LLOYDS BANKING GROUP PLC – Q1 2023 INTERIM MANAGEMENT STATEMENT – PRESENTATION TRANSCRIPT
(amended in places to improve readability only)

Wednesday 3 May 2023 – 9.30am

LBG:
William Chalmers, Chief Financial Officer

William Chalmers
Good morning everybody and thank you for joining our Q1 results call. Let me start with an overview of our key messages on slide 2.

The Group has continued to deliver in Q1. As ever, and particularly in the current environment, our purpose of helping Britain prosper is central to how we operate. Our purpose-driven business model enables the Group to offer significant support to customers and colleagues as they navigate the increased cost of living.

We have also continued to deliver against our strategic ambitions for the Group. You will hear more about this at the half year and in our deep-dive sessions in H2. Underpinning this, we delivered a solid financial performance in Q1, including strong income growth and capital generation. Our confidence in the Group's business model, strategy and continued financial performance are reflected in our maintained guidance for 2023. In an environment of change, our commitments have remained constant.

Let's turn to the financials on slide 3. Lloyds Banking Group delivered a solid financial performance in the first quarter of the year. Net income of £4.7 billion is up 15 per cent on the prior year, supported by a net interest margin of 322 basis points, growth in other income and a continued low operating lease depreciation charge. Operating costs of £2.2 billion are up 5 per cent on the first quarter of 2022. This reflects our continued strategic investment, alongside inflationary effects on the cost base. We remain committed to maintaining our market leading efficiency position and are on target to achieve our guidance of circa £9.1 billion for 2023.

Asset quality is resilient. The impairment charge of £243 million is equivalent to an asset quality ratio of 22 basis points, supported by a small release relating to the improved macroeconomic outlook versus Q4.

Consistent with recent periods, given the reporting changes we implemented a year ago, underlying and statutory profit before tax are now largely aligned. Statutory profit after tax for Q1 was £1.6 billion and the return on tangible equity was 19.1 per cent. This drove strong capital generation of 52 basis points, even after taking the full £800 million fixed pension contribution. Alongside, TNAV is up 3.1 pence per share after the IFRS 17 restatement.

I will now turn to slide 4, to look at our resilient customer franchise. Mortgage balances stand at £307.5 billion. This is down £3.7 billion in the quarter, largely driven by the £2.5 billion legacy portfolio exit that we mentioned at the full year. Excluding this, the open mortgage book was down £0.6 billion in the quarter, reflecting lower activity levels across the market.

Alongside, we continued to see modest growth in our other Retail businesses, with credit cards, loans and motor finance all showing progress. Likewise, we continued to take advantage of strategic growth opportunities within the Corporate and Institutional business, delivering growth of £0.7 billion in balances in Q1. As in previous quarters, this is offset by repayments of Government support scheme loans within SME and some lower underlying balances.

Turning to the deposit side of the balance sheet. Total deposits are down £2.2 billion in the first quarter, or roughly half a per cent. This includes a reduction of £4.3 billion in Retail and growth of £2.7 billion in Commercial Banking.

The Retail balance development includes an outflow of £3.5 billion in current accounts. This reflects unusually high seasonal outflows, mainly tax payments, higher spend given inflation and rates, and a more competitive market, including Government NS&I offers and our own savings rates. Looking forward, it is likely that the higher customer spend levels, internal churn and market competition continue, but we do not expect to see the circa £2 billion of tax payments repeating this year.

Savings balances in Q1 were essentially flat, albeit with some expected movement from variable to fixed rate. In Commercial Banking, we saw modest SMB outflows due to spend increasing and Corporate Institutional inflows. Some of these inflows were strategic, some likely short term, quarter end balances. Across deposits as a whole and acknowledging uncertainties, we expect balances in 2023 to be broadly flat on 2022. Alongside, we have continued to see good organic growth in Insurance, with circa £2 billion of net new money in the quarter.

Moving on to slide 5 and the Group's strong income performance. Net income of £4.7 billion is up 15 per cent year on year, with higher NII and other income. Net interest income of £3.5 billion is 20 per cent higher than the prior year, benefitting from a stronger net interest margin and higher average interest earning assets.

The Q1 margin of 322 basis points is up 54 basis points year on year, but stable on Q4 as we had expected. As set out at the full year, we have seen continued pressure on asset margins, broadly offset by tailwinds from base rates and benefits from reinvestment of the structural hedge.

Mortgage completion margins were around 50 basis points in the quarter. This average included slightly higher new business margins and slightly lower product transfer margins.

As you can see, the nominal balance of the structural hedge remains at £255 billion. The weighted average life also remains around 3.5 years. Given an average yield of around 1.2 per cent and currently prevailing swap rates, reinvestment of hedge maturities are expected to continue providing a healthy tailwind in the coming quarters.

Looking forward and as outlined in February, we continue to expect the net interest margin to reduce in Q2, before stabilising in the second half of the year. Overall, a base rate rise beyond our initial expectations has been offset by tighter product margins. We therefore continue to expect a full year margin in excess of 305 basis points. Alongside, we continue to expect broadly stable AIEAs in 2023.

Turning briefly to other income. OOI of £1.3 billion in the quarter is up 6 per cent year on year and up 11 per cent on Q4. We have continued to see activity build and benefits from investment, providing underlying growth. In addition, Q1 also benefitted from benign weather in insurance compared to Q4 and a profit on sale of the legacy mortgage book. We continue to expect other income to build gradually, supported by customer activity, our ongoing strategic investments and releasing the store of insurance earnings within our CSM liability.

A brief word on operating lease depreciation. The charge of £140 million in the quarter is higher than previous periods. The Lex car fleet grew and we recognised lower gains on sales in Q1 as new vehicle supply constraints eased. Augmented by Tusker, we expect this trend to continue through 2023 and therefore to see the operating lease depreciation charge grow through the year.

