LLOYDS BANKING GROUP PLC – 2023 Q3 IMS – SELLSIDE ROUNDTABLE TRANSCRIPT
(amended in places to improve readability only)

Tuesday 31 October 2023 – 4.00pm

LBG:
William Chalmers, Chief Financial Officer
Jon Burgess, Group Financial Controller
Cecile Hillary, Group Treasurer
Douglas Radcliffe, Group Investor Relations Director

William Chalmers
Thanks very much indeed operator and thank you to everybody for joining this afternoon. You will have seen last week we put out some numbers which reflected a robust performance across the business. Balance sheet growth in terms of lending and likewise stability in terms of deposits. From the P&L perspective we saw NIM pretty much performing as we have guided. We saw some growth in OOI. We saw continued cost discipline and we saw a stable credit performance. All together that allowed us to deliver strong capital generation and also a strong 14.6 per cent CET1 stock capital level.

Behind the scenes we are getting on with, as you would expect and hope, our strategic implementation. We have very much within the organisation a focus on delivery with 2024 and indeed 2026 in mind. It is our ambition in that context as you know to deliver strong, sustainable and growing returns. Overall, we have very much an eye on predictable earnings and capital generation and likewise distribution.

So, with those opening comments, very happy to take questions as relevant and as helpful to you.

QUESTION AND ANSWER SESSION

Question 1 – Rohith Chandra-Rajan, Bank of America
Thanks very much, afternoon William. I had a couple please. The first one was on deposits. So adjusting for a lower cost makes it look like you price deposits broadly in line with the market. I wanted to check that that was broadly correct. And then also to get some insight into how you manage deposit pricing and migration across the products and the brands and then I have a second one on mortgages please.

William Chalmers
Thanks for that Rohith. Just on the deposits questions to kick off with. I would have thought yes, we would price more or less in line with market, you know we are obviously competing in the same market. We have broadly speaking a customer demographic that is probably similar to the large incumbent banks. So, I would expect this to be more or less there or thereabouts in terms of market. It is also the case when we look at any given point in time including at points of bank base rate changes or an ongoing basis, we are very much looking at our offers on the instant access side, on the savings side and benchmarking them to other offers from competitors out there in the market. So yes, I think we do price in-line.

In terms of deposit migration across our product areas it is very much the intention to stay relevant to customers. So as mentioned in the comments last week where we see PCA outflows we are probably capturing about two thirds of those in the context of our savings offers. How are we going about that? We are making sure that we stay very much in contact with our customers as part of our overall customer strategy. So for example we have had mobile app contact to around ten million customers to encourage them to review their savings. We have sent about eight and a half million emails to customers on ISA products. We contacted about two and a half million customers based upon their behaviour where we think they could benefit from better rates if you like. And so, we are managing migration from PCAs into savings number one, and within savings from instant access into fixed term. And we are doing so within a construct that we think is consistent with our consumer duty obligations, as we have done to be fair before consumer duty came in, in July, but we continue to do so on an ongoing basis. With the intention of ensuring that we treat our customers the right way and to the maximum extent possible capture flows within our own savings offer, if they choose to move across products and between products.

Rohith Chandra-Rajan
Thank you and I mean I guess you are different to most of the other big banks in that you have multiple brands. So how do you manage those and do you think that helps with retention?

William Chalmers
I think to a degree it does Rohith, I think to be clear we want to be competitive across our brands. And so, you know it is very important to us that there is no laggard within the overall portfolio. I think where it does help us is it helps us bring out on occasion new propositions in respect to certain new brands. And so, you know when we look across the brand portfolio, not just the Halifax, Lloyds but also MBNA for example. That gives us a degree of flexibility to introduce new propositions. I think alongside of that Rohith, a point that I would make that probably is at least as important as brands is product innovation across the piece. And so, I think I mentioned last week the development of a limited withdrawal product for example which is intended to meet customer needs where they want to have a degree of access but also have a better price versus regular instant access savings. That is a product which works and is very much tailored towards consumers who have those preferences, which allows us to manage the deposit book in a way that meets customer needs, and at the same time from our perspective at least is more flexible frankly than just taking them straight out of instant access and going into the fixed term product. And so, I think Rohith it is not just about the brands but it is also product innovation within the products across brands.

Rohith Chandra-Rahan
Thank you and you previously talked about deposits, expecting deposit spreads to trend down towards 200 basis points. Is that still your expectation?

