in any way affect the sensitivity if house prices were to fall?

And then secondly, I guess related to that point, if we were looking at a recession in the UK which is perhaps driven by higher commodity prices squeezing spending across the economy, but unemployment still remaining low, which parts of your book would you expect to see more stress show up in? I am sure you run various stress tests internally, I am just interested in what areas you think might be vulnerable in this type of macro scenario. Thanks.

William Chalmers
Thanks Raul, important questions. First of all, in terms of the RWA changes that we saw 1st January, as you say, some quite significant changes in that period. We had total RWAs as of 1st January of £212 billion which then netted down to £210.2 billion at the end of quarter by virtue of optimisation offsetting balance sheet expansion in that time. Within 1st January 2022 RWA impact, we saw essentially a net increase in RWAs of just over £16 billion. And that, as you point out, was composed of a variety of things, but the CRD IV mortgage models was a big part of that. So some £14-15 billion or so was effectively the mortgage models within that change on a gross basis. There has, I think, been a bit of a shift towards overall hybrid approaches to mortgage modelling across the industry, it is not so much a Lloyds point it is a generic point. Therefore, I think in line with that hybrid approach there has been a bit more sensitivity built into overall mortgage RWAs than there might have been beforehand.

Now having said that, I think it is safe to say that the extent of that sensitivity or procyclicality if you can call it that, is much more limited today in terms of the end delivery of where we think we have gotten to, versus where we thought it might go this time last year. I think there were some concerns within the industry about procyclicality being more exaggerated than it seems to have landed now. I would say that, with a caveat that things are not yet finalised. So we and the rest of the industry are still in discussion with the PRA about the finalisation of some of these models, but based upon where we are today, there is a degree more of a hybrid nature to models which in turn indicates a little bit more sensitivity, but not as much as we had feared might be the case this time last year. And so an impact, but perhaps limited.

In terms of stresses in the portfolio, what would I draw attention to? I think I could talk about a number of different areas in a generic sense, but equally you would need to take a look at the puts and takes in that respect. So where might you go? When we talked about cards earlier on, I think what you might say around that, you might say it is a prime book. We are very careful about ensuring that credit extension is matched by affordability on the customers behalf. We also stressed up to levels where we can test customer affordability for higher interest rates, which in a sense are a proxy for higher cost of living more generally. You can see the experience that we have via Penarth, through the charge of processes as mentioned earlier on. You can see the development of stage three. So you might look at the unsecured book within cards, but again, you have to look at the performance today number one, and also the affordability and stress tests that we put our customers through as well as credit extension number two, as a flip side of that. Where else might you go? You might look at the CRE book, where we have got around £12 billion of CRE exposures. We have also got significant risk transfer against a further component of these. So that CRE book is consolidated and reduced in size a lot over the course of the last few periods. The watch list in CRE has been completely flat over the quarter recent periods, including in Q1. A very large proportion i.e. well over three-quarters of that CRE book has a loan to value ratio of less than 60 per cent with an average loan to value ratio of a touch over 40 per cent, 42 per cent to be precise. And then in turn, we have been pretty cautious around the segments that we look at in the context of the CRE book.

Where else might you go? You might look at the mortgage book and say well, what strands within the mortgage book might I be concerned about? And as you know within there we have a period, a block of mortgages originated between 2006 and 2008 which is around a £40 billion or so number now. That historically has been instigated, originated, based upon credit standards that would not survive today i.e. credit standards that are lower than what we have had in operation over the last ten to twelve years or so. Now having said that, that heritage mortgage book has an average LTV of 38 per cent. So if you have a probability default that rises, your expected loss is going to be pretty low. Likewise, as you can imagine, the book has seasoned considerably. Elsewhere in the mortgage book, the overall mortgage book has an LTV of 41 per cent. Therefore again probability of defaults might go up but I think you have to look at expected loss in that context as well.

