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

Tuesday 27 February 2024 – 4.30pm

LBG:
William Chalmers, Chief Financial Officer

William Chalmers
Thanks very much indeed, operator, and thank you to everybody for joining this afternoon. You have seen our financial results on Thursday, which we, I think rightly described as robust, and alongside of that our strong capital distributions. I probably don't need to make any further introduction really, but happy just to hand over to you all to ask whatever questions are helpful. So over to you. Thank you.

Question1: Rohith Chandra-Rajan, BANK OF AMERICA
Hi, good afternoon, and thank you very much, William. I just had a couple, please, on revenues. The first one is on NIM, where I think you have been very clear on your expectations on NIM drivers on the liability side of the balance sheet, but I wondered if you might be able to help a little bit more on mortgages to help us just put some of the guidance together. So, you mentioned some pull forward of NIM pressure from prepayments in Q4, but also lower volumes expected from deferred SVR refinancing, and also another £2.5 billion from the disposal in Q1.

So I wondered, putting all of those together, the volume impacts and the prepayment impact, do you expect the mortgage headwinds to NIM in Q1 to be smaller than Q4? I think that is what you are indicating, but I just wanted to check, and then the second one is on OOI. So, looking at the trends last year, it really stepped up in Q1 last year, and was relatively stable for the subsequent three quarters, and it is really only retail from a divisional perspective that is sort of showing continuous incremental growth. So, just wondering if you could build on Charlie's comments from last week to help us understand the growth drivers for OOI this year, please. Thanks.

William Chalmers
Thank you Rohith. Maybe just take each of those in turn. First of all, on the margin, I think you get the big picture, that is to say we ended Q4 at 298bps, we expect greater than 290bps as guidance for 2024. Within that, the Q4 performance was a couple of basis points lower than we had expected, and there were three main ingredients to that. One is PCA balances, which ended very strongly, but nonetheless were relatively weaker for much of the duration of the quarter until the latter part. Second, the impact of movement within commercial banking really around non-interest bearing current accounts and into term, in part, much of that was recaptured in term savings product, but of course that is lower margin.

And then the third one that you highlighted actually in your question, which is around mortgage impact. There we saw just a couple of behavioural traits really from volatile swap markets; so for example, people were slower to prepay on old fixed rate products, that was one. We give people an option to switch in and out of products with a six-month window; they can put down and mark off a product, they have then got six months to either take that up or alternatively not take it up and that option was a little bit more expensive than we had anticipated. And again, that is a hallmark of relatively more volatile swap rates than expected, which you saw in the fourth quarter, and as your comment alludes to, well, two points really, one is, these are kind of a basis point each or thereabouts, which do not forget, is about £10-11 million per basis point in the quarter so you are talking about really very small monetary amounts here. Albeit it makes, say a basis point of difference in the quarter, and we saw two or three similar things, PCAs, commercial banking and the mortgage impact.

Some of those, as your question alluded to, Rohith, we would not necessarily expect to be repeated, if we see swap stability let's say, in quarter one, some of those mortgage points will go away. But a couple of points really, one is, I do expect the mortgage headwind to still be there in Q1, and indeed throughout 2024, I will give you a couple of numbers on that in just a second, and two is, the types of changes as mentioned that we saw in Q4 that are not going to repeat in Q1, it is a basis point or thereabouts. So I would not get too hung up on it, I suppose.

Coming back to this mortgage headwind, just to give you a bit of context, which might be helpful. We have seen mortgage maturity margins, by which I mean the rate at which old mortgages are coming off to be refinanced by new mortgages, we have seen those at around 1.6% in 2023. That maturity margin comes down by around 50 odd basis points in 2024 so you can see the ebbing away of the headwind but as long as completion margins are below that, that is why we are expecting the mortgage refinancing headwind to still be there. As you know, completion margins are 60 basis points so even though the maturity margin is coming down at a reasonable clip, nonetheless completion margins remain below it and so you are going to see that mortgage refinancing headwind still be there. It will, to your point, slightly decline in the course of Q1 but again, just bear in mind the earlier comments that I made.