Now looking at costs on slide 6. Operating costs of £2.2 billion are up 5 per cent year on year. As you know, the increase is driven by our planned strategic investments, the costs associated with our new businesses and inflationary effects on the cost base. The cost:income ratio of 47.1 per cent, or 46.6 per cent excluding Remediation, continues to be competitive.

Looking forward, we will maintain our rigorous cost discipline and remain on track to deliver operating costs of circa £9.1 billion in 2023. Remediation was very low in Q1, at £19 million. There is no charge in respect of HBoS Reading, although, as ever, uncertainties on this remain. We continue to have a base case for Remediation charges of around £200 million to £300 million per year.

Let me now move on to asset quality on slide 7. Asset quality continues to show resilience across the Group. Our Retail businesses are performing well, with arrears at or below pre-pandemic levels. Meanwhile, Commercial performance is strong, with the Q1 charges largely relating to cases that were already in Stage 3.

The net impairment charge for Q1 was £243 million, equivalent to an asset quality ratio of 22 basis points. This includes a £322 million charge before the updated economic scenarios, roughly consistent with Q4 and equivalent to an AQR of 28 basis points.

As you can see, there is a small release in respect of the updated macroeconomic scenarios. Stemming from reduced energy prices and a looser fiscal constraint, the base case represents a modestly improved outlook. As usual, the detail of our scenarios is in the appendix.

The stock of ECL on the balance sheet is marginally lower in the quarter at £5.2 billion, with coverage levels remaining very strong. And given everything we can see, we continue to expect the net asset quality ratio to be around 30 basis points for 2023.

Turning to slide 8 and looking across our portfolios. Retail performance is resilient. We are seeing a modest increase in new to arrears in some portfolios, but from a very low base. Movements are within, or in some cases better than, our expectations.The mortgage book is very high quality. The average loan to value is 42 per cent and 93 per cent of the book is below 80 per cent. We have seen a small uptick in arrears in the variable rate legacy books from 2006 to 2008, but the rest of the portfolio shows no noticeable movement. The unsecured book meanwhile, is performing better than we had expected.

In the Commercial business, we continue to see stable SME overdraft and RCF utilisation trends. Watchlist and Business Support Unit levels are stable to modestly down on year end. Our Commercial portfolio is very high quality. Around 90 per cent of SME lending is secured whilst more than 75 per cent of Commercial exposure is to investment grade clients.

Within the Commercial business, our net real estate exposure after significant risk transfers, is £11 billion and has been significantly de-risked in recent years. Lending is focused on cash flows, with 84 per cent having interest cover of 2 times or more. The average LTV of the portfolio is 44 per cent, while 95 per cent have an LTV below 70.

The portfolio is also well diversified and subject to sector caps and limits. Our exposure to offices is around 14 per cent of the portfolio, 10 per cent to retail and 11 per cent to industrial assets. Across our businesses, we feel very comfortable on asset quality.

Let me now move on to slide 9 and the Group's liquidity position. Given recent events, it would be remiss not to spend a moment on deposits and liquidity. The Group continues to have a very well diversified high deposit base and a very strong liquidity position. The net stable funding ratio at 129 per cent and loan to deposit ratio at 96 per cent demonstrate the strength of the Group's funding.

We benefit from a predominantly Retail-focused deposit base, with around three quarters of deposits coming from Retail and a well diversified portfolio of SMEs. Over 90 per cent of the deposit increase of circa £60 billion since the end of 2019 has been in the Retail franchise.

A very significant proportion of our customer deposits are insured, with over 80 per cent of Retail customer balances and 57 per cent of total deposits protected by insurance schemes such as the FSCS.

The liquidity coverage ratio of 143 per cent is stable and is well above both regulatory requirements and our internal risk appetite. The Group's liquidity remained robust throughout the recent volatility, with all liquidity measures well above internal thresholds at all times.

Our liquidity pool of around £140 billion is held in high quality liquid assets, with the majority held in cash and Government bonds. The entire portfolio is hedged for interest rate risk with only credit risk driving limited movements in fair value through other comprehensive income. And this was negligible in both 2022 and in Q1. Together with central bank facilities, this provides over £210 billion of available liquidity, a very strong position.

Now, moving on, let's look at TNAV and capital on slide 10. Tangible net assets per share are 49.6 pence, up 3.1 pence in the quarter, after the IFRS 17 restatement. This is largely driven by attributable profit, but also benefits from the cash flow hedge reserve movement and pension surplus build.

Risk-weighted assets at £211 billion are flat in Q1 as we continued to benefit from portfolio optimisation. We saw no impact from credit migration.

We expect to receive an update on CRD IV models later this year and for this to result in an increase in risk-weighted assets. Having said that, this will still be consistent with our 2024 RWA guidance of £220 billion to £225 billion.

Capital build remains strong at 52 basis points. Within this, we have now taken the full £800 million fixed pension contribution for the year. The CET1 capital ratio is stable in the quarter at 14.1 per cent. This is after the impact of regulatory change, the acquisition of Tusker and accruing for the dividend. We remain comfortably ahead of the Board's ongoing target of circa 12.5 per cent plus a management buffer of circa 1 per cent. Looking forward and including the strong performance in Q1, we continue to expect 2023 capital generation to be circa 175 basis points.

Turning to slide 11 to wrap up. In summary, the Group has delivered a solid financial performance in the first quarter, supporting strong income growth and capital generation. We are committed to supporting our customers. Our franchise and portfolios are demonstrating resilience.

Looking forward, we are maintaining our guidance for 2023: We continue to expect:

- The net interest margin for 2023 to be greater than 305 basis points
- Operating costs to be circa £9.1 billion
- The asset quality ratio to be about 30 basis points
- Return on tangible equity to be circa 13 per cent
- And capital generation to be about 175 basis points

You can see that in an environment of change, the Group's commitments have remained constant. We remain well positioned for the future.