William Chalmers
I think over time it is likely that you see some continued deposit spread compression Rohith and I think there is a couple of things going on there. One is the increasing movement in the migration of deposits just as we discussed last week which is to say PCAs into savings, from savings into instant access and fixed term. And that activity itself compresses spreads clearly within the overall deposit portfolio. I think the second part is obviously a competitive environment and so we expect to see that rolling forward into Q4 of this year and indeed into next year. That is our base case of expectations Rohith and it is very much consistent with the margin guidance that we have given for next quarter and the headwinds and tailwinds that I put forward for 2024 last week. And so, the deposit price movements of the type that I just described are consistent with both of those Rohith and indeed it represents, frankly, our base case. At the same time one of the drivers for that deposit compression also impacts the structural hedge rate and so you know you see a degree of deposit price compression for want of a better word, but one that is very much offset by continued hedge margin expansion. And as you see that hedge mature, 12 billion for the remainder of this year, 40 billion for next, then you also see the hedge margin if that is the right word for it, hedge yield is probably a better word, expanding. I think I mentioned last week 1.36 per cent in Q3, that will go into 2024 and look much more in a kind of 1.6 to 1.7 type range. And then continue to build from there into 25 and 26 and you know what is going on in the hedge right now, it is effectively under earning. And as it refinances into the high yield environment it starts to adjust and indeed provides a platform to absorb any deposit price compression.

Rohith Chandra-Rajan
Thank you very much for that. The other thing I just want to ask very quickly was just to get your interpretation of the Bank of England data yesterday on this drop in remortgage approvals and what might be driving that, so some combination of people locking in their refinancing rates earlier in the year, more customer retention that doesn't show up in that remortgaging number or actually some people choosing to move onto SVR. Just interested in your thoughts on that please?

William Chalmers
It is probably a combination of the three would be my guess Rohith. It's a little difficult when we look at Bank of England data to draw too many conclusions from a particular point in time that they give us. I do think broadly speaking, the data is consistent with what we are seeing going on in the mortgage market right now and hence that explains some of the spread movements that we have seen.

As we look forward, well two points really, one is the Bank of England data is obviously sectoral data, any given bank's experience will be a function of its own book. Two is as we look forward we do expect that picture to gradually evolve. I mean I don't expect frankly a particularly robust or strong mortgage market next year. But I think in the years thereafter we would expect it to return to normal levels and change customer behaviour and change pricing alongside of it.

Rohith Chandra-Rajan
Okay and thank you very much for that.

William Chalmers
Thanks Rohith.

Question 2 – Raul Sinha, JP Morgan
Hi William, thanks very much, just maybe a couple of questions. Obviously you have got the best track record of forecasting what is going on with the margin so I was hoping you could help us a little bit more in terms of some of the trends. The first one, just broadly I was wondering if you might be able to talk a little bit about the seasonality within the deposit flows and pass through during the year. Whether we should think about perhaps more pressure or pass through if you will around Q4, Q1 type periods, just given the seasonality within the deposit base and some of the flows that you see on an annual basis relative to the other quarters.

And then secondly I guess maybe partly related to that, I was just wondering, you have talked about the profile of your hedge maturities the 40 billion and I think you also talked about how they are obviously back-end loaded. They tend to be back-end loaded at Lloyds and I guess that is the same expectation for 2024 which would then imply that in the earlier part of the year, obviously because you have got less maturities, there might be a little bit more pressure on the NIM starting at the start of that year. So, I was just wondering if you could comment on those two things together please. Thank you.

William Chalmers
Yeah thanks Raul, both obviously important questions. On the first one, you know flattery will get you nowhere but I will do my best to answer the question. The overall view on seasonality, yes there is a touch of seasonality in our numbers always and you will see that. At the same time I am always hesitant to read too much into any given profile, any given point in time. So for example, within any given season including within any given quarter you will get aberrations, ups and downs quite sharply potentially within that quarter that might overwhelm any seasonal impact. And so, what I mean by that is over the course of the summer for example people spend a lot of money and then tend to restock during late summer, early autumn period. On the other hand what we saw this time is that actually NS&I came into market in that late summer, early autumn period, August, September I mean. And that completely overwhelmed the restocking effect that you might expect to see. So you will see seasonality, that will impact if you like going into the Q4 period and the early parts of Q1 of next year. I would expect money to be drawn down during the Christmas period for want of a better word, then to be gradually restocked in the periods in the months thereafter. But look out for other noise that is going on there. Other competitors for example, also the ISA season starts early part of next year typically which has a draw down effect.

And so and then the final point which I have made, beyond seasonality, beyond competitor actions, Raul is, it sounds a bit crude, but any given day on the calendar month in which a period ends is important in terms of determining the outcome of deposit flows during that period. And so if you end the month on a payday you would end up with high balances verses if you end the month on a day in which payments are going out. And that too affects any given quarterly outcome. So I think Raul yes the seasonality, your point is right but look out for the other noise that affects that and potentially overwhelms the seasonal effects during that time.

On the second question Raul, structural hedge, you are right it is backend loaded. It's not a huge skew, but it is certainly back end loaded if you look at it over the course of the year. It is not evenly distributed over the twelve months. And that does have an effect on the NIM averaging that you would expect to see over the course of the year. And we will be more precise on this when we come to the end of Q4 results in February of next year. But you know I would expect as we discussed on Wednesday last week to see a Q4 margin that comes down a touch, as said just over three hundred basis points that is are expectation. That then feeds into the first half of next year, driven in part by continued deposit migration, driven in part by mortgage headwinds. The hedge certainly plays a role in the first half but it plays a stronger role in the second half, both because of the maturities and because you get the full in year effect, for want of a better word, as you progress through.

And final point, when you put that together Raul, think about the averaging effect of that on the margin during the year. You know you are starting off with just over three hundred which is our exit margin for Q4. Without giving guidance at this point, you may end up there or thereabouts but think about the overall averaging effect, from what goes on in between, on your overall margin.

Raul Sinha
Got it, but I guess if you layer in on top of that, the mortgage churn affect as well which I think starts off perhaps at a slightly higher pace or slightly more negative rate and sort of depreciates through the year, then that would have another sort of amplification effect on the negative side at the start of the year. Is that a fair read?

William Chalmers
Yes, I mean actually it's interesting. The mortgage headwinds, they are on a trajectory that is travelling downwards from pretty much here until you know 25, 26 and by the time you are into 25 this thing has largely played itself out. That is you know middle of 25 for example those things have basically played itself out and you are replacing mortgages with new spreads that are not dissimilar from the spreads and the mortgages that you are replacing if you like. That roll off is pretty similar on a spread basis. So that journey is underway at the moment, it travels in basically the same direction if you look at it from here to mid 25. But there are particular months in between, because of the way in which mortgages are processed as spreads at the point of the offer if you like two year mortgages written two years ago, 18 months ago whatever it might be. So you get lumpiness during the year in the year in short Raul. So it is not a smooth line, you will get quarters where it is a bit stronger, quarters where it is a bit weaker. But the overall shape is downwards from here through to about mid-25.

Raul Sinha
Thank you, thanks very much William.

Question 3 – Alvaro Serrano, Morgan Stanley
Hi William. A couple of questions from me. One on the structural hedge. I think you've quoted in previous quarters a buffer you have got over the size of the structural hedge. Maybe you quoted it this time as well, but I don't have a number and maybe you can speak to that. And related to that the structural hedge at the moment, I know you hedge some instant access accounts, obviously we can see how the current accounts are coming down, but you also hedge some instant access accounts. So could you maybe explain which ones are eligible for the hedge and which ones aren't. Given all the movements we have seen this year is that changing at all? So obviously I am trying to sort of model what the size of the structural hedge might be, but maybe the underlying trends there.

And second, kind of a follow up from the previous question. It sounds like when you talk about the first half, second half dynamics next year you do sound more cautious calling for ongoing margin pressure which is not the case for some of your competitors, which as Raul has said, have less of a track record. But I was just wondering if you think you have more for example margin pressure in mortgages than peers or something that might explain that or just a more cautious view generally? Thanks.

William Chalmers
Yeah, thanks Alvaro for those questions. First of all hedge buffer. The hedge buffer we didn't really disclose at Q3 for no particular reason other than the buffer is a little bit less than we historically managed at. The way in which we are managing the hedge right now is a combination of the buffer plus the maturities over the next three months for the hedge. So you know any maturities coming up in the next three months effectively forms the same purpose or rather serves the same purpose as a buffer. So I won't put a precise number on it, but right now we are looking at the buffer of around sort of five-ish billion or thereabouts on an average basis. Plus we are looking at maturities over the next three months, the addition of those two is around 15 billion. That is the type of risk metric that we are managing to and that is the type of risk metric that guarantees if you like that we don't have to break any hedges in the context of the structural hedge. In fact you know it does more than that to be perfectly honest Alvaro, it gives us way more liquidity than we have either seen or expect to see in any historical period. So it is that combination, that hopefully addresses your question Alvaro, and as I say from our perspective we look at those two together.

To the hedge, I mean the simplest way to think about this is that we are able to hedge the instant access accounts and limited withdrawal accounts, but not the fixed term accounts which obviously have a customer facing swap against them. And instant access and limited withdrawal are hedged, they are hedged subject to the interest pass on decisions that we make and assumptions that we have given you in the past. But you know subject to those interest pass-ons, those accounts are hedge-able, they are hedge eligible for want of a better word.

Your third question around margin pressure Alvaro. I don't think that we would expect to see any different pressures, or churn migration from the deposit side. I think if anything we perhaps have a slightly more broadly spread deposit base than perhaps some of our competitors. I don't know that, but that is my supposition and therefore I wouldn't expect to see any difference there really. I think that we have typically done better on the structural hedge because of the way in which we manage it. It's you know, frankly, it is not that different to a caterpillar hedge but at the margin we manage it a shade more actively than others and that delivers for us perhaps better returns over the course of the cycle. But we are as you know committed on the hedge right now. We have got a two hundred and fifty one billion investment within the hedge which in turn is committed and so in that sense at least, we have it fully invested.

The third point on mortgages, I think we have a mortgage book which is probably bigger and is probably subject to pressures that reflect that over the course of this year. Therefore I think there probably is a sense in which our mortgage headwind maybe a notch higher than others. It's nothing really different to what we told you in the past, you know we have got a fixed rate book of about two hundred and forty-five billion out of our three hundred billion or so mortgage book. We expect about sixty-five billion of that to roll off in the next twelve months. As you know and as further comments to response to Raul's question earlier on, we are refinancing right now about one hundred and seventy five going to fifty basis points. We expect that to be largely eliminated by the time we get halfway through 2025. It is not linear, but that is the type of headwinds that we are facing in respect of mortgages and I wouldn't be surprised if that's a touch more than others are necessarily because of the shape of their mortgage books Alvaro.

By the way I mentioned the hedge size of two hundred and fifty one billion, as of Q3. Two hundred and fifty five billion as of Q2, as said I wouldn't be surprised if we take that down a touch more during the course of Q4 as indicated. That will be consistent with our guidance for a modest decrease in the hedge. So hopefully that fills you in on the question.

Alvaro Serrano
Yeah, thank you very much William.

William Chalmers
Thanks Alvaro.

Question 4 – Aman Rakkar, Barclays Capital
Hi William, I had a question on the hedge please. I just want to check something. So when you guys give your hedge tailwind year on year, the pick up in the NII contribution from the hedge each year. It seems to be around forty billion or so of maturities that you have, and the repricing tailwind in terms of gross yield, the pickup on the gross yield. I guess I just wanted to check that because the related question I had was around the extent to which we should or shouldn't even care about how much of the hedge you actually roll over. So how much of the actual 40 billion you roll over? Because my understanding is that the structural hedge is actually just the source of deeply negative carry for you. You know your deposit base should be earnings Sonia, it is not earning Sonia it is earning a fixed rate. So you know you can kind of think about the hedge as just being a deeply negative NIM, and you know the expiry of the deeply negative number is actually just in and of itself, a tailwind right. It doesn't actually matter the 40 billion, if you only chose to reinvest 20, in some ways it actually doesn't even matter. So I just wanted to double check my understanding there and you know if you could just clarify on what basis you know I think you talked about eight hundred million pounds of income pickup in 2023 and I am not sure if you are guiding for a bit more in 2024 year on year. But on what basis have you constructed that guidance please?

William Chalmers
Important questions Aman. There are a couple of different ways of looking at the hedge. You know the hedge is either something that is growing at about eight hundred million this year, probably a similar number next year. You can look at it that way or you can look at it as you say as the elimination of a large negative. And so if you look at it right now, you know as said earlier on we are earning I said 1.36 percent in Q3, but for the sake of argument call it one and a half percent on two hundred and fifty billion. If instead you are earning you know more like four and a half percent on that two hundred and fifty billion. Then the difference is a 3 percent rate on two hundred and fifty billion roughly speaking. So you know 3% on two hundred and fifty billion is somewhere in the order of eight billion or thereabouts. That is the type of I suppose negative margin that we are earning on the hedge right now, that will gradually works its way out over time. Now of course we won't earn that eight billion because some of those deposits are going to move and they are going to move from PCAs into savings and within savings from instant access and into fixed term. But you know status quo, if you were to earn it all based upon basically prevailing rates you will be earning an additional eight billion based upon where you are today. And as said it is the elimination of that that takes place over the next, well the average weighted life was three and a half years, our total life therefore is about seven, so it is the elimination of that eight billion over the course of seven years that is going on right now. One other way of looking at that as a data point Aman, which is maybe helpful, is that as you know we show the half year and at full

year the customer deposit margin. That customer deposit margin I think at the half year we show is around 1.3, 1.35 per cent thereabouts. That deposit margin evolves as the structural hedge evolves and you know it is another way of looking at it. So, as said, you can either look at the structural hedge as the building of an income stream or you can look at the hedge as gradually eliminating the negative earnings stream that we have right now because it is invested at lower yields. And either way you get to roughly the same answer Aman.

Aman Rakkar
Thanks, that's really helpful. I guess just to extend that point then I guess if you have got forty billion maturity next year, I know you won't be getting a full run rate benefit of that in full year 2024, you are getting half of that on average. But you will clearly be picking up some of the benefit of the hedge maturity from this year. So you should be getting the best part of forty billion of repricing tailwind right, just the expiry of this negative. And I guess you know you have got a three hundred basis points plus pickup on that right, just a deeply negative number coming less negative. It does point to a hedge tailwind which should be stronger than the eight hundred million kind of level, that you are alluding to. I don't know but it feels like there is something I am missing.

William Chalmers
I don't think there necessarily is, we talked about deposit mix, that is one factor. We talked about timing differences for hedge renewal over the course of the year. That is a further factor. The other factor that you don't have access to which obviously the team here does is the varying yields within the hedge book. So you are going to see yields that or rather hedge derivatives that are put on a different point in time that will have different yields attached to them. That in turn is going to impact any in year benefit from the unwind refinancing of the hedge. So there are three factors there Aman which will be influencing the hedge progress if you like. There is no doubt that over time it cumulatively builds in the way that you described. But as said within any given year you are going to get those three points of variance as an example.

Aman Rakkar, Barclays Capital
Thank you very much, really appreciate it.

William Chalmers
Thanks Aman

Question 5 – Chris Cant, Autonomous
Good afternoon, thanks for taking the questions William. I just wanted to ask on mortgages. So one of your domestic peers indicated a very sharp step down in their back book spread during the third quarter and as of the first half slides you gave us the deposit margin, you also gave us 1.32% gross margin on mortgages in the first half of 23. NatWest indicated 86 basis points out of the third quarter. So quite a lot lower. I just wondered if you could help us to understand how much of the gap there is there. As you indicated, you think there is probably a bit more mortgage pain to come in your case than to some pears. But that is a fairly stark gap on the face of it. So if you could help us understand where you are on that, that would be much appreciated I think and we can take a view on how quickly that trends down towards the fifty bits refinance level you have been talking about.

On the hedge piece a similar question to Aman really. Could you just help us understand the yield on the hedge positions that are maturing over the next couple of years. You talked about a one point two percent yield in the first half, one point three percent yield as of now. I think implicitly if it is just an 800 million tail wind year over year your sort of at or potentially slightly above that on the maturities as we look into 2024. If you could possibly help us there, that would be appreciated too. Thank you.

William Chalmers
Sure. I am going to answer your first question but I will probably leave you a bit short on your second Chris. So in terms of the overall mortgage book and the pricing there to give you some idea. The mortgage book yield in the third quarter was around 1.2 per cent, it is just a shade over actually but it is about 1.2 per cent. That's down from about 1.3 per cent in quarter two which I think is a number that you referred to. So it is coming off, you can see roughly the rate at which it is coming off in that way. And then as said we had a book that was maturing at about 1.7, just a shade over 1.75 percent in Q3. That clearly goes down over time and as said it is not linear, but none the less you are chipping away at it through the course of the next 18 months. That is how the book shapes up which hopefully gives you a good idea as to how to model the mortgage headwind. I remember back in February 2022 we said that we expected a mortgage headwind of maybe one to two billion or so. I think now based upon mortgage spread

developments that we have seen, the mortgage headwind that plays out over 22, 23, 24, it is over two billion because of the development within mortgage spreads and again hopefully that gives you a sense as to where things are at.

On the hedge I'm not going to give any further numbers beyond what we have already given in terms of the yield that we see roughly speaking, I've given you the yield for next year. As said, the hedge is not a totally even earnings stream, just like it isn't in the mortgage space. And as said we will give you guidance every year as to what we expect the overall hedge tailwind to be for sure. And that in combination with the yields is what we'll do. But I don't think Chris, we're ever going to split the hedge out in terms of the particular month and the particular maturities and what rate they are maturing at.

Chris Cant
Okay thank you

Question 6 – Andrew Coombs, Citi
Good afternoon. Just to follow up quickly on Chris's point for clarification. The one point two you quote down from one point three includes the SVR as I recall. You provide it based on the whole book whereas I think the numbers in Nat West gives us is ex SVR. Is that right for yourself?

William Chalmers
Yes Andrew I think that's right.

Andrew Coombs
Yeah okay and then I wanted to ask about front book spreads. We had this debate a couple of quarters ago but you're guiding to fifty basis points, it looks like some of your peers are actually writing business even lower than that. And one of the things I wanted to just ask about is the whole debate around refi vs new business. I know that with a lot of the refi offers that go out you can potentially fix your rate up to six months before the actual maturity takes place. And so in an environment where you have got rising rates and the swap curve going up. Presumably that is detrimental for those refi rates relative to the new business rates. And so now we probably reach a point of you know table mountain style peak rates, would you expect the gap between refi and new business rates to converge?

William Chalmers
Yeah thanks Andrew. In relation to our mortgage spreads, as said last week we are issuing mortgage products that are both above and below that 50 basis points, it is perhaps just worth highlighting. So what I mean by that is that where we know the customer, where it's a long-term relationship that we have had with them and their retention comes up, we will often write business, product transfer we call it, that is below that 50 basis points completion margin. And we are happy to do it because we think we know the cost of risk, because we know the customer will often be in a much broader relationship with us beyond the mortgage. And so all of those things taken into account will lead us to a determination as to what price we are happy writing business at and that might well be below 50 basis points Andrew. So that is worth mentioning. It is the case that even below 50 basis points we are still making a decent economic return, you know to be clear there is a point to which that exhausts itself so we are not going to go down to you know such low levels. But none the less we are tolerant of going a little below 50 basis points where it makes sense and we can still earn a decent economic return on that product. The 50 basis points therefore is also a function of us writing higher return business from primarily new business in addition to that. And you know as said last week that is relatively thin volumes because of the nature of the mortgage market that we are in right now. I hope that over time that will change, I will expect it to as the mortgage market and the housing market start to reflate a little bit.

So with your refinancing point, it's an interesting point. Whenever we basically give offers on mortgages we are pre-hedging that position so we are not going out into the market with a fixed rate exposure against which we are not hedged. Now that has not always been perfect, so for example if you wind the clock back to 2022 when we had the mini budget for example, we felt an obligation to stay out there in the market with offers as the UK's largest mortgage provider. That, because of the volatility that we saw in swap rates, ended up with us writing a bunch of pretty low margin products. That is a function of what we saw as you know frankly our job, as our responsibility. We would not make a habit out of that, as a general matter as a business practice we are pre-hedged on any exposures that we have out there and mortgage offers that are things like fixed rate exposures that can be refinanced or changed if you like six months ahead.

Andrew Coombs
That's very helpful, thank you. Perhaps just one follow-up. You talked about being slightly below 50 basis points on some of the products, including some of the product transfers, but it is still decent returns, still economically viable. At which point do you think it becomes uneconomic and non viable?

William Chalmers
Yeah we haven't put a number on that Andrew. And I think we would shy away from that, partly because we do look at it on a product standalone basis which is the answer that you are looking for and as said we don't disclose a number on it. We also look at it in terms of is there a protection relationship for example in the context of that product, and in some products that works and in some products it doesn't. So that will also change the economics. I am not giving you the full answer, I realise Andrew, but hopefully that gives you some insight.

Andrew Coombs
That's great, thank you.

Question 7 – Edward Firth, KBW
Thanks very much, afternoon William. I have two questions if I may. One is just giving your thoughts on Harriet Baldwin's comments yesterday around banking just doing enough in terms of pricing and consumer duty. And I guess I was thinking of some of the earlier questions about the structural hedge and we can do the maths, if you do the maths, ex the structural hedge you are making a sort of product margin of just short of 500 basis points, so once it was all priced through you would be making about a 30 per cent return on equity, something like that. And I guess the thinking is that as the hedge rolls, you then give the benefit back to the customers and net net you end up back where you are. But I just wonder whether there is a risk in the current political environment, with the election coming next year, potentially new party, what your thinking is about the risk of them stepping in and saying essentially your customers are paying for the hedge which you chose to put on, there is no need to have that. Perhaps next time we go into a zero rate environment we will perhaps be a little less anxious to get such big hedges on. But I suppose that is my first question which is the political side.

And secondly I have got a slightly left field question so I apologise for that, I know it is supposed to be a result call but I thought I would take the opportunity. I was in a tech conference recently and they were talking about the biggest risk in the tech sector as main frame computer systems. And obviously banks were mentioned a lot in terms of they are still heavily reliant on a number of their core system areas on mainframe computer systems. So I just wondered, internally it must be a huge project in terms of what you are going to do with that, how you are going to phase it out etc. So I suppose firstly do you have a set of plans to phase those out? And secondly is there a date by which you expect to have those all out and consigned to history as sent. And if that is the case is there kind of some big lump of costings that needs to go with that or do you think that's something that can be afforded within a sort of you know your 9 to 10 billion cost level over the next you know four or five years? So it is a slightly left field question I apologise but I thought I would take the opportunity.

William Chalmers
First question I am not going to comment on what politicians are saying, treasury select committees and the like, safe to say there is a lot of things said in treasury select committees that you know may or may not approximate the truth and reality and all the rest of it. So that is for you to decide, not for me to comment on.

I think your comment around what type of ROEs that we'll be looking at going forward, again I'll leave you to do the analysis on that and come up with your conclusions. But I think it is safe to say that any politician and regulator around them you know that eco system if you like is going to look at, through the cycle returns for the banking sector. It is very likely that the pricing for products evolves over time just as the structural hedge matures as we have said a number of times. I think it is also the case that any regulatory political ecosystem wants a stable, profitable banking sector. And if you doubt that I would again ask the politicians or regulators whether they think that's a reasonable ambition or not. And then again I will leave you to do the analysis about what that implies.

Ed in terms of the main frame question, it is an interesting one. The technology renewal programme is very much part of our strategic transformation. So if you look at our transformation as articulated in February 2022 we talked about the business units, we talked about retail and we talked about commercial and we talked about insurance pensions and investments. And those are product propositions, those are delivery mechanisms and kind of digitalisation and advancements of that type. But underneath it we also talked about data, technology and people.

And so in support of the customer proposition and indeed the operational resilience of the bank, we are making huge investments in technology. That's within the four billion that we put forward over the 22 to 26 period. It's within the three billion that we put forward over the 22 to 24 period. So that is all part of the plan. You may have noticed we have actually recently hired over the course of the last year or so a chap called Ron van Kemenade from ING who is responsible for the transformation of ING. And has frankly a fantastic track record in terms of getting this done. So I am not going to give you timetables as such on it, other than to say we are in pretty good hands, it is very much part of the plan and it is costed and budgeted in the investment profile that we have given you.

Edward Firth
So William just to come back to this quickly if I may on the two points. So broadly speaking, I am not going to hold you to it or anything, is the idea that in four years time main frame systems will be gone from Lloyds?

William Chalmers
Well we have a bunch of systems within Lloyds so you know there are various systems being if you like optimised and modernised and decommissioned likewise at various different paces. So I won't go into detail on that, any further than that. But as I say there is a technology renewal programme that is ongoing, that we are all contributing to, that has a modernisation, decommissioning plan associated with it. And as said that is very much part of the transformation you are seeing.

Edward Firth
Great, so and then just back on the hedge question. I suppose telling the question in another way. The whole sector and this is not peculiar to Lloyds and I guess you weren't even responsible so I'm not holding you responsible William. But the whole sector wrote these huge hedges when interest rates were at zero percent. And I remember at the time there was extensive discussion about whether this was really a very sensible thing to do or not. And I guess with the benefit of hindsight it clearly wasn't a sensible thing to do. So I am just wondering internally from the sort of management perspective are you reflecting on that and thinking about perhaps if we go into another ultra-low interest rates environment, would you expect the sort of learnings from that perhaps that writing huge hedges at very low rates just to save you know ten million quid on a quarter perhaps wasn't the best thing for sector returns through the cycle?

William Chalmers
Ed I think you misunderstand why we employ the structural hedge. We employ the structural hedge because we want to deliver earnings predictability, capital generation predictability and distributions to our shareholders in a predictable fashion. That is why we employ the structural hedge. And that indeed is what it delivers. Alongside of that during a long period of time the structural hedge has delivered significant values to shareholders. It is also a mechanism that the regulators take some comfort from because it produces predictable earnings and therefore gives us benefits in terms of the amount of capital we have to hold against the business. So I think you know in each of those fronts what are we trying to do with the structural hedge, it is about predictability. What are we delivering? It is about value and how does the regulator think about it? It is a good thing and it benefits our capital structure. So I would just step back and think again about how you look at the structural hedge.

Edward Firth
Okay, thanks very much.

William Chalmers
Thanks Ed.

Question 8 – Robin Down, HSBC
Good afternoon, you will be pleased to hear I'm not going to ask about the hedge. I have a quick question around TFSME, whether you can update on some of your thinking about repaying that, you have got the biggest balance outstanding out there. I know it is not due for maturity kind of in the next twelve months but I think you have hinted in the past, you might look to repay early so perhaps we could have an update on your plans, that would be great?

William Chalmers
Sure Rob, and by the way I don't want to discourage anybody from asking about the structural hedge as it is an entirely legitimate set of questions.

Robin Down
It is all to do within the interest rate risk of the banking book isn't it?

William Chalmers
That is one way of looking at it for sure, hence the regulatory points.

The TFSME Rob, the TFSME that we have on the balance sheet right now is 30 billion total as you may know. We have got maturities of about 21 billion in 25 and about 9 billion in 27 I think it is. That is something that we are approaching with 25 in mind. So at the moment at least we have done probably around 15 billion of funding overall for 23. That is mainly to satisfy 23 needs, a little bit of an insurance for 24. And then as we go into 24 I expect we will pick up in terms of our overall funding. And a lot of that Rob will be to effectively de-risk the 25 profile. I guess we are fortunate to say that so far at least the funding that we have done for 15 billion in 23 year today has all been inside of our expectations for where we thought that we would get that funding done which is something that our group treasurer constantly reminds me of as you can imagine. But nonetheless it is done so far at least at prices in turn that are better than we had expected. I very much hope that continues to be the case in 24, but as said we are going to start to prefund some of those TFSME maturities in 24 in order to effectively de-risk 25.

Robin Down
Is that why, you used to always warn about the costs of wholesale funding and that seems to have kind of disappeared from commentary recently. Is that because the pricing has improved relatively?

William Chalmers
No not entirely Rob. The pricing is better than we had expected. I'd like to say it was that much better but it isn't. The funding costs, the increased funding costs from wholesale, we haven't put a number on it but they are growing in year to date verses 22. It is my expectation that they also grow 24 verses 23. And that is a function of us effectively refinancing wholesale maturities at higher rates. Again we haven't put a number on it but if you think about a number this year for example between one to two hundred you are not going to be a million miles away in terms of the increased wholesale funding costs from issuance at higher prices versus where that funding was originally done Rob. So hopefully that gives you some idea, again better spreads certainly help but they don't totally offset the higher funding costs off the back of the wholesale markets.

Robin Down
Great, brilliant, thank you.

Question 9 – Jonathan Pierce, Numis
Hi William. Two quick ones if that's okay. The first on CRDIV and risk weighted assets. You, I think, can't remember the exact phrase you use last week, I think you said you were still hoping to be within 220 to the 225 RWA guidance next year which sounded a little more pessimistic perhaps than we heard before. I just wanted to get a, maybe a firmer commitment to being in that range even if it's the very top end of the range and how confident you are on that.

The second one on one of these calls I think maybe a couple of quarters ago, you suggested I think that the intangible assets would probably peak at the end of this year. So I guess into next year maybe the P&L amortisation chart starts overtaking what you are capitalising on the balance sheets, which is obviously important from a capital generation perspective. Can you confirm that, is that roughly where we are getting to now on the intangible, a peak going into early next year? Thanks.

William Chalmers
Yeah thanks Jonathan. On the RWAs for next year, 220 to 225 is very much our ambition for end of 24. So you know that is very much what we are aiming for and I would be very hopeful that we can deliver. What are the uncertainties around that Jonathan? The uncertainties are we obviously have a discussion with the PRA which we still need to get to the end of. Having said that we do have a place marker for CRDIV in that number of 220 to 225. So I would hope that you know absent, something unexpected which I can't rule out, but absent something unexpected we are still aiming for the 220 to 225. So finalising that PRA discussion is one exposure. We also have you know a set of macro economic assumptions which roll forward in the way that you are familiar with. We set out last week. If for whatever reason those are materially more adverse. That will obviously change some of the picture in terms of things like credit calibrations for RWAs for example. Likewise if let's say mortgage markets for the sake of argument and other asset markets expand greatly beyond what we expect. That's a lending risk to RWAs. But I think, I am just saying that really

Jonathan, just to highlight kind of where the exposures are. The main point to take away from this comment is that 220 to 225 is the RWA ambition that we have and we expect to fulfil it.

Jonathan Pierce
Okay it's, sorry I was just going to say it was not because you have got more nervous about CRDIV as the year has gone on?

William Chalmers
I think the discussion with the PRA has definitely been maturing on CRDIV over the course of this year. And you know if I were to put a comment on it Jonathan I would say that the understanding of the PRA models around hybrid has improved during the course of the year, which probably means that we are going to get a touch more CRDIV impact than we have previously expected. So that is the way I would characterise it but again that does not change our expectation around the 220 to 225 RWA target. We may have to work a little harder in respect of some areas, for example optimisation we may lean more heavily on in certain areas. Only where it is NPV positive I hasten to add but where it is NPV positive, we may take a little more RWA off the balance sheet. And in that way that will help us to the 220 to 225 target. But the target remains out there.

Jonathan Pierce
Okay thank you then intangible build?

William Chalmers
Yeah the intangible build Jonathan, we are looking for intangibles to peak a little later than your comment there. So I think intangibles will build into 24. I don't want to be overly precise but if you have sort of midpoint to second half of 24 as the intangibles peaking and then coming off in the periods thereafter. I think that would be a kind of a rough estimate to put into your numbers.

Jonathan Pierce
Okay perfect. Thanks a lot William.

William Chalmers
Thanks Jonathan.

Question 10 – Alastair Ryan, Bank of America
Yeah thanks very much for taking the question. I'm pleased Harriet Baldwin is not running your hedge William. Just on mortgage pricing, you know the UK banks have kind of got previous in convincing themselves that any basis points is value added. We keep creeping down and the share price keeps creeping down. I think there is a relationship, you know it was 80, then at 70 and the it was 50, now it is a bit below 50. Just to give us a sense of what's the discipline at Lloyds. It feels like it is a slippy number this mortgage margin and the market is clearly uncomfortable with that, I mean structurally that is something the UK can't get away from, as the biggest mortgage bank I guess we are looking to how you act on that. Thank you.

William Chalmers
Thanks Al it's a fair question because we have seen spreads compress. If I think about when we presented in February 22, we expected a spread then of around, I think we said 75 to 100 basis points and we are now operating at 50 basis points. Again just bear in mind that product mix point that I made earlier on and you know hopefully that concluded to a slightly better outlook for spreads on an equilibrium basis. But also to answer your question more directly, mortgages are a core business for us. We do expect, you know to stay in there over not just the short and medium term but long-term. We will at times trade a little bit of share and value to make sure that our presence in the market is what we would like it to be. But having said that, 50 basis points has been a consistent delivery over the course of the last three quarters, and if I would put a number on what I would expect quarter four to be, again 50 basis points would be there or thereabouts for my expectation. So while I think your point is right over a longer time period we have been pretty sticky around the 50 basis points, and I expect us to exert a degree of discipline around those types of numbers as we look forward.

The other point Al which is very important to us for the function of our strategy launched last year, is that we are trying to build up customer relationships and there are some signs of success in that, we will report more fully on it next year and indeed at the end of 24. But we are building for example in protection in the mortgage product. We are building, there is a product right now which combines a joint kind of liability and mortgage asset type product. This type of holistic customer relationship with ancillary products which are, you know they obviously need to give value to the customer and indeed they do, but this type of ancillary product relationship allows us to offer value to the customers which is a function of our business model and indeed both gives value to the customers and enhances returns from our perspective. And that is very much embedded in the strategy as we look forward.

Alastair Ryan, Bank of America
Thanks very much William, thank you.

William Chalmers
I think we may be at time so I'll perhaps just say thanks very much indeed to everybody for joining, I very much appreciate the interest and the coverage as always. And we will look forward to continue dialogue over the course of the coming weeks and months. So thanks very much indeed everybody and have a good afternoon.

END

FORWARD LOOKING STATEMENTS

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