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

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William Chalmers
Good morning everybody and thank you for joining this morning. I guess you all heard our Q1 announcement last week and many of you joined the call, so without further ado we can just step straight into questions. I am happy to address whatever issues are important to you. So over to you.

Question 1 – Chris Cant, Autonomous
Good morning, thanks for taking my questions. I just wanted to ask about deposit price changes, in terms of your guidance for margins to be stepping lower into the second quarter; whether you could give us an indication of how you are thinking about the order of magnitude of the cumulative beta catch-up that we'll see played through into Q2? When we look into H2 you've indicated margins are going to be stabilising, partly because presumably the structural hedge maturities are helping in H2 but also partly because the beta catch-up pressure is abating somewhat in your thinking. I am trying to get a sense of how that beta catch-up dynamic plays out through Q2 and into H2. So if you could give us an indication of where your betas were at the end of Q1 and where you think they might be into Q2, that would be really helpful. Thank you.

William Chalmers
Thanks Chris. A couple of points there. On the deposit price changes, we have been feeding through deposit price changes over the course of 2022 and into Q1 2023 and we'll continue to do so over the course of this year. We don't formally disclose the exact deposit beta that we have passed on but it is reasonably spread around products. We have some market leading products at one end of the spectrum. We obviously also have some lower rate products that are more instant access in nature. We have so far seen pass on in total has been a little below our 50 per cent assumption in the sensitivities that we have given you, but very much in line with the sector. That has been increasing a little over time, so for example in February and March we passed on about 40 per cent of those combined rate increases at that time, and we will have to see how we fair over the course of Q2 and beyond. As we look at the overall margin development, there's two factors going on there, one is the pass on in terms of the rate changes that we have seen, which is as I have just outlined. Two, is the extent to which we see any churn in the overall deposit book. As we said on Wednesday of last week, we have seen some churn during Q1 which has been a movement primarily from variable rate savings into fixed rate and limited withdrawal savings. So higher rates in exchange for lower access. I expect we will see some churn during the course of Q2 but it may be a little bit less than perhaps we have seen during Q1. I think we just have to see, it is still early in Q2 to make a call on that. But if we see a combination of lower churn in Q2 than we saw in Q1, and bank base rate changes that are passed on in the direction I have indicated, then we will see a change in margin in Q2 that is still a reduction during the quarter, but it may be a little bit more benign than we have previously expected. Because of additional bank rate changes and because churn, having taken place in Q1 and is still going on in Q2 to be clear, may be attenuating a little bit in terms of its pace.

As we look into H2 you see the mortgage headwind start to build and that displaces some of the churn pressure that we saw in Q1, some more of which we will see in Q2. That starts to build and that is then offset also by structural hedge maturities being reinvested at levels which are well in excess of the current yield on the structural hedge. So those are the two main factors that are playing out in H2 which take the place of some of the churn developments that we have seen in H1. The caveat to all of that Chris is that we are in an interest rate environment which we haven't really seen for about 12 to 15 years and so there is a little bit of a sense in which the sector is learning by doing, but hopefully that gives you an idea as to what we expect to see.

Chris Cant
That's helpful, thank you. Could I ask one question in terms of thinking back to that pre GFC period. One of your domestic peers indicated recently that the proportion of non-interest bearing accounts they have is roughly double what it would have been pre GFC, and I appreciate the complication in your case given the HBOS acquisition, but I was wondering if you give us some colour on how that has changed for the Group? Thanks.

William Chalmers
Yes sure. It is the case if you look at the balance sheet now versus pre GFC, the portion of non-interest bearing accounts is higher. I think that is a natural consequence of interest rates being low on a sustained basis over the course of the last 14 to 15 years or so. So I think that is a feature of the balance sheet. We don't formally disclose the exact numbers that are interest bearing and non-interest bearing, but I gave some numbers last Wednesday that indicated about 30 per cent of the commercial banking deposits are non interest bearing. And then of course you have got our PCAs which are by and large non interest bearing, or at least essentially so. So that gives you a sense as to where we are today.

If you wind the clock back to before the GFC it was certainly a higher proportion that was interest bearing in that context. But having said that, Chris, these things move pretty tectonically, meaning that is to say, you see some very gradual movement in terms of non interest bearing into interest bearing, just as we did in Q1. But if you look at it on an overall balance sheet basis it is really quite slow to move. So I do think that over time we will see a continuation of that gradual movement. I don't suppose it will go back to pre GFC days because I think people will keep greater precautionary levels of balances, and also have some of the inflationary effects on wage settlements feeding through into the balance sheet. So I don't expect it to go back to pre GFC days but I do expect the migration from variable rate to fixed term deposits as an example, to be a fairly continuous process as indeed we expect our pass on to be a fairly continuous process over the course of the cycle. Albeit, all of that is contained within our greater than 305 basis point guidance and likewise it is all contained within the longer-term guidance that we gave back in February. So no change to that picture. I think if anything, we have seen a couple more base rate rises, we are seeing perhaps the beginnings of a little bit more of a benign trend in churn. We have to see how that plays through as we are in early days but nonetheless those are the kind of immediate indicators. Longer-term it will continue to migrate but I am not sure it will go back right the way to pre GFC days.