That concludes my remarks for this morning, so thank you very much for listening. I will now hand back to the operator for Q&A.

Question and Answer Session

Question 1 – Raul Sinha, JP Morgan
Thanks very much, good morning William. Maybe two questions from my side to start with. Given the margin seems to be behaving exactly as you predicted last quarter. I was wondering if I could ask you about the extent of the margin decline in the second quarter. And in particular I guess, if we were to assume a base rate hike for the May MPC, shall we still expect it to be down or would you then expect it to be flattish?

And then my second question is around the other income line which I would see as a very good outcome this quarter. I am just trying to get a sense of the new underlying run rate, if there is one, and how big the mortgage loan book sale gains were? And it looks to me like the annualised run rate might be closer to £4.9 billion to £5 billion almost. Would you agree with that? Thanks very much.

William Chalmers
Thanks Raul for those questions. In terms of the margin developments in Q2, you saw in Q1 that our margin was 322 basis points which as you say was pretty much as we'd expected when we gave our full year results announcement. And the combination of factors at play there include the benefit of base rate changes somewhat offset by the mortgage headwind. Those are the two main factors together with some run through of the hedge maturities in Q4. When we look forward into Q2 we do continue to expect a step down in the margin just as we highlighted at the full year results. That is going to be driven by a variety of factors, but the principal factor in terms of the headwinds to the margin in Q2 are around the bank base rate changes, combined with the churn and pricing impact on the deposit side. So it is really around the evolution of the deposit base and the pass through of some of the pricing changes that we have seen in deposits into Q2. And that has the preponderant effect in terms of the evolution of the margin going into the quarter. We do not have any structural hedge maturities in Q2 so that is an absence, if you like, of our tailwind that we would expect to see playing through later on in the year. And then further as we go into the year, the mortgage headwind starts to evolve. So in Q3 and Q4 you see more or less an offsetting impact, with the structural hedge maturity on the one hand against a kind of maturation of the mortgage refinancing headwind on the other. But for Q2 it is largely around that churn and deposit pricing impact.

You asked about the effect of the bank base rate in Q2 and if we do see a further bank base rate change what affect that might have. It is, as you know, normally the case that bank base rate changes will help our margin and that is off the back of leads and lags and to an extent any deposit widening or liability widening you might see. Having said that, we are seeing a competitive deposit market and so the question will be, in Q2 Raul, if we do see a bank base rate change, how much of that feeds through into deposit pricing in the market as a whole, and how much do we see it as appropriate to ensure that our deposit base is as resilient and robust and competitive as we have seen it in Q1. So those are the dynamics. I think overall even if we do see a base rate change and even if that does benefit the margin slightly in Q2, I would still expect to see a step down in the Q2 margin. That is not going to change.

Your second question, Raul, on OOI. OOI as you say was a pleasing performance in Q1, £1.257 billion. That was up as said 11 per cent or about £130 million off the back of Q4, £1.128 million or thereabouts. What's going on there? There's a couple of different factors going on. In each of our business areas we have seen some positive developments. So in Retail, for example, we have seen some positive underlying developments in Lex business growing, likewise in terms of cards related activity. Within Commercial we have had a strong first quarter as we normally do, but it has been particularly marked this quarter which is good to see. And then in Insurance, Pensions and Investments we have seen two benefits really. One is the absence of weather that we saw in Q4, so the absence of a negative there. But then more importantly we have also seen the contractual service margin off the back of the IFRS17 changes in 2022, start to roll off the liability into Q1 of this year. When we look forward, there are as you say a couple of one off benefits. We talked about the legacy mortgage book, I just talked about weather, or the absence of weather, in insurance. Those two will clearly ebb away but their place will start to be taken by activity led growth by some of our strategic investments, both organic and inorganic, and they will play into OOI looking forward. So I think off the back of this £1.25 billion that we produced at Q1, you should expect to see that consolidate over the course of the remainder of this year. As you know, we don't predict OOI so I won't go into that precisely now, but I think that £1.25 billion is likely to be a roughly consistent type of run rate that we would expect to see for the remainder of the year.

Raul Sinha
That is very helpful William. Thank you.

William Chalmers
Thanks Raul.

Question 2 – Benjamin Toms, RBC
Morning William, thank you for taking my questions. The first one is on costs. If I take the Q1 and multiply by four and then add in something like £150 million for the bank levy I think I am a bit below your guidance for the full year. So is it fair to say that costs will step up slightly in the coming quarters?

And then secondly a question just in response to news flow around pre-funding and the deposit guarantee scheme in the UK. Have you had any discussions with the regulator in respect of this and do you have any thoughts you can share with us on it? Thank you.

William Chalmers
Thanks Ben. In relation to costs, I think the important point in costs is that we are sticking with our guidance of circa £9.1 billion for the full year. That is going to be the bottom line for the full year. We will deliver on that guidance just as we always do. In respect of Q1, as you say, we got £2.17 billion for operating costs in Q1. There are some factors that play themselves out in the later part of the year: (i) bank levy, you mentioned; (ii) there is a bit of a pattern to the overall investment spend and associated charges with that; and (iii) there is a bit of a pattern to inflationary pressures over the course of the year including things like pay settlements and so forth. And so that combination, Ben, is going to produce a pattern of costs which will vary a little bit quarter by quarter, but again I would focus on the bottom line of the circa £9.1 billion guidance that we will deliver.

In terms of the protection schemes that may or may not come to pass as a result of the recent volatility we have seen in the banking sector, we have not had any discussions so far with the regulator about what may happen there. Whether there is a focus on deposit insurance or whether it is focus on liquidity. And indeed the extent that it is the former, how would it be funded. It is, in its current form at least, going to be a funding mechanism which should have a relatively modest impact on our overall earnings going forward simply because of the way in which the funding mechanism feeds through into our P&L. So absent a very significant change in the quantum of insurance or alternatively the way in which it is funded, we see this, if it does change, having a relatively modest impact on the P&L, if that gives you some indication of the bottom line expectation.

Benjamin Toms
Thank you.

Question 3 – Martin Leitgeb, Goldman Sachs
Good morning, thank you for taking my question. I just have two questions please relating to NI and the margin outlook. On the first one I was just wondering if you could comment on the evolution of product margins. You have called out product margins earlier, which have obviously had an impact in Q1 with completion margins at 50 basis points in mortgages. Could you just highlight what you have seen recently and whether application margins have started to edge higher?

And secondly, I was just wondering in terms of deposit composition going forward, how should we think about the shift from current accounts, particularly in Retail, to other pockets of deposits going forward? There is I believe a 3 per cent decline, quarterly decline, in current accounts in Retail; would you expect this base to continue or dramatically change from here? Thank you.

William Chalmers
Thank you Martin for those questions. Taking the first question on product margins and what have we seen. As said, we have seen product margins tighten slightly over the course of the quarter; it has been relatively competitive markets both in deposits and in mortgages. Taking each of those, there are two effects really within the deposit market, one is the pricing offers that you make to customers, obviously some of that attracts new money and some of that also generates internal movements. And as you

have that internal movement, that increases your deposit cost by virtue of deposits moving from interest free, in the context of PCAs, into interest bearing in the context of let's say fixed term deposits for example. So some tightening up. We have some good offers out there in the market just as others do and that overall is leading to deposit costs which are increasing on a quarterly basis.

Within mortgages we highlighted a completion margin of 50 basis points. As said in my comments earlier, that 50 basis points is composed of two elements. One is the product transfer, or retention, part of the market which is actually marginally below 50 basis points. Why are we comfortable with that? It is because we know the customers, it's because of building the relationship and so we see an attractive return profile for that type of mortgage even if the headline pricing spread is slightly lower. The other component is new business margins. New business margins are in fact higher than the 50 basis points that we give. We haven't put a number on it but we have seen new business margins anywhere between 60 basis points to 80 basis points through the duration of the quarter depending on which particular point in time that you look at. So those are higher. The challenge is that the volumes of new business in the current market is relatively modest. And so that overall produces a blended margin of the 50 basis points that we have given you. That is the completion margin for Q1.

As we look forward, our expectation is that the mortgage market will continue to be relatively muted and therefore retention will continue to be a significant component of our overall completion margin within the mortgage business. That in turn, I don't want to be too predictive at this point, but that in turn leaves us to think the completion margins in Q2 will probably not be terribly different to what we have seen in Q1. We will see how that evolves but that is our base case right now. It's worth saying that in other products as well, unsecured for example, we have seen slightly higher funding costs there while pricing has stayed more or less stable. So there is a little bit of margin compression going on there. But all of these developments – deposits, mortgages, unsecured and indeed the commercial book – are all contained in our greater than 305 basis points margin guidance. And as per the comments that I made to Raul's question earlier on, if we see base rate changes and not all of those base rate changes get competed away, then indeed one might expect to see a little bit of upside in our margin develop over the course of Q2 and indeed into the remainder of this year. I think we just have to see how that plays through, but again, if we do see more base rate changes perhaps that is where it ends up but it depends upon how the liability markets move.

In terms of movement in the overall book we have seen some movement from PCAs into fixed rate and also a product that we call limited withdrawal, which gives customers slightly better rates in turn for sacrificing instant access as the name implies for a slightly more limited basis. We have seen money flow out of PCAs, about 25 per cent of that £3.5 billion outflow in PCAs has actually been recaptured in our fixed rate limited withdrawal products. We have also seen within the savings book a little bit of movement from variable rate into fixed rate and likewise with limited withdrawal. And then we have also seen new money from outside of the bank come into that fixed rate limited withdrawal product. So, that overall is leading to changes in the composition of the book. You look at it on a quarterly basis and the overall changes are pretty modest on a quarter by quarter basis, but of course that is what we saw in Q1 and I would expect a little bit more of that to continue going into Q2. And again that is all contained in our overall margin guidance of greater than 305 basis points for the year.

Martin Leitgeb
Thank you very much.

William Chalmers
Thanks Martin.

Question 4 – Jonathan Pierce, Numis
Morning everybody. I have got a couple of questions please. The first is on net interest income. The margin was slightly better than people thought and the interest earning assets likewise. But the headline in NII was a touch lower and it is this non-banking interest expense that has moved up quite sharply in the quarter. I'd just like to understand: what that is, whether it is equivalent to what some other banks call trading book funding costs, and is there an offset that is going through non-interest income. And if so should we be looking at that sort of run rate of £75 million or so a quarter now, so long as base rate stays up where we are?

The second question is on the scale of the risk-weighted assets increase you might be looking at later this year on the CRD IV clarification. Could you give us a sense as to how large that is and which particular area it is coming from? And sorry an additional in relation to that. I think when CRD IV changes came through earlier last year there was not only some increase in RWAs but there was an increase in some capital deductions as well. So can you just tell us whether this may affect both the numerator and the denominator, or is it just a risk-weighted asset issue? Thanks very much.

William Chalmers
Thanks Jonathan. First of all on the net interest income and impact on the net interest margin of non-banking interest income. When you look at the progression of net interest income quarter four into quarter one, and as you point out Jonathan, you look at the margin, it is basically the same, you look at the AIEAs and they are basically the same. To your point, what is going on there?

Two things, one is there is a day count issue, there are fewer days in quarter one than there are in quarter four. That is about half of the impact. And then the second one as you point out is the non-banking interest income, which actually if you look at our disclosures at the back of the interim statement is an expense and, it is an expense of about £76 million in quarter one. That is up a little from quarter four and on a year on year basis it up about £55 million or thereabouts, £56 million I think to be precise. As you look forward, that is a run rate number and, to explain what is behind it, is that it is basically funding the non-banking businesses, the non interest income driven businesses. You described it as trading expenses in other institutions and there is a bit of that with us for sure. There are also things like Lex, for example. These are businesses which are not driven by virtue of interest bearing balances and that in turn drives the non-banking interest income expense which is essentially a funding expense for those businesses. Now to a degree, as those businesses grow, you would expect to see some benefits from that coming through other operating income. The Lex business increasing in size for example, benefits other operating income. Likewise with some of the trading activities. But actually the main factor driving it alongside of that is the increased funding cost, the increased interest rate environment that we are in. And that is what you see playing through into Q1, and as said, you should expect a run rate not dissimilar really to what you saw in Q1 for the remainder of this year. When we calculate our interest margin of 3.22 per cent we exclude that component. And that is how you can reconcile that plus the fewer days point to the run rate net interest income from Q4 going into Q1.

You asked about CRD IV, Jonathan. As said in my script, we do expect to receive further news on from the PRA over the course of this year and it is likely we think that that will lead to a modest increase in RWAs. Just to track back and give some history on that. When we set out our CRD IV expectations on January 1 2022 which you referred to in your question, we saw at that point about a £16 billion increase in RWAs, £14.5 billion of that was in relation to mortgages. We said at the time that the CRD IV component for mortgages was a best estimate, if you like. It was a place-marker based upon the fact that the discussions of the PRA and the models were not totally finished business. As we roll forward since that time we have learnt more on the PRA technical requirements in this area. We have learnt more about their approach to historical data and to a degree their approach to cyclical sensitivity. And so off the back of that we expect a modest increase in RWAs to be informed to us, if you like, by the PRA later on in the year. I think the most important point there Jonathan is that, I won't put a number on it precisely, but that increase is within our circa 175 basis points capital guidance and also within our 2024 RWA guidance of £220 billion to £225 billion. Tracking back at the year end, I said that was, broadly speaking, a linear trajectory, 2023 going through into 2024. So that is how that CRD IV expectation from the PRA is factored into our numbers.

Specifically on your point about is this a numerator and denominator issue. No, is the answer. This is likely just to be RWAs, which is a denominator issue for purposes of our capital calculations.

Jonathan Pierce
Okay, brilliant. Thanks a lot for that.

William Chalmers
Thanks Jonathan.

Question 5 – Chris Cant, Autonomous
Good morning, thanks for taking my questions. I think we've covered quite a lot of ground already but just a couple of follow-ups around NII and your thinking there going forwards. In terms of the mortgage piece, could you give us an update on where the back book mortgage spreads are on the non-SVR component of the book, just so we can understand the degree of headwind that kind of 50 basis points level is likely to present.

Then thinking about the structural hedge, obviously you have seen some current account outflows and you have said given the deposit market competition you expect some of those trends outside of the tax impacts to persist. So how are you thinking now about your structural hedge size prospectively? You previously said you were very, very comfortable maintaining it given buffers, et cetera. But if you are now expecting to see some persistent current account outflows, even if they are relatively modest, how does that then feed into your thinking on the size of the structural hedge? Thank you.

William Chalmers
Thank you, Chris. Just taking each of those. On the mortgage book first of all, I won't give you quite the split that you want, but I will give you a few numbers that hopefully will help you reconcile some analysis. When we look at mortgages, the yield on the mortgage book this year we expect to be about 135 basis points. To give you some idea as to the effect of refinancing this year, we have probably got about £65 billion to £66 billion rolling off from the fixed rate book during the course of this year. That stock of refinancing fixed rate mortgages is around 1.8 per cent and, as you know from our comments around completions, that is rolling back on, or that part which we retain, is rolling back on an average completion margin of around 50 basis points. So quite a significant headwind this year. I know it is not the split SVR versus fixed you are asking for but it hopefully gives you some idea that will allow you to get to that answer. Having said that, the headwind from that refinancing next year starts to dampen down because the maturities, or the price of maturities at which they are rolling off, starts to get significantly less. It is well below the 180 basis points that we are going to see this year. I won't put a number on it, but it's well below the 180 basis points and therefore is much less of a squeeze in terms of the headwind that it causes. That means, as we said before, the bulk of the mortgage headwind is addressed and dealt with by the time we get to the back end of 2024.

You asked about structural hedge size. The structural hedge size is currently £255 billion. That is the size we feel very comfortable with today. We have a buffer which is about £19 billion. In the past we have always operated with a buffer which is around 5 per cent of the structural hedge. £19 billion is more like around 7.5 per cent of the £255 billion that we have got on the structural hedge today. So the buffer of £19 billion is probably in excess of the types of levels that we would seek to carry going forward.

Now, having said that, as you say deposit churn we believe will continue, we think we will continue to see a little bit of outflow within the PCA. Why is that? Well it is because spend is clearly greater in an inflationary environment than it was before, people are paying higher interest bills than they did before. We will not clearly see a repeat of the tax issue within January that we and other banks saw. Having said all of that, that means we may see a little bit more PCA flow. Likewise PCAs will also be attracted into savings books including, as I mentioned earlier on, our own. Within the savings book we would expect to see: (i) a little bit more out of variable rate and into fixed term deposits; and (ii) limited withdrawal because, as said, people are prepared to give up access for a bit more income in a higher rate environment. So I think we expect to see that continue to a degree going into Q2. That clearly has an impact on the structural hedge in terms of the balances that are available to be put within there. But at the same time we have two or three tools to manage that. We have the size of the buffer as said, £19 billion probably in excess of what we choose to run with. We also have upcoming maturities. Can you play if you like a slightly lower buffer off the back of a significant volume of upcoming maturities? Yes, the tools will interact with each other. Thirdly you have the weighted average life; you can slightly shorten elements of the structural hedge and bring the weighted average life in. Again it is a further tool for managing the hedge. And then finally we have very conservative pass on assumptions within the structural hedge. So those in turn give us a further degree of security as we look at the overall structural hedge.

So I think in sum, Chris, where we are with that is the size is currently £255 billion and we feel comfortable with where it is today. We are also conscious of the fact that we are in an evolving environment. We have not been in a rate cycle for let's say 15 years and it is not entirely clear how that plays out and the pace with which it plays out. And so we are where we are today, we feel comfortable with it but we monitor the position and we will keep an eye on it going forward.

Chris Cant
Thank you.

William Chalmers
Thanks Chris.

Question 6 – Aman Rakkar, Barclays Capital
Morning William. I just wanted to touch upon deposits again if I could. I am sure we can kind of piece it together with the various bits of disclosure that you give us, but could you just confirm what proportion your deposit base are non interest bearing current accounts currently? And also what proportion of your deposit base are termed deposits as things stand?

And then secondly could you maybe just give us some indication of what deposit mix you have assumed in your NIM guide? Alternatively, could you help us kind of understand some kind of sensitivity that might pose a risk to your outlook for NIM or NII, so if it is actually more migration of current accounts to term deposits, what's that threshold in your mind that we should be thinking about? Thank you very much.

William Chalmers
Yes, thanks Aman. A couple of questions there. One is the split between interest bearing, non interest bearing within the deposit book. And then the second around sensitivity to the margin from deposit movements. We do not formally disclose the split between

interest bearing and non interest bearing within the deposit book but I am going to give you a couple of numbers that will enable you to make some assumptions and get there. First of all you can see the PCA volume in our retail book, that is disclosed from our balance sheet every IMS so I will leave you to look at that. Second of all, the commercial book is roughly speaking 28 per cent, or thereabouts, non interest bearing. So that has given you a very precise number but, 25 per cent to 30 per cent, it will go up and down quarter by quarter. But if you combine that with the PCAs, you have got a pretty good idea I think as to the non interest bearing components of our overall deposit book.

The second question is around how we see the flows within our deposit book and to what extent might those cause sensitivity to the interest margin. In short, in quarter one, we saw within our deposit book a combination of: (i) variable rate to fixed rate; (ii) PCA into fixed rate term and limited withdrawal; and (iii) indeed our Wealth deposits into limited withdrawal or fixed rate. That number in total was about £8 billion or £9 billion, thereabouts. That type of movement is probably not totally unrealistic to project forward into Q2, but then as we see bank base rate increases starting to steady off i.e. fewer base rate hikes thereafter, we think you are going to see less movement thereafter because there is less reason to move if you like, you have got less change in rates. You will still see some playing out of a higher interest rate picture to be clear, but less movement. So those are the types of flows that we see in Q1, those are the types of flows that we might expect to see in Q2. But as you can imagine, we built a degree of cushion within our overall interest rate expectations to ensure that we are able to give you guidance that we can achieve. And I would add to that, if we see the bank base rate environment play out in a way that was being discussed earlier on in the call, to the extent that is not fully passed on or competed away in the deposit market, that probably causes a degree of upside to our overall margin expectations. Again we still expect that step down into Q2 and levelling off in the remainder of the year, but at all points greater than 300 basis points and again there maybe that benefit, that depends on how the bank base rate and deposit margin play out.

Aman Rakkar
Thanks very much William, that is really helpful. Can I just clarify the amount of term deposits that you have is part of your overall mix? I think you refer to it in some place in the disclosure but I am never quite sure if you are exactly referring to fixed rate term deposits. Could you confirm that number for us please?

William Chalmers
I don't think we do disclose that amount. I mean you can see on our slides, page 9 I think it is, the Retail savings and Wealth components. You can see in my comment earlier on the amount of flows that we saw in the context of Q1. And the splits that we have given on the balance sheet analysis in the IMS is probably about as far as we go, I think, in terms of disclosures. So sorry, we are not going to get back to you precisely on that.

Aman Rakkar
Okay, thank you very much, I really appreciate it.

William Chalmers
Thanks Aman.

Question 7 – Andrew Coombs, Citi
Morning, one numbers question and one more strategic question I guess. The numbers question is just on the AT1. You did a large issuance in March, I think you said you are going to call another at the end of June. Any thoughts on the AT1 balance unfold and the coupon cost over the remaining quarters of the year?

And then the strategic question. Wealth is obviously an area you are focused on, an area you talked about growing as part of your non NII growth initiative. I was just interested because in Wealth you've seen a 10 per cent decline in deposits since year end, that was partly due to tax issues mentioned; but it was also a 15 per cent year on year decline. And so what is causing the decline in the Wealth deposits at the time when you are trying to grow that business?

William Chalmers
Thanks Andrew, thanks for that. We did do an AT1 issue earlier on in the year. As you say that was deliberately done in order to take advantage of market opportunities in the context of the year and to a degree at least, pre-fund any upcoming activity that we might have in AT1s. As you will be aware, we have got a call out there for a small AT1 instrument right now. We are currently operating in excess of our regular AT1 guidelines and have got more AT1s than we necessarily have on a run-rate basis on the balance sheet. That's fine, we feel comfortable with that position. We have AT1 developments over the course of next year and it is worth mentioning actually that we have got our issuance away before the disturbance within Switzerland, which in turn allowed us to deal with any AT1 requirements that we might have for the remainder of this year. So we are done effectively for AT1s.

There is an AT1 instrument up for call next year, we will obviously have a look at economic circumstances and other factors as we approach that, but we are done for this year.