So hopefully that gives you a bit of a picture there, but when you look over the book you can look at areas that might be more sensitive than others, but in each area we feel that credit extension has been carefully monitored. We feel that the book is well collateralised and therefore we feel that while probabilities of default might rise in the context of more challenging economic environment, the expected loss feels pretty manageable. I don't want to create hostages to fortune, one should never say never about what might happen in the economy, but overall we feel pretty well positioned.

Raul Sinha
Thanks William, I might follow-up as I am just interested in some of the answers around the sensitivity on mortgage areas but in the interests of time perhaps I can take it up with the team? Thank you.

William Chalmers
Sure.

Question 11 – Ed Firth, KBW
Hi William. I had a question looking slightly more broadly in terms of margins. Do you have a sense internally as to what is a reasonable margin for the business to generate sort of through the cycle? And I guess with your current business mix? I guess I ask that in the context of, there is a lot of pressure at the moment in terms of some of the utilities around pricing etc and taxes. If we look at a lot of the Government support through the pandemic I guess the biggest beneficiaries by some margin were the banks in terms of furlough scheme etc. Yet we are now all facing a cost of living crisis and yet you are looking, as a sector, that there is a danger of us looking at the sort of margins you know each 25 basis points just add a few £100 million more to everybody's revenue. And I am just wondering, I can't believe that is really it in reality. I mean if interest rates go to 4 per cent, you are not going to be making you know 20 per cent returns. So I am just wondering what you think is the sort of reasonable level because you are now making double digit returns and I guess you are making a cost of equity. At what point do you start thinking look guys that is enough, we need to start competing this away?

William Chalmers
Thanks Ed. Well maybe a couple of points to make. The first of which is that I do not focus so much on the margin as on the return on equity as a business. You know ultimately that alongside of capital generation is what allows us to deliver returns to shareholders and therefore that is what I focus on.

In terms of the drivers of the RoE, I mean you identify interest rates as one component but there are many others. If you look at the RoTE, we are driven by not just rates but also asset growth, increased levels of activity, operating leverage off the back of a relatively fixed cost base. All of these things are perfectly legitimate business operating factors that benefit providers at scale such as us, that in turn drive up RoEs. So I would dispute the connection necessarily between high interest rates and correspondingly high RoEs. I think decent RoEs are built on many other things as well and that is worth bearing in mind. But when I look at acceptable return for the business, I think that we look at it on a medium-term basis. In the past I have talked about RoE in excess of cost of capital. I would expect this business to at least return that and frankly more over the course of the cycle.

Ed Firth
Okay and I guess connected with that, there has been a lot of talk in the press about, it seems that all the banks have got no problems with credit anyway except the one problem where there is credit is all the stuff the Government did. And again it just makes me a bit uneasy sort of looking at the history of banking and the extent to which Government step in when they feel they are getting the raw end of the deal. I mean what is your feeling around that, I mean how are your collections going? What sort of discussions do you have with the Government about the losses they are taking? And do you feel they are getting a fair deal from that process I guess?

William Chalmers
Well maybe a couple of points Ed, I think one is you have to track back to what we did during the crisis and then during the crisis we lent well over £12 billion of credit to businesses both in the context of bounce back loans and CBILS. The customers who frankly needed that cash in a short space of time and we operated under Government mandated schemes in line with Government guidelines. Therefore, I think we were quite counter actually to what you are saying, a very important bridge to ensuring that the economy survived that particular crisis. Without the banks, I think they would have had frankly a tougher time and I think the banks played a very valuable role, not just through bank loans and CBILS, but also in the context of things like payment holidays to ensure that the effect of the pandemic was not immediately felt by customers, retail or commercial, and to ensure that the bridge that the Government was trying to build between the inception of the pandemic and the recovery from it, was a complete bridge. I would absolutely say that banks were an important part of that overall strategy and played their role including Lloyds. I think Lloyds were proud that we did. So I would somewhat refute the premise to your question. I think added to that, we as said very much employed the bounce back loan scheme in line with Government guidelines. We have specifically focused it on business

accounts and did not allow new to bank customers to open bounce back loans., deliberately because we wanted to keep fraud to relatively, well as low levels as possible. Indeed, based upon our experience to date, that has been the case. We have very modest fraud in terms of what we put forward. If you look closely at treasury select disclosures you will see the numbers that we put there. So again low levels of fraud, we are doing our best to recover both fraud and any other loan losses where we see them and we will treat the money as our own in terms of our recovery strategy. So we have absolutely no question about the strategy that will deploy.

And the final point Ed because your question is sort of suggesting that somehow banks are not playing a useful role in the context of difficult economic times, we consistently one of the UK's biggest tax payers at Lloyds. You might check out other corporates as to whether they can fulfil that description.

Ed Firth
Okay, thanks very much.

Question 12 – Guy Stebbings, Exane BNP
Afternoon William thanks for hosting the event and taking my question. I was just following up on asset quality, more on the operational side of things. You highlighted a lot on competent characteristics about the size of collateral etc. But because it has been a long, long time since we have actually been through a stress that resulted in any significant defaults given, you know during COVID we were, the support mechanisms helped us to avoid that. So, I just wondered how prepared you actually would be if we were to go into a severe downturn? Presumably you don't have lots of employees just on standby for arrears handling with positions in case a downturn happens. So are there any operational challenges you need to deal with any associated costs if it was a significant downturn or can you simply re-deploy staff just a capacity there, it is easy to retrain people? I was just wondering if there are any considerations around that. Thanks.

William Chalmers
It is a good question, as you say we fortunately have not been through a significant stress event for some time. Having said that, an awful lot of operational capacity has been built up in the context of other similar types of exercises. So we talked a second ago about the exercise during the pandemic in the context of bounce back loans and CBILS. That was a good example of an operational challenge that required a very significant redeployment of resources to meet that demand. And so, I know it is not a stress as such, but it is an example of where we have had other needs to call upon and put our resources to use them.

I think one of the contextual points that is important to make here is we have, while we haven't been through that stress as you described, we have been very focused on trying to increase the, well I should be careful about the words I use, but essentially the interchangeability of staff to different tasks within the Group. As a result of that, we feel that staff are increasingly equipped to move at pace around different areas of the Group whether it is in relation to handling calls or whether it is in relation to addressing default experiences or helping customers and customer assistance. That is very much the purpose of the exercise to make sure we are not rigid in our overall approach to deployment of resources around the Group; call centres can be put to many uses, that has been a deliberate strategy. It is not to say that in the context of a stress we would not experience some potential cost increases in some areas. I think we would, and you know collections is an obvious example. There will be others in terms of similar customer assistance type exercises. But on the other hand, you would naturally expect to see some compression, some lesser cost rise in some of the other areas. And so, in part at least I would hope in significant part, it would be achieved by reallocation which has been very much a strategic thematic about how we sought to manage the cost base over recent periods with COVID being an example.

It is probably also worth saying that in a sense, underneath the surface, we have been engaged in many of these activities on an ongoing basis. So for example, since 2021 we have helped around 160,000 customers move out of persistent debt. We have helped over 100,000 customers consolidate debt into a single loan in the course of the last year. Alongside of that, we have obviously had the bounce back loans and the CBILS requirement. And so, and again in commercial for example we have an extensive RM network dealing with many of the requirements of our agricultural clients. So these are not examples in a severe stress time, I would certainly concede that point. But they are examples of a) versatility and resources and b) a kind of an ongoing exercise to try and help our customers where that help is valuable to them which in turn call upon resources of the Group.

Guy Stebbings
Okay thanks that has helped.

William Chalmers

I was just going to call time because we have just reached the stroke, actually just after the stroke, of 5. So if there are other questions, we can certainly answer them but perhaps if you could call the Investor Relations team that would be helpful. In the meantime, I would just like to thank everybody again for taking the time to join and look forward to the continued dialogue.

END

FORWARD LOOKING STATEMENTS

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