Chris Cant
Thank you.

William Chalmers
Thanks, Chris.

Question 2 – Grace Dargan, Barclays
Hi good morning. Thank you very much for taking my question. Just a more high level one. There has been a fair bit of coverage in the last couple of days around the reintroduction of 100 per cent LTV mortgages from another bank. Do you think it is the start of a shift in the mortgage market? And from your perspective, given your average LTV is so low, do you see opportunities there maybe to step up the risk curve a little bit or do you see other ways to support first time buyers? Thank you.

William Chalmers
Thanks for that, Grace. We actually are quite a significant player in the first time buyer market. I mean it is part of our philosophy for increasing access to housing, and that commitment remains, and will be maintained. As you say that is in the context of a pretty cautious risk appetite. So the overall LTV of the book is just over 42 per cent now, only around 7.5 per cent is greater than 80 per cent LTV. And only a very small percentage i.e. less than 2 per cent is greater than 90 per cent. So our risk positioning in mortgages is pretty conservative, our affordability measures for example are if anything erring on the conservative side and that drives our pricing, that drives our share and so forth. So those are factors. But as you said, first time buyers have been an important part of our portfolio, they will continue to be an important part of our portfolio going forward. Overall I think we will have to see in terms of our overall risk appetite, for the mortgage book as a whole, we will have to see how the macro economy develops and adjust our risk profile accordingly.

Grace Dargan
Understood, thank you.

William Chalmers
Thanks Grace.

Question 3 – James Invine, Societe Generale
Great, good morning William. I just wanted to ask please about your new to arrears chart. It seems that the steepest line on there is the buy-to-let one. I was just wondering if you could give us any more on that please? Is that the buy-to-let landlords who have had to refinance their fixed rate deal? Does it imply that we have got more pain coming here? And just any more colour you can give, so is it the single property landlords or maybe landlords with a few more? Any details you can give please?

William Chalmers
Thanks James. It may be worth just starting off with the punchline actually which is that the new to arrears is a very benign set of developments. The new to arrears pattern is showing a very benign performance. That is across all portfolios. That is within the mortgage portfolio and that is also true within the buy-to-let portfolio. So if you look at those lines you can see, James, they are in all cases at or below pre-pandemic levels for all the various asset classes.

Within the buy-to-let, I don't think there is any particular development that I would call out. The buy-to-let portfolio remains very benign. It is just shy of £50 billion in total. It has got an LTV of about 47 per cent. The book has shown very constructive credit trends actually which I think have surpassed our expectations i.e. being better than expectations in terms of the performance. The area of the mortgage book where we have seen a slight tick up in arrears is actually the 2006 to 2008 originations which is in the old HBoS legacy book, as you will be aware. A part of that is buy-to-let, but by no means all of it. So if there is anything going on within buy-to-let it is within that 2006 to 2008 portfolio that I mentioned, and not more expansive than that, not more of an issue than that. Again I reiterate the punchline, which is that the overall arrears developments that we have seen within the book as a whole have really been very benign.

James Invine
That's fine, lovely thank you. And I think in the past you have called out the LTV on the 2006 to 2008 book, can you just remind us what that is please?

William Chalmers
Yes, absolutely. The 2006 to 2008 book is a series of very low balances. So the book in that context sits around £30 billion or £40 billion or so. LTVs typically around 40 per cent more or less in line, so 36 per cent average LTV for that book, a little below the 40 per cent I just mentioned. As said we have seen a little bit of an uptick in arrears there, it is primarily off of a relatively low LTV base combined with a relatively low average loan base which from memory is around £100,000 or thereabouts, around £105,000, on an average loan basis. And again, we feel pretty comfortable with that James.

James Invine
That's perfect, thanks William.

Question 4 – Robin Down, HSBC
Good morning William, thanks for taking the question. It was just really one around mortgage pricing. And obviously I think last week you talked about the internal transfer pricing being sub 50 basis points, whereas the new to Group pricing being perhaps 20 basis points to 30 basis points higher than that. I am just kind of curious as to where you see pricing structures being maintained going forwards. Just intuitively, it feels like internal transfers you know the customer but equally you are offering them the substantial benefit of not having to go through the cost and hassle of refinancing somewhere else. Do you expect internal transfers to maintain pricing structures below new to Group, or is that just a one off in Q1?

Answer – William Chalmers
Thanks Robin. Before coming to your question Robin, just to get back on James's question on the figures for the book as I was searching around a bit for the numbers. The heritage book that I was referring to, that is the 2006 to 2008 maturities, I described it as about £40 billion, the actual number is just over £33 billion. The average LTV I mentioned 35 per cent and the average loan, I think I said £100,000 to £105,000, it is actually £107,000. The other characteristic of that book, James and for others that are interested, is that it has got by its nature, about 14 years to 15 years of positive HPI growth built into it. So they are the statistics that I was searching for, I just wanted to make sure you've got them.

Mortgage pricing Robin. As you say, mortgage pricing has been quite competitive. Our Q1 comps number is about 50 basis points. That is composed of two components, new business comps which are higher than that, product transfer comps which are a bit lower than that and then that overall completion margin is weighted by the flows that we see in each of those two products, whether it is new business or whether it is PTs. In answer to your question, do we expect to see pricing continue at that level? It is a little hard to say Robin, I mean what we have seen is new business applications actually perform reasonably well over the quarter. The issue has been as you know that volumes have been relatively modest. It is ultimately the case I think that if we see a more constructive overall mortgage market then new business volumes will form a more weighty component of everybody's pricing. That is likely to exert some upward pressure on product transfer margins simply because the dynamics of the mortgage market will change, and that is to say there is more business to go after. New business applications will be more attractively priced, that will pull up retention margins. Now as said the other day, when we look at retention margins, because we know the credit, because we are trying to build the relationship, we see them still as economically attractive. Even at the level at which they were at in Q1, i.e. below the 50 basis point mark, we see that as sort of product that is worth writing. I do think new business margins have been north of that and overall more constructive during Q1. I do think in turn that gradually pulls up retention margins but as said the effect of that on completion margins, all depends upon the weighting in the market. And at the moment there is more product transfer business than there is new business.

Robin Down
Okay, thank you.

William Chalmers
Thanks, Robin.

Question 5 – Jonathan Pierce, Numis
Hi morning William. A couple from me please. Firstly just looking for some updated thoughts on Basel 4 now that we are less than two years away from day one impact, in particular whether some of the changes to the CRD IV RWAs you talked about at the Q1 numbers are having any influence there. I think you previously suggested there could be some modest RWA benefits on day one, 1 Jan 2025, from Basel 4 so keen to hear your updated thoughts on that.

Secondly on the TNAV, I asked you at full year whether you felt consensus TNAV was too low and you I think basically said 'yes'. And I think since then the market's forecast TNAV hasn't really moved. So just if you could confirm you still think that's the case, so 53 pence at end of this year and 58 pence end of next I think is where we were coming into Q1 numbers? And just a supplementary to that, in the TNAV walk that you gave us on slide 10 at Q1, the pensions and other drag was about 0.4 of a penny. But I think the buybacks and the intangibles are in there. They were pretty big, so there must have been quite a large pension remeasurement positive in Q1. Was that the case and what is driving that, could we see that more moving forwards? Thanks William.

William Chalmers
Thanks, Jonathan. Basel 4 or Basel 3.1 as it is called. So what do we expect to see there? As you know that is first of all due to come in, in around 2025 time frame. There are still some aspects being sorted out, I will come back to those in a second. But overall we expect there to be no material net impact on Basel 3.1. If anything as you say Jonathan, perhaps a slight benefit. To elaborate on that a little bit. What do we expect to see? Some Foundation IRB benefits, reduced scalar in IRB for example. Reduced credit conversion factor, reduced standardised loss given defaults. These things will help us in terms of Foundation IRB. One of the benefits of being on Foundation IRB is that there's less to lose, I suppose, when the approaches of the regulators get more standardised in their nature because we are kind of already there. There are some headwinds for us, removal of the SME scalar for example, removal of the corporate CVA exemption, standardised operational risk. Those things are headwinds for us, I expect they are for the rest of the sector. But overall, we expect to be net neutral, possibly a modest benefit i.e. reduction in RWAs from the Basel 3.1 changes. So that position has remained the same. I think that might be getting a little bit better, but we have to see. We were previously focused on the output floors and how they were transitioned in in a period after 2025, there are some open points to be settled in that respect, in particular mortgage valuations. But we think that trends for mortgage valuations and the approach to mortgage valuations is becoming more constructive, where we thought output floors perceivably could bite as we move from 2025 to 2030 actually looks better and it might be that actually they don't bite. And as a result, we feel that the overall effect of Basel 3.1, right the way through, should be a modest benefit to us. There are still some open points, Jonathan, to settle but the bottom line is a neutral to modest benefit is our expectation from 2025 onwards.

As to TNAV, what do we think of TNAV at the end of the year? As you know we don't really comment on consensus expectations but I think the factors that will drive TNAV over the course of the year, very much remain the same as outlined at the year end. So we will see over that time the attributable profit playing a role. We will see over that time the pension surplus building, the cash flow hedge reserve negative dropping out. And those factors will start to bear out, to improve TNAV over the course of the year. The pace of the cash flow hedge reserve in particular, is dependent upon two things, one is maturity of the structural hedge which obviously we know pretty well. And the second is the pace of interest rate changes and how they evolve, and it is that point Jonathan which is a bit of an unknown. That in turn has an effect upon TNAV. Overall, I stick by the comments that were made at Q4 actually around the overall trajectory of TNAV. We do expect it to build over the course of this year, indeed over the course of forecast period, driven by those same factors.

Jonathan would you mind just reminding me of your third question, I didn't quite catch it?

Jonathan Pierce
Yeah. Because you don't give us a more detailed OCI at the quarterly stage, we are sort of dependent on this TNAV walk on slide 10 that has a category called 'pensions and other' which was negative 0.4 pence. But I think my back of the envelope is maybe £900 million of intangible and buyback costs in that. So it implies it was quite a big pension re-measurement in Q1. I just wonder where that is coming from and if it might come through? And then of course is it new as well?

William Chalmers
Yes absolutely, a couple of points on pensions and TNAV. One, you will appreciate Jonathan, is that from a technical perspective the subtraction of cash and the insertion of contributions, if you like, into pensions, that is net neutral from a TNAV perspective by definition. So as you say it really then rests upon the OCI changes, and what has been going on there to increase the accounting surplus which does feed into TNAV. That is in part driven by OCI movements which in turn are led by reduction in gilt spreads and an increase in senior spreads. Those two factors are driving an improved pension surplus, not because of contributions but rather because of OCI movements and that is pretty consistent with what you just said Jonathan, so I think your analysis is not far off.

Jonathan Pierce
Okay brilliant, thanks a lot.

William Chalmers
Thanks Jonathan.

Question 6 – Ed Firth, KBW
Good morning everybody. Could I ask you a question about hurdle rates of return and in particular what cost of equity are you using now in terms of looking at new investment opportunities, but also when you are pricing products. How do you do that because it seems to me that if we look at front end pricing of mortgages you must be pretty tight on any cost of equity hurdle rate. But also if I look at deposit pricing you must be making almost infinite returns. So how do you square that internally, what is the rate you use and how do you apply that?

William Chalmers
Thanks Ed. We don't disclose our formal cost of equity, we never have done and it is just a matter of practice really. One thing I guess I would say is that we have to, in order to run the business successfully over the course of the cycle and ensure its future prosperity, we obviously have to have a stable cost of equity that doesn't fluctuate too much with market volatility. While we also need to ensure that whatever price signals that we are getting from the market, we take those into account. We're trying to build the business as well and so the cost of equity therefore won't be necessarily hugely different from what is commonly used amongst the broker community, but stability is important to the growth of the business as we look forward.

To your point around products, I think what you have just said has to a degree at least been ever thus, particularly the deposit point. Deposits by their nature are a low capital intensity business, you clearly have to have some capital and certainly liquidity and so forth for deposits, so from that perspective there isn't a denominator. Nonetheless, in a positive interest rate environment, deposits have by their nature been strong RoE products and that hasn't changed, at least not in the time I have been in banking. Within mortgages as you say that does fluctuate, a couple of points on that, the margin on mortgages has been very volatile of late, partly because of the swaps volatility. So you need, again, to somewhat look through that in order to get a more stable view as to what you are earning on mortgages at any given point.

The other point that I would make is that when you look at the overall benefit from mortgages you are obviously getting the interest yield, and you are also getting the fee benefits. Then at the same time you also need to look at the affordability constraints that you impose on the mortgages to realise what the mortgage return is on a risk adjusted basis, which as I mentioned earlier, for us at least, our affordability constraints have been pretty cautious in the context of the current environment. So looking through all of that, when we look at the particular product margin on mortgages, on a risk adjusted basis, it continues to be pretty attractive for all of those reasons once all of those factors are taken into account.

A further point I'd add, Ed, is that consistent with our strategy, we are building a customer profitability perspective in addition to a product profitability perspective. So we are building customer relationships which are founded upon not just a single product but also a holistic relationship with that customer, which in turn allows us to tolerate some stronger margins in some areas and some weaker margins in others.

Ed Firth
So that was what I was trying to understand. Do you look at the total spread rather than a product by product basis, is that perhaps a more important guide to pricing than individual products? I guess that is one supplementary question and the other supplementary is whether it the same with share buybacks; do you look at share buybacks versus dividends with a sort of cost of equity head or is that more about EPS enhancement?

William Chalmers
Thanks Ed. The first of those two follow-ups, we look at product margins. I should be very clear about that. We look at product margins first. We do look at customer margins and indeed that's consistent with the strategy as just outlined. But there is no doubt

that when we look at our relationships and our offerings, we are looking at product margins and again when you look at mortgages, when you take into account the interest yield, the fee yield, the affordability constraints and therefore the risk adjusted margin that we are getting off of it with a capital base as a denominator, we are seeing profitable, attractive opportunities in that market. So, that's first and foremost what we are looking at. We are, as said, looking at a customer approach, on an increasing basis actually, consistent with the new strategy. The buyback is obviously an important part of our capital return approach. What do we think about when we look at the buyback? We obviously take into account investor preferences first of all and its very clear that investors want a combination of a progressive and sustainable dividend. But also they are interested in the context of capital return by buyback on the other hand. When do we look at it? The form and the quantum of distribution is obviously primarily a question for the Board. But what are the factors that go into the buyback to your point, clearly the cost of equity is one Ed, but also we look at the share price, we look at our views of value and we also look at EPS accretion and the future DPS accretion off the back of the buyback. So all of these things come into play: value, EPS accretion, DPS accretion as well as and perhaps most importantly investor preferences. Those are the factors that are input, if you like, to our overall capital return analysis.

Ed Firth
Great, thanks very much.

William Chalmers
Thanks Ed.

Question 7 – Joseph Dickerson, Jeffries
Hi William, I just want to circle back on something you referenced in your discussion about the margin performance Q2 in Q1. You referenced something, I believe you said more benign churn trends. Could you just talk about what you mean there? Is this less people refinancing? Customers being more inert? Is it industry wide or company specific to you given some of the smaller size of the mortgages in that back book? Could you just clarify that because that was a very interesting point you made?

William Chalmers
Thanks Joe. The bottom line is that I was talking about deposit churn and our monitoring of deposit churn on an ongoing basis. So let me elaborate a little bit on that. When we look at the margin development over the course of the year, we have looked in particular, and we've talked with you all a lot, about the developments over Q2 in particular. I mentioned on Wednesday that our expectation is that in Q2 we will see a little bit of a step down in the margin from the 322 basis points that we saw in Q1. What is driving that? In the main it is the evolution of the deposit base and indeed the churn expectations of the deposit base from variable rates, to a degree from PCA and to a degree from Wealth, into fixed term deposits and limited withdrawal deposits. That's a big part of the overall expectation for the Q2 margin development. Alongside, it is supplemented by the absence of structural hedge maturities. But the main headwind is that churn, it is the absence of base rate change expectations that are built into our forecast. Now we will still see some of that for sure and we will still see therefore some reduction in the margin from Q1 into Q2 exactly as we have outlined. But the ingoing assumptions that we have made as to churn are pretty conservative on the whole and we just have to see how those play out because it may be in the early evidences that actually there is a little bit less churn than we might have expected, number one. Number two, we are seeing a bank base rate change likely today, we don't know, but if that happens that is also a helpful contributory factor. I do expect, consistent with what I said on Wednesday, that a fair bit of that base rate change will be fed through to depositor rates. I do expect that pass-on to be pretty meaningful. But nonetheless that is a bank base rate change that we didn't expect and to the extent that it is not competed away, we should see some benefit of that flow through. So Joe, in answer to your question: (i) it is the churn and how that develops that we are keeping a very close eye on, early signs are a little bit more constructive at the margin than we have previously thought; and (ii) it's that bank base rate change. As said, I do expect a fair bit of that to be put into depositor rates but let's see how much. Those are the two factors that were behind my earlier comments Joe.

Joseph Dickerson
Okay thank you.

Question 8 – Jonathan Pierce. Numis
Just a broader thematic question around liquidity and deposit guarantee schemes. You touched on this a little bit in Q1 numbers. But I am interested in your view of how the liquidity situation in particular plays out because, at the aggregate level at least, with the QT and the TFSME maturities over the next few years are going to drain maybe £300 billion to £400 billion of cash liquidity out of the commercial banking system with a pretty pronounced impact on the liquidity coverage ratios. Whereas, I guess, in the other direction banks are looking to maintain LCRs broadly where they are at the moment. We could end up seeing quite a fight for deposits which ultimately would be a zero sum game. I would be interested in your broader views around what could give here. It sounds like the Bank of England may change tack a little bit on that central bank liquidity drain.

Can I ask you about deposit guarantee schemes as well, whether you think a pre-funded deposit guarantee scheme in the UK is appropriate for a market which is pretty concentrated, and where we have ring fencing rules, and so on and so forth? So a couple of bigger picture questions for you.

William Chalmers
Thanks Jonathan. In terms of the overall picture looking forward. As you say there is an environment of rates going up and maybe a bit of QT. TFSME is interesting. TFSME is quite a significant part of the overall sector picture, as you know. We ourselves have got about £30 billion of TFSME. I would stress that TFSME, as its name implies, is very much a funding question rather than a liquidity question and we look at that in terms of our maturities that we have got in 2025 and 2027, as being just part of our overall funding picture that we will be looking to address over the course of the coming years. It is not entirely clear to me what the Bank of England will do, I do think there is a kind of autocorrect mechanism in place which is to say if funding markets get too tight, if there are any signs of distress around the margin which means, banks like us fund very effectively and efficiently but banks at the margin have a much tougher time, then I wouldn't be surprised if there is bit of an easing back. I don't think that is a scenario that the Bank of England wants to see play out. You know, even if it were to the advantage of bigger players I don't think that is an environment the Bank of England kind of wants to see play out. So there is that automatic stabiliser looking forward. As to the deposit guarantee picture, you are right I think, our base case is not that we moved to a pre-funded deposit guarantee. As said on Wednesday, if we were to, we would expect to earn some return on those deposit guarantee pre-fundings and that in turn would offset any economic impact on it. So if it does, I think overall we see either an increase in the caps of deposit guarantees or alternatively a change in the overall funding mechanism as having a pretty limited economic impact on the business. That isn't the source of concern. But like you, I tend to see a pre-funded mechanism as perhaps appropriate for some other regulatory regime, less appropriate for this one and the indications, if any, from the Bank of England are not obvious that they are moving in that direction. I think they are broadly comfortable with where they are.

Jonathan Pierce
Thanks that is really useful, but can I just ask you quickly to expand on the point around if you were asked to pre-fund the scheme in the UK? There is obviously an annual cost that could go on for a number of years as we see in Europe, what is the offset that you are talking about in terms of getting some return on that funding?

William Chalmers
Well it is speculative really Jonathan because I don't think any of us quite know how a pre-funded deposit guarantee might actually play out and what the rules of the game will be. But my working assumption is that if we are required to pre-fund a deposit guarantee, depending on the way in which it works, with contributions that come from individual institutions, we would ask at least for the contributions that we make to be offset by yield from that pre cash that is being invested by the Bank of England. Either at base rate level or something similar. Jonathan, it is speculative because whether they would tell us to get lost or whether they would accept what we think is a reasonable ask, I don't know.

Jonathan Pierce
No, it is helpful, thank you for that.

William Chalmers
Thanks, Jonathan.

Question 9 – Chris Cant, Autonomous
I just wanted to ask a little bit about some of the moving parts within the capital walk for the remainder of this year. So one of the things I'll be honest I have always struggled to get a handle on how it is going to develop, is the insurance deconsolidation adjustment. Should we be still anticipating limited ongoing benefit from that into future years. I think in the past you talked about wanting to retain more capital within the insurance business to fund growth there. But if you could give us an indication as to how we should be thinking about that, that would be helpful.

On a related point, intangible asset developments for the year. We don't get the capital bridge for Q1, I know you alluded to Jonathan's maths earlier in terms of the net buyback and intangibles number for the quarter being about £900 million. But how should we be thinking about that going through this year? There was obviously a big step up last year but that was partly M&A related, so any steer you can give on the quantum of the net capex build would be of interest, I think. Thank you.

William Chalmers
In terms of the capital walk, the movement on the insurance side, the best way to put it is that the aspirations for the target capital level within insurance have not really changed. I don't think we disclose exactly what that is but it is not hugely different to where we ended up in Q4, adjusted obviously for the dividend that you see within the insurance business. So it is roughly speaking, in

the 150 per cent range or thereabout from a solvency ratio point of view. I don't expect that to change. I do expect a consistent dividend to be coming out of the insurance business, allowing them to build the business, but also allowing the group to receive a steady dividend from it, and hopefully a growing dividend from it in future years. We had an outsized dividend during the course of 2022, that was off the back of rate rises. I don't expect that to be repeated in 2023. So that is the overall picture that I expect to see from insurance. There are from time to time, some adjustments in our capital calculations which as you know relate to the threshold benefits around insurance. But I don't expect those to be particularly material during the course of the year and it isn't a major feature in terms of our capital walk.

In terms of intangible assets, Chris, the expectation is consistent with the investment plan and consistent with where we are deploying the funds, or the investments rather. We do see intangible assets increasing over the course of the year, consistent with that investment plan. I think what that will do, is it will lead to the intangible asset growing in 2023, peaking around about the end of this year and then starting to come off as the investment plan slows down consistent with the outline that we have given to you before. So I think the intangible assets likely peak around about the end of this year and likely come down thereafter as amortisation outpaces incremental add-ons to that intangible asset, again consistent with the plan. That will vary a little bit depending upon capex at any one given moment, but roughly speaking what I just said ought to be right.

Chris Cant
Thank you.

William Chalmers
Thanks Chris.

Question 10 – Robert Nobel, Deutsche Bank
Hi William. I had a question on deposits. You have guided to flat deposits this year. So how do you go about forecasting the level of deposits and what is the over / under on that number? How wrong could you be on that number and what are the variables you think about when you look at that?

William Chalmers
Thanks Robert. As you say we expect deposits to be broadly flat in 2023. What are we basing that on? It's founded upon a view as to how we expect the deposit market overall to grow in 2023 and what we expect our market share to do within that market during the year. So if you look at 2023, we do expect some deposit market growth, albeit perhaps more muted than it has been in previous years. What's driving that? Wages for example and inflationary wage settlements, interest income clearly is part of that and then that is offset against things like QT, the point we were discussing a second ago, also interest rate expenses and inflationary affects upon spends. So those are the types of factors that are, I suppose, behind our expectations as to the deposit markets. Now within that, we do expect to see some changes in composition so perhaps a little bit of reduction in PCAs off the back of spend, off the back of inflation, off the back of movement and savings. And probably a little bit of an increase in savings balances for the reasons just mentioned. So that's the overall picture within the year. I think then the question is how do we see our market share developing? Actually one of the interesting features I think of our market share is that it has been very steady during the course of Q1 and we continue to see that pattern within the business. So behind that picture is a market share that is pretty consistent. So modest growth, pretty consistent market share and that results in our expectations for the business to be broadly flat. I think having said that Robert, consistent with your comment, we are in a period of time the like of which we haven't seen for 15 years, and so there are inherently some uncertainties about how things develop and any forecasts that we give you is subject to those uncertainties. But what we have given you is our best estimate, as it were.

Robert Nobel
Thank you.

William Chalmers
Thanks Robert.

Question 11 – Alvaro Serrano, Morgan Stanley
Hi William. I just want to clarify one point. Thanks for your helpful comments on the deposit churn. But I am conscious the results were last week and it does sound a slightly more optimistic picture than was, as you say, factored into the guidance that was reiterated just last Wednesday. Is this the weekly developments, is this the April data that you have looked at that shows better trends than you had budgeted, just to get a feel of what has prompted that slightly more optimistic tone? And to clarify in your comments, is this something you would expect to hold in H2, I think you touched it but I may have missed it. Thanks.

William Chalmers
Thanks Alvaro. It is not intended to be different to the position that we conveyed last week. That is to say we experienced churn in Q1 consistent with my comments last week. We expect to experience churn in Q2 consistent with my comments last week. I think the developments within churn will be important to the overall margin within Q2. Also important to that will be the bank base rate and the extent of pass on. I think I made the comment last week that the more of that that is passed on, the less benefit the bank base rate changes will have. But having said that, there is still a bank base rate change in excess of our expectations. Overall it is not predicated upon new information as such since last week, I think it continues to be founded upon our pretty conservative views that we have built into our churn expectations, and I think we just have to see whether and how those play out. Off the back of that, we continue to see again, as I said last week, a step down in Q2 margin. Albeit, it will be a softer step down if we see less churn and if we see a bank base rate change today. All of which I think is consistent with what I said last week.

Alvaro, you had a second question but I'm afraid I missed it.

Alvaro Serrano
It is just the churn, this slightly better churn. I don't know if you touched on it already, I might have missed it. But if you have lower churn.

William Chalmers
Yes, your question was about H2 wasn't it in that context?

Alvaro Serrano
Yes do you think it is just a delay or is it going to hold in H2? What would be your guess, I realise the last 15 years have been difficult?

William Chalmers
Yes a couple of comments on that Alvaro. H2, again, we have got some pretty conservative expectations for churn built into our H2 forecast. So I would start there consistent with my comments around Q2. But having said that we do expect to see fewer, if any, bank base rate changes and that in turn is something that will, I don't think it will totally abnegate churn, I think churn will continue. But on the other hand, fewer bank base rate changes will mean fewer catalysts for that churn and therefore we have to see how that develops. But I think overall therefore it is our expectation that the types of movements that we saw in Q1 are unlikely to be seen in Q3 and Q4, really for those reasons. That in turn is what gives us some confidence that the structural hedge will be in place and allow us to protect the income stream, not just for 2023 but also protect the income stream for future years by continuing our investments in the structural hedge based upon the current rates curve. That is an important underlying part of our philosophy. We are trying to build earnings stability into the business which is why maintaining the structural hedge is important to us. Not in order to boost earnings today, ironically enough, if we reduced the structural hedge today we would earn more money because we would be able to put it in bank base rate in the short term. But our philosophy is to try and protect the earnings going forward and hence, Alvaro, making sure that the churn is within acceptable levels is important to maintain that structural hedge, which in turn gives us earnings resilience in to the years well beyond 2023.

Alvaro Serrano
That's great, thanks William

William Chalmers
Thanks Alvaro.

Question 12 – Martin Leitgeb Goldman Sachs
Good morning. Could I just have a follow up on the structural hedge and then one broader on just the growth outlook as we head into 2024? I was just wondering from some of the discussions about policy rates approaching peak level, has anything changed with regards to how you see the hedge going forward? Could there be a scenario at present or in the near term where it makes sense to lengthen the weighted average life of the hedge from 3.5 years to somewhat more, given the expectations are for rates to maybe decrease in the not so distant future?

And secondly I was just wondering in terms of the outlook for average interest earning assets, obviously the guidance for this year is clear, I was just wondering how you think about prospects for growing the underline asset base. As we head into 2024 to 2025, which particular profits could see growth coming back? Thank you.

William Chalmers
Thanks Martin. In terms of structural hedge, the position today as you know is we have £255 billion invested and we have a comfortable buffer at £19 billion and, looking forward, we maintain our view that will continue to invest the structural hedge at

current levels. As ever that depends on how the year develops but that is certainly our view as of today. When we look at the term of the structural hedge, as just said in response to Alvaro, it is important to us to protect the earnings stream over future periods and therefore at some level at least, if we reduce the structural hedge today, we will earn more overnight income from those elements we reduce it by. But actually what we are trying to do is protect the earnings stream into future years. So far we have been successful in that and our base case is we continue to be successful in that.

When we look at the overall structural hedge weighted average maturity right now, as you know it is three and a half years. How do we look at that? Most importantly we look at the behavioural life of the components that are invested in the structural hedge. That is the foundation for it. We do have scope to marginally increase the weighted average life and you know we will think carefully about that. But at the same time we will keep a close eye on how the components of the structural hedge behave in the meantime. As said, in a rising interest rate environment you know there is some inherent uncertainty around that. So we just need to keep an eye on it. The other tools available in managing the structural hedge as said on Wednesday are: (i) the buffer that we have at the moment, £19 billion, I do expect that to come down as it is an unusually large buffer; (ii) also upcoming maturities. So all of these things will play into the overall management of the hedge. Weighted average life is one factor, but we do need to keep a careful eye on the behavioural life of the liabilities within it.

The AIEA picture as you know is pretty stable for this year. I do think that is going to evolve in future years. We haven't given explicit guidance on it but the types of things that will drive it are, probably a more constructive mortgage market. Alongside of that some attenuation on the commercial side. Gradual attenuation of the Bounce Back Loans repayments, offset by the growth given increased demand accompanied by our strategy within the SME business, and then the continued growth of the C&I business. So all of these things will play a part. I didn't mention there Retail unsecured where, as you know, we saw some growth in Q1 of this year. Depending upon economic circumstances, that too should help a little bit. So, Martin, without giving explicit guidance on AIEAs, I think we will be following the macroeconomic developments that we forecast in our plans.

Martin Leitgeb
Thank you very much.

William Chalmers
Thanks Martin.

Question 13 – Robert Noble, Deutsche Bank
Hi, the non-banking interest expense that we talked about on the call, that you guided to as a run rate and a funding expense for the other businesses. Presumably that steps up for the base rate increase this year. So does the run rate go up and come down, does it follow the rate curve? Is that the way we should think about it? And in terms of the funding, it being a funding cost for the rest of business, does it therefore reprice immediately? So should I track perfectly what the swap curve does, or how should I think about that?

William Chalmers
Thanks Robert. As said the non-banking interest income is a function of two things really. One is the size of the activities going on with non-banking. So as things like Lex grow, as the Commercial C&I activities grow, then you have a volume effect on non-banking interest income. Secondly, the funding cost associated with non-banking interest income based in turn around effectively internal transfer pricing which does have a relationship to market rates. And that is the second factor, there is a volume factor and a price factor Robert. That is not as fluid as market developments, so I'd be a little bit careful. The comment made on Wednesday around the charge that we saw in Q1 being more or less a repeat picture for the year, I think I would stick by that, that is the right way to look at it. It might change a little bit at the margin, but that is broadly speaking the right way to interpret it. Any refinancing implications therefore will happen only gradually through time, Robert, depending upon markets and clearly rates, but also depending upon size and scale of activities.

Robert Noble
Great, thank you very much.

William Chalmers
I just want to say again, thanks very much indeed to everybody for taking time. I appreciate the questions and look forward to the ongoing dialogue. Thanks very much indeed.

END

FORWARD LOOKING STATEMENTS

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