You asked about Wealth and what is going on within the deposit base there. In short, very similar things to what is going on elsewhere in the deposit base. So, if I look at that and what has been factored into the deposit base over the course of this year. So far, as said, we have seen spend trends off the back of the inflationary environment, we have seen higher tax outtakes in January and we have seen some migration within instant access into savings books. This has been across the book, including Wealth. And so in particular if you look at that Wealth number, a fair bit of that outflow was actually captured in our savings products. I mentioned earlier on the overall £9 billion that we had seen move around the deposit book. At least £1 billion of that, perhaps a touch more was coming out of Wealth and into those savings products. So we would see that as a significant build on that Wealth relationship. You know, we are offering the Wealth customer who has an instant access transaction based account additional products, tailored to their needs. As we look forward into 2023, that mass affluent Wealth offering, is going to build on asset products and liability products and indeed on the interaction with investment products. So the ambitions there, Andrew, are very much in the process of being achieved. There is nothing that we are stepping away from, it is very much business as usual.

Andrew Coombs
Thank you and on the aggregate coupon costs on the AT1?

William Chalmers
I don't think we have disclosed the aggregate coupon costs. In short Andrew, we were pleased with the aggregate coupon costs relative to either historical issuance, or alternatively market benchmarks. I think we felt like we got a good issue away.

Andrew Coombs
Okay, thank you.

Question 8 – Guy Stebbings, Exane BNP
Hi morning William. Thanks for taking the questions. I had one on interest-earning assets and one on capital or buybacks. So on interest-earnings assets, £454 billion in the quarter and ended the quarter I think at £455 billion, I appreciate you have flat year over year guidance, but I was just thinking about that exit rate and should we therefore be assuming some small reduction to get to the guidance? If so, is that just the closed mortgage book and slightly softer volume trends more broadly, or am I being too specific thinking about the guidance and really is it just a flattish outlook from here?

And then on capital, historically you talked about excess capital distributions as being a decision for the full year, but you are sat at 14.1% and you sound as confident as ever on the delivery of the capital generation targets, even with the CRD IV changes to RWAs. And some of the concerns around asset quality have maybe receded. So I recognise you are still progressing a large buyback but you are in a good position. So might a further buyback be announced before full year results? And also with the Bank of England stress test results in hand which aren't too far away now, or should we just expect to wait until later in the year? Thanks.

William Chalmers
Thanks Guy. On AIEAs, the simple answer is just a flat outlook for the year as a whole. So that is a simple answer. And within that there are two or three dynamics that are going on. One is as you will have seen from the Q1 results, a continued run off of the closed mortgage book. We expect that to continue a little bit, although I suspect what will happen is it will flatten off as the year goes on, just because you will get to a stub of customers who are happy with what they have got. Number one.

Number two, Government lending, we have indicated that bounce back loans were repaid over the course of quarter one. I think that will continue over the course of quarter two and beyond.

And then number three, as you'll be aware, we have had a sale of a legacy mortgage book which is actually in AIEAs but not in lending. So you have got a slight discrepancy going on there.

Those are the factors that play into AIEAs and then alongside that clearly, there are the regular asset growth patterns. Now what we have seen so far this year is relatively muted asset growth in many of our major markets. Broadly speaking, we have seen a little bit of outflow in the open mortgage book. If you exclude the legacy sale, that is about negative £0.6 billion so it is negligible in terms of the outlook for that business, i.e. we would expect it to grow a little, but not very much. We have actually seen some growth in our unsecured books and motor within the Retail business, which is pleasing to see. I think that will flatten off during the remainder of this year. And then maybe C&I continues to grow a little bit and SME impacted by the points that I have just made. So, overall I think a flat AIEA picture over the year with those component parts moving in the way I have just described them.

On capital, your second question. As said, we had a very strong performance on capital in Q1, 52 basis points. We stand on a 14.1 per cent CET1 level, which feels pretty robust, particularly in the context of us having front loaded the pension payments of £800 million. There are one or two factors at play for the remainder of the year. We talked a little bit about the CRD IV increase from mortgages expected later on this year. That asset growth that I indicated will be modest, but on the other hand it will grow RWAs a little bit with it. And so overall the capital growth for the remainder of this year is probably not going to be as strong as 52 basis points and I just point you to the circa 175 basis points annual guidance for capital growth for the year as a whole.

Coming to your final question Guy, what does that mean in terms of our statements around buybacks, capital distributions, for the remainder of this year? As you know, we put in place a healthy, progressive and sustainable dividend off the back of 2022, that hopefully will get confirmed by the AGM and therefore allow us to pay that out. I am sure that we will look at the interim dividend at the half year and recommit to our progressive and sustainable dividend in that context. Our buyback is underway right now. The number that we produced at Q1 has been supplemented by ongoing progress in the buyback and I think it is publicly available, but we have probably bought back about £700 million to £750 million worth of stock right now, which will help us in terms of building TNAV per share and indeed EPS looking forward. So there is a lot of capital activity and distribution going on right now, dividends and buyback included. I don't think, Guy, that with all of that going on we are going to move from our standard practice of looking at capital in the form of buyback and final year dividend at the year end. My guidance to you would be to say that would be a year end board decision this year, just as it always has been.

Guy Stebbings
Okay, thank you.

William Chalmers
Thanks Guy.

Question 9 – Rohith Chandra-Rajan, Bank of America
Hi good morning William, thank you. I have got a couple please on margin. Apologies, you probably thought you were done with that but hopefully they are relatively quick. The first one is on the mortgage completion spread, 50 basis points in Q1. It sounds, from your earlier comments, like you thought that was probably around the number that we'll see in Q2 as well. So first I wanted to check that? And then I guess as we progress through the year in terms of looking at where spreads are in new offers in the market today that will probably not complete until Q3, they are starting to look a little bit better. So I was wondering, in terms of either pricing or mix, how you think that will progress particularly through the second half of the year in terms of the new mortgage spreads?

And then the second one, just on deposits, you talked a lot about mix which is helpful, thank you. Can I ask what the pass through is on the latest rate hike that will impact the NII in Q2, so the most recent 25 basis point hike? Thank you.

William Chalmers
Thanks Rohith. In terms of mortgages, overall, as said, we saw 50 basis points completion in Q1. It is a little early to comment on Q2 but our expectation is that it will not be significantly different, let's say, in the context of Q2. And as we saw in Q1 I would expect that to be composed of two inputs. That is to say product transfer below 50 basis points and new business above 50 basis points. We have seen new business materially above 50 basis points at times during course of quarter one, Rohith. So your point around new business margins I think is a fair one. But a couple of points to add to that.

One is that we have also seen quite significant swap volatility and that hasn't really gone away and so at any moment in time, our new business margins are impacted by where swaps stand. With them going up and down so much on a daily or weekly basis, that is driving quite a lot of volatility, and new business spreads with it. It is not clear to me whether that will go away or not, but I think you will only really get a sense as to equilibrium new business spreads in an environment where you have more swap stability than we have seen for the last quarter. I would be hopeful that over time, that equilibrium new business pricing steers itself back towards a traditional 75 basis points to 100 basis points guidance that we have given you before. But I think, as a composite based upon retention plus new business, even if it does, I would expect our completion margins to be south of that 75 basis points to 100 basis points for the remainder of this year. And indeed, that is what is in our planning assumptions, that is what is in our greater than 305 basis point interest margin guidance, i.e. the number being less on a composite basis than the 75 basis points to 100 basis points corridor.

In terms of your second question Rohith on mix and pass through. The pass through that we saw off the back of the February and March interest rate rises was around the 40 per cent mark. So that gives you some idea, and what you are seeing there is effectively the pass through moving up over time and we are not done yet. I think as we go through the remainder of this year and into next, we will see that pass through continue to gravitate towards slightly higher levels. So 40 per cent is the most recent experience off the back of the combined February and March rate rises.

You also see, to be clear, some further effective pass through, although it is not often described as such because of the overall churn within the book. That is to say every time the deposit migrates from PCA into fixed term deposit, that in a sense is another form of pass through, whereby the customer gets the benefit of the rate increase. But 40 per cent is your headline number for the February and the March interest rate rises. I would expect our pass through, or at least our interest rates for depositors, to continue to mature in the second half of 2023 and into 2024. And again all of that is contained within the margin guidance that we have given you.

Rohith Chandra-Rajan
Thank you. Could I just come back very quickly on the mortgage spreads. Are you seeing any initial signs of change in mix between internal transfers and new to banks as there seems to be some green shoots at least in terms of the mortgage and housing market?

William Chalmers
There are some green shoots. It is looking a little bit stronger than we had previously thought. I think as a general comment actually Rohith, and this applies not just to mortgages but more broadly across the business, the economics are looking a little bit more favourable than we described them at the end of Q1, and there are all the factors you are aware of going into that. But that is leading perhaps to a slightly more robust activity picture than we have previously thought. That in turn may play through over the course of the year. We have to say it’s too early to call that, but that is the direction of things I suppose since we struck numbers. In terms of competition in the mortgage market, a slightly better picture, perhaps fed by some of the points I have just made. But again Rohith I would be a bit cautious about over interpreting at this stage. You know we have to see how the coming weeks fair before really making a call on it.

Rohith Chandra-Rajan
Okay, thank you.

William Chalmers
Thanks Rohith.

Question 10 – Joe Dickerson, Jefferies
Hi, good morning, gentlemen. Can you just clarify, I think this needs to be clarified, your comments on your non-banking NII and annualising this £76 million headwind? Does this reflect on the other side, as we have seen at pretty much every other bank, higher non interest income? So is this a more of a broadly neutral matter for total income? If you could just address whether this is like a kind of trading for funding cost and so forth, is there a corresponding benefit to the non interest income line? Thanks.

William Chalmers
Thanks Joe. Let me take another stab at that. The non-banking net interest income is really driven by two things. One is interest rate rises, because it is effectively a funding cost from non-banking activities. I mentioned Lex earlier on, but you also mentioned trading activities there. The same sort of thing, you are funding those activities as interest rates go up, so the cost of funding those activities go up. And that is a factor in non-banking net interest income, or non-banking net interest expense as it is at the moment.

The second thing that is going on is that as the size and scale of those activities increase, whether it is in Commercial Banking consistent with some of our objectives within Corporate & Institutional for example, or whether it is in Lex, e.g. we have now got the Lex car fleet growing once again. That will also increase non-banking net interest expense. And again, that is simply because the volume of what you are funding is going up. And so the twin effects of rate increases number one Joe and activity increases number two, or scale of activity increases number two, is what is driving that non banking net interest expense. I think if you are annualising what we saw in Q1 you are not going to be far off for the year and it is a reflection of the two underlying activities.

And finally Joe, to the point you were making therefore, a component part of that non-banking interest expense is playing itself through in terms of the benefits that you see in other operating income. Commercial and Lex being good examples. So you do see a part of that playing through and benefiting other operating income. And part of that was at play in our £1.257 billion, part of it will continue to be at play in that line through the year.

Joe Dickerson
So the short answer is, because of increased activity, there is some corresponding benefit to other income?

William Chalmers
That's right Joe, yes, that is the short answer.

Joe Dickerson
Okay because you know what the market is going to do. I f you just take your costs and annualise them and add the bank levy, I think the concern of investors is, are you annualising the £76 million and taking it off your revenue estimate? It sounds like that would be the wrong conclusion to draw here?

William Chalmers
I think on a total basis that's right, there's a netting off in terms of OOI that you expect to see. But I would just refer you back to the OOI comments that I gave earlier on and that gives you a good sense of where we would expect OOI to be.

Joe Dickerson
Fantastic, thank you.

William Chalmers
Thanks Joe.

I think we are concluding on the call today so I just want to say thank you very much indeed to everybody for taking the time for your interest in the story and we will look forward to a continued dialogue. Thanks very much indeed.

END

FORWARD LOOKING STATEMENTS

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