Then, Rohith, you asked about OOI. A number of dynamics really in OOI. So if I look at the four main components, we have had retail, we have had growth there from PCA, from cards, from transportation, from wealth. Alongside of that we have had commercial, so trading and financial markets, number one, capital markets number two. A stronger Q3 in particular than we saw in Q4, I will come back to that in just a second. Then IP&I I mentioned at Thursday's results session, that we were up 26 per cent over the year, and then in Central is a couple of different things, the equity business and also central funding items. So those are having a slightly different effect within the central line but my point is, Rohith, overall, you are seeing growth across all of the retail, commercial and IP&I businesses within other income. But I would say that you are also seeing seasonality and so in any given period you are going to see more or less from different components of that other operating income and that is perhaps partly what is behind your question.

Rohith Chandra-Rajan
Okay. Thank you, William.

Question 2: Ben Toms, RBC
Afternoon, William. Thank you for the session this afternoon. Two questions please, both on motor finance. So one of the things that I find most interesting about this topic is that some banks have concluded that there is too much uncertainty to take a provision whereas Lloyds has, albeit with different accountants, taken a view that it's more likely than not the admin costs, and redress will be incurred.

So, my first question is, as the largest motor finance provider in the UK, have you spoken with the regulator on the topic? And has the discussion informed your view on taking provision? I'm obviously not asking here about specifics on what was said, just did what was said impact the decision-making process when taking the provision? And secondly, which is more relevant to the data behind your assumptions, given how far back the review potentially goes, can you confirm that Lloyds has kept the relevant data all the way back to 2007, which you would need to feed into your modelling? Or have you only kept data back six years post the end of the motor financing arrangements? Which means that say, pre-2013, to calculate your provision, you've had to estimate both the population size and the amount of discretionary commission that was paid to the dealers. Thank you.

William Chalmers:
Thanks Ben. Couple of thoughts there. As you say, there is a lot of uncertainty. The regulator has set out the review standards looking for the extent of misconduct and customer loss, if any, and it appears to be the case that they're looking for both and it's unclear frankly, whether there is any misconduct and customer loss at stake here. As said on Thursday, we complied with relevant regulations at all the relevant times. When we look at the provisioning standards, I can't really comment upon what others have done, or how they got to their decision but when we look at the provisioning standards, there are two components that we focus on.

One, is an impact, let's say, probable. And number two, can we form a reasonable estimate around it? In terms of the provision itself, as you know, the provision has two components. One is the operational legal expense, and the other is the potential redress, and the £450m has both components in it. So, when we look at the probability test, we're not just applying it to potential redress, but we're also applying it to operational legal expenses and it seems in the context of the review, it is very likely, I would say near certain frankly, that we are going to be subject to administrative costs and so that's the basis on which we can come to a probable conclusion, whatever one thinks about the potential redress that comes out of this. The second component is a reasonable estimate, and I think that's where it gets much harder, frankly, Ben. So obviously, as I say, I can't comment on where others have gotten to, but I do note when I read what others have done, that it's the reasonable estimate point that some of them have felt is more subjective and I think that’s understandable.

When you look at our approach, we've taken an impact, part of the £450m, for operational legal expenses. Of course, the extent of those will depend upon how long the review goes on for, where does it go? And so forth. And then we've also taken a component of our provision for potential redress, which as we said on Thursday, is based upon a whole variety of scenarios which reflects the uncertainties that we're subject to. And so, the reasonable estimate, it is a reasonable estimate based upon a variety of different scenarios with different inputs in those scenarios and that may be a place where others have taken different views, I don't know. But certainly, from our perspective at least, we've compiled a range of scenarios, we've put those in alongside the operational legal expenses, and as we’ve said, based upon that, we think that we can get to a reasonable estimate based upon that aggregation, not based upon a point.

You asked then whether we've spoken to the regulator. We have spoken to the regulator, yes, and we stay in fairly close contact with them, and have done for a little while on this. But I wouldn't say that is necessarily any more than anybody else has done. I would be surprised, frankly, if any of the affected parties have had more or less conversations than us, I suspect that we've all had various different forms of engagement.

But I think it's also worth saying that in that context, that our judgment around the £450m provision is our judgment. It's not the regulator's judgment, it's not their view of what might come out of this, it is our judgment based upon, again, those two components of, expenses on the one hand, and redress on the other, premised upon the scenarios. So, while we've all stayed in touch with the regulator, the determination to, A, take the provision, and B, the quantum of that provision, is entirely our own judgment based upon the same set of facts that I suspect is available to everybody out there. You asked about Lloyds' data, I shan't comment on that. Safe to say that we would expect to do whatever the compliance and legal regulations require us to do in respect of customer data, and adherence to that is obviously part of our Group policies.

Ben Toms
Thank you very much.

Question 3: Aman Rakkar, BARCLAYS
Just two questions please. One is on structural hedge, I just wanted to clarify a point please, so you talk about slide 18, £700 million higher hedge earnings in 2024 on 2023. Now, you've obviously also told us that you expect a modest reduction in the notional year-on-year. So, I think you're referring to the kind of interest income pick up on the £32 billion. Well, sorry, £32 billion, is obviously my assumption that we see a similar £8 billion runoff in the notional in 2024 as you saw in 2023.

But can I just clarify that £700 million, it does relate to the reinvestment purely on that £32 billion? And I guess relatedly, how should we think about the other £8 billion in this example that doesn't get reinvested into structural hedge income? Because I think there is a decent net interest income pick up associated with that £8 billion. I think you'll probably report that somewhere else as deposit income. But I think it is a chunky amount of net interest income associated to the expiry of those £8 billion of hedge swaps.

And then the second question was actually just a re-run of a question I threw at you at Q3, and you very kindly entertained me. Could I get any indication on your term deposit evolution in Q4? You gave us a split of the retail savings component that is term at Q3, could you give us that and perhaps maybe even more? I'll take whatever I can get, but I'd be keen to hear about your term deposit migration in Q4.

William Chalmers
Sure, that's fine. On the first question, the hedge earnings during the course of 2023 were around £3.4 billion. That was up about £800 million I think year-on-year and looking forward in '24, we expect that £3.4 to go up again by £700 million. So, you're looking at a number just north of £4 billion, obviously in that context. Now, where that is coming from is effectively the reinvestment of the hedge as we see it over the course of the year, plus any pre-hedges that we have put on from previous years becoming live at that point.

So that's really the combination that is going towards that £700 million increase. That is net of the reduction in hedge earnings that we see from that, you described as £8 billion, we described it as a modest reduction. Whatever that number is, that is net of the reduction in hedge earnings from that number coming out of the hedge. So hopefully that answers the first part of the question, but you also asked about what happens to that £8 billion, and is there any earnings that might accrue from that £8 billion? And I think the answer there is it depends on where it goes. And so we're making an assumption, that we continue to see a degree of deposit churn over the course of the year. Most of that deposit churn, if history is anything to go by, is going to go into our fixed term deposit, some of it'll go into our limited withdrawal products and we will earn a margin clearly on those. Fixed term will not be hedge eligible, limited withdrawal typically is, but at much lower percentages than clearly PCAs or any other instant access accounts and so are we still going to earn any money from that £8 billion that comes out of the structural hedge? It depends upon where it ends up and indeed some of it clearly will leave the organisation, so you might expect reasonably to earn something of a margin from some part of that, you called it £8 billion, in our terms, a modest reduction of the hedge that occurs and the extent of that margin will depend upon where it goes.

You asked about term deposit evolution over the course of the quarter, I can't quite remember exactly what data we gave out at quarter three, but just to give you some assistance in that. I think we said that the term deposits were around 20 to 25 per cent range of our retail savings, which is more or less about right, still today that range holds.

To give you some further colour on it, I think we've seen about a £3 or £4 billion increase in fixed term deposits over the course of quarter four, £3 or £4 billion increase as you know on our circa £200 billion or thereabouts of savings is by extension about a point and a half to a couple of percentage points of our retail savings base, which is why if we were in 20 to 25 per cent in Q3, we're still in 20 to 25 per cent today. We're just a nudge higher the upper end of that range.

Aman Rakkar
Thank you so much. Can I just ask a quick follow up then? So the modest reduction in the hedge notional from here, is it right, based on your comments, this is primarily motivated by your expectations of deposit churn from this point forward rather than banking the experience up until the 31st of December '23? Because I think you would be able to have a bit more certainty that this would be a decent income pickup if this was deposit behaviour experienced already rather than deposit experience to come, right?

William Chalmers
A couple of points maybe on that. One is, yes, is the short answer to your question. We ended up with £247 billion of invested hedge balances as you know, that £247 billion is after the 8 billion reduction that we saw in the course of 2023. When we then talk about the modest reduction in 2024, that's going to be a new number from the £247 billion as of the year-end. The income impact of that though, which is the second point, to the extent that we see that being put back into either limited withdrawal, or fixed term, or any other offering that we may have, and to the extent that we see that leaving the organisation, we are making assumptions on that and those assumptions in turn are built into our greater than 290 NIM guidance for the course of the year. So, I wouldn't describe that as incremental extra that will come on top of anything that we've described to you. It's embedded within our guidance.

Aman Rakkar
Thank you so much. Really appreciate that.

Question 4: Chris Cant, AUTONOMOUS
Afternoon, William. Thanks for taking my questions. I just wanted to ask about your deposit margin that you give us in the slides. I was spending a bit of time wrestling with slide 14 and slide 17, essentially your NIM bridge and then the half-half splits you give us for the gross deposit margin as you call it. I guess what I'm trying to get at is understanding where that gross deposit margin is as of the fourth quarter, I think it must be around about 1.2 per cent, maybe a fraction lower than that based on the fact that your NIM bridge for Q3 to Q4 is a slight net negative between the base rate deposit and hedge bars in your NIM bridge, and I think that's essentially what you're capturing within your gross deposit margin. But I was trying to piece this together versus where you got to in the first half and I really can't reconcile that with the NIM bridge, so perhaps I'm misunderstanding the dynamics there.

I guess coming back to some of the stuff that Charlie was talking about on the call, in terms of the situation he inherited and the improvements that he's expecting over his tenure, low yielding structural hedge was one of the things that I guess you're waiting to improve and that's embedded within that number. So, just keen to understand where that gross deposit margin was. The other thing I just wanted to ask as well, it's sort of related to the prior question on the deposit mix. We can see in the 20F that you have notice and fixed term accounts combined equivalent to 21 per cent of your book, above the 16 per cent one of your peers gives in its slides. I just wanted to try to square the circle here in terms of some of the commentary you're giving around the retail mix.

I think perhaps it's a definitional point on what you class as notice, and I know you've talked about limited withdrawal. I guess the question becomes, NatWest tells us 16 per cent in notice and fixed term, is the number for you 21 per cent in notice and fixed term, which is what the 20F is telling us, or is that definition a bit distorted by the classification of some of these limited withdrawal products? Thank you.

William Chalmers
First of all, on the Q4 deposit margin, Chris, the first of your two questions, you're not far off in short. It's worth just highlighting a couple of points really, one is we saw in Q3 in particular, quite a bit of churn and I highlighted on Thursday that actually, we saw that slow down a fair bit in Q4 and so that's why you get that shape that you can see on page 17 that you're referring to in terms of the margin. There was attrition in the deposit margin in the course of Q4, but it was a lot less than the attrition that we saw in the course of Q3, primarily for those churn related reasons. And so, I shan't quote on the exact number, Chris, because we haven't disclosed it, but the number that you are suggesting is not far off where we would get to.

The 20F disclosures, notice and fixed term combined book, it may well be definitional around some of the product definitions. I mean, the best way to look at it is just going back to the comments that I gave to Aman in the earlier question, which is to say we saw about £3 to £4 billion pickup of fixed term deposits over the course of quarter four. Those in turn led to around a 1.5 - 2 per cent increase, and we started out before that at a range of 20 to 25 per cent at Q3. We started out at the bottom of that range in Q3, we ended up around about in the middle of it in Q4. That is as a proportion of retail savings to be clear, Chris, so hopefully that answers your question and to the extent that there are particular 20F disclosures that need more conversation, it may be worth just hooking up with Douglas and the team.

Chris Cant
Thank you. Yeah, I'll circle back around on that. I mean, that particular disclosure for NatWest gets quite a lot of attention, so just keen to understand if there is a difference or whether those are comparable statistics.

William Chalmers
As I say, I can't comment on NatWest because I'm not familiar with their disclosures obviously, but if you take for us that the fixed term book is around about middle of the range of 20 to 25 per cent of retail savings, you're going to be pretty close and I can't really comment on how that compares to NatWest for obvious reasons.

Chris Cant
Got it. Thank you.

Question 5: Ed Firth, KBW
Good afternoon, everybody. I had two questions if I may. The first one was on motor finance. Just going back to the £450 million, I think you mentioned in either the Q&A or in the presentation that one of the big variables was whether you had to redress people the total commission paid or a reasonable commission paid, and you said that could change the charge by up to 50 per cent. So in the £450 million, what have you assumed there? I guess is the first question, in terms of that redress element. And then related to that, could I just check my understanding, how does it work if the FCA come up with something which, was say, a reasonable redress, but the Ombudsman, certainly in the two cases that were highlighted, gave a total redress of the commission. If the FCA come up with one, can in theory complainants continue to go to the Ombudsman or does the FCA now supersede the Ombudsman? I just would be grateful for your understanding of that. That's my first set of questions.

And then the second question was back to the margin, and firstly just thank you very much for continuing to persist with the margin because to me, it's a pretty important number in banking and it's pretty extraordinary that half your peers don't seem to be able to talk to it anymore. So firstly, thank you very much for that. The second question I had though relates to the margin, really just looking at longer term, because I think one of the problems the market as a whole has is quite a lot of volatility short term around the margin and how obviously some of the quarterly numbers can change relative to what some of the longer term trends might be. So, I'm just trying to think how should we think about the margin in terms of a sustainable level going forward over 3, 4, 5 years? Because it seems to me a lot of the short-term volatility is starting to weigh over the course of this year.

And you could get very optimistic and say, well, you're getting 15 to 20 basis points on the hedge for the next seven years, that gets margin to over 400 basis points, and this is amazing, but that sort of feels like quite an unrealistic scenario, I don't know, but maybe you think that is realistic. So, you talk about, for example, through the cycle impairments, I think at around 30 basis points, have you got a sense as to what we should think about what you as a management team think is a through-the-cycle margin; once we get through the short-term volatility, what is the sort of margin that equates to that 30 basis points? If we can just get some idea of that would be very helpful. Thanks.

William Chalmers
Thanks, Ed. Just to start off on motor then. The question that you asked was around the relationship between the provision and the commission structure that might be adopted in the context of the review. Maybe I will just take a step back for a moment and explain the basis of the £450 million provision and in particular the basis of the redress component of the £450 million provision. The redress component of the provision is built upon a variety of scenarios, and those scenarios basically flex different levers or different inputs to a given scenario. So, some of them go right the way back 2007, some of them go back to 2014. Some of them have a zero-commission model associated with them. Some of them have a reasonable commission model associated with them. Some of them are adopting a proactive remediation approach. Some of them are adopting a reactive remediation approach. Some of them have high uphold rates, some of them have low uphold rates and so forth.

Those levers are pulled in different ways to describe different scenarios and so we take a bunch of scenarios, I won't tell you how many because it isn't important almost, and we put all of those together and we say, well, based upon that, based on obviously arithmetic and also looking at what numbers look like and so forth, we come out with the redress component of the £450 million provision. So, in answer to your question, Ed, there is no single approach within the £450 million provision or within the redress component of the provision as to the zero versus reasonable commission rate. There are a range of, again, permutations for that zero versus reasonable decision in a range of different scenarios. And we take a look at all of those, put them all together and come up with the £450 million in total.

Ed Firth
So it's a composite of the scenarios?

William Chalmers
That's it. Exactly. It's a composite. Yeah, I mean you might describe it as a weighted average. It is a weighted average, but it is also with the benefit of judgment, in that overall weighting, it would be remiss of me to suggest that it wasn't. So, that's the way in which that is looked at, now, the way the levers that we are pulling, or rather the variables that we are adopting to come up with that £450 million provision are paying particular attention to what we think are the most sensitive inputs to that provision. The most sensitive inputs as we discussed on Thursday are this zero versus reasonable commission point, the proactive versus reactive remediation and to an extent at least, the uphold rates that one might see and so forth. Some of them are very sensitive and I mentioned on Thursday that the zero versus reasonable rate, for example, has the potential to cut a provision in half or in fact more than half, but take that as a guideline.

So, what we're trying to do really, Ed, is to highlight that the redress component of the £450 million provision is established from a bunch of different scenarios with different levers going different ways, number one. Number two, to give you some insight as to the particular points of sensitivity in coming up with that estimate. You asked then about what happens if the FCA decides differently to the Ombudsman. One point by way of background, which I mentioned on Thursday, but it might be worth highlighting, is at the moment we've received one false judgment.

We have also been party to a series of county court cases, the majority of which have decided in our favour and the reason for mentioning that is because therefore the evidence base is a) limited, and b) quite mixed. So, it is quite possible that the FCA come out in a different place to the Ombudsman, county courts have done, so there must be an argument at least that the FCA may take a different view. I don't know, it's a perspective if you like, but there are clearly differences of opinion in this area. One of the outcomes here is that the FCA decides that it wants this review to come out with a certain shape to it, that's the end of it, we all look at that and we all work with the FCA to implement an orderly redress regime, if that's a path they decide to go down.

Another of the outcomes here is that the FCA decides that they want to put a few questions of law through financial test cases. If that's the case Ed, that then goes beyond the FCA review and goes into the courts clearly to establish the law off the back of which any remediation output, or none, can then be built upon. So Ed, I think there's a number of different outcomes here. One is the FCA comes out and decides that this is the way it should be, based upon many of those levers that I described earlier on and that either goes with or doesn't go with the Financial Ombudsman. Another way that comes out is that it goes into financial test cases, in which case expect this to carry on for a bit longer.

Ed Firth
Just to clarify, if the FCA come out with one of the settlements on the first of your two choices, does that effectively preclude, is your understanding, rather, that that effectively precludes people subsequently going to the Ombudsman or would they still, if they weren't happy, if they felt the FCA was not as generous as the Ombudsman, could they still then take it to the Ombudsman? Is there a clear understanding on that?

William Chalmers
Well, you'd be better off consulting a lawyer on the precise answer to that, Ed, but my understanding is that the law has the ability to bind the Financial Ombudsman. I'm not sure whether the FCA does or not, but I would check that out with a lawyer because I can't claim legal expertise in this area.

Second question that you had, Ed, around the margin, there are, as you say, a bunch of uncertainties clearly about the margin, but I think also, there are some pretty mechanical ways in which the margin works out over the course of the year. We discussed this afternoon, the mortgage refinancing headwind and how that starts to slow down in '24 and then abates through the remainder of '25. That's a fairly mechanical output. As I said on Thursday, as long as you don't think the completion margin is going to collapse, that's a pretty mechanical output of refinancing maturity margins going down and completion margins at least holding steady, and therefore, you eliminate the headwind.

The deposit headwind is obviously more about customer behaviours, although, clearly, in a declining interest rate environment, you can be more confident about what those customer behaviours might look like. Then the third element, the big tailwind, of course, is the structural hedge, which, again, is pretty mechanical. The yield in the full year for the structural hedge in 2023 was about 1.34 per cent, the yield in Q4 is a touch above that, of course, and the yield is going up all the time.

So when you look at the margin and the development of the margin, there are uncertainties, for sure, but there's also a degree of mechanics about it. And again, as long as you, in the structural hedge case, believe that refinancing rates are going to stay at a certain level, i.e. base rate and swap rates are going to stay at certain levels, then you'll see that mechanical cost today, that is imposed by the structural hedge, just work its way through.

Coming back to what does that mean through the cycle margin, I'm not sure that you get into heroic territory you described of 4 per cent, but I do think that over time, the types of tailwinds/headwinds balances that we're seeing in our margin this year of greater than 290, they play themselves out a little bit. The headwinds abate, tailwinds strengthen, and so you would expect to see the margin naturally build a little off the back of that. The timing, we haven't really specifically commented on, Ed, and I probably won't go there now because that's a subject for end of this year and into next, but that's the kind of evolution that I would expect to see over time.

Ed Firth
Great. Okay, thanks very much.

Question 6: Robin Down, HSBC
Hi, William. Hope you're well. I've got a question on an area that we don't normally talk about, which is what I would call corporate centre, but I think you give it a slightly different name. I'm a bit baffled as to what happened in the second half of '23. There's quite a big swing, £300 million or so, on the banking interest income line going through there. I could see this brief commentary about changes in transfer pricing and income from investing, the proceeds of structured credit notes, et cetera, but I was hoping you might give us a little bit more colour as to what's changed there, H2 versus H1, and perhaps how we should think about that going forward?

Then, in ally to that, I guess the other income line there, there's a bit of a negative going through there, something to do with the funding cost on those structured notes, perhaps how you're thinking about the other income line going forwards, and maybe if you could include in there any thoughts on crystallisation of equity gains? I guess they were probably quite low in '23, I guess you're probably hoping those recover in '24, '25. Any colour you can give us there would be hugely appreciated. Thank you.

William Chalmers
Thanks, Robin. As you say, there was more change in the central items than you would normally see. We call it equity investments and central items. Let me start just by briefly explaining what is in that space. So within central, we effectively have three main items. One is the equity businesses, so it's things like LDC, for example, it's things like the Business Growth Fund, for example, and one or two others, but those are what we describe as the equity businesses.

The second is central funding items, basically around transfer pricing within the overall business, but there's a couple of items of particular note in there. One is effectively an MTN funding structure of around £5 billion and the other is basically short-term hedging within the business. So those are the two elements that stand out in respect to central funding items. The third element within central income, which is, by quantum, a lot less important, but for the sake of completeness, it's basically asset sales or purchases around gilts, which are done just in the context of the liquidity management of the overall institution.

Robin, your question is what was going on there during the course of '23, and in particular the H1 versus H2 split. In essence, there's a couple of things going on there. Taking the first of those two items, we saw a little bit of weakness in the overall equity business, and that, in turn, was partly responsible for some weakness in OOI. Now, I would expect that to come back in '24. Maybe I'll comment on '24 in just a second, but you saw a bit of weakness therefore in equity businesses within central items or within equity investments in central items that plays into other operating income.

At the same time, the MTN notes are about £5 billion or so in quantum; because they are attached to derivatives, they are effectively charged into the OOI account, but benefit in the NII account. And so when interest rates rise, Robin, effectively, what you see is the charge going up, which is a negative in OOI, and the benefit going up, which is the charge to other businesses, going up in NII.

So you are seeing benefit to NII and downward pressure on OOI as a result of the accounting of the MTN, medium-term funding notes, because they're linked derivatives, and therefore require accounting through the fair value through the profit and loss. It is a technicality, Robin, that, in a sense, is I am spending more time on it than it necessarily warrants, but you're seeing that trade-off, benefit to NII, cost to OOI.

It's worth just highlighting there, that is a net nil effect, number one, Robin, and number two, this is all internal mechanics. The cost of those MTN notes to external counterparties remains exactly as it was on day one because it's all hedged in line with everything that we do around the funding, as you know. So that's the give and take that's going on.

Looking forward, where do we expect this to go? I think you can expect the MTN issue to remain roughly the same over the course of '24, it isn't going to vary much. It'll vary a little bit as rates go up or more likely go down during the course of the year, but I don't think it is going to really fundamentally change the picture, but I would expect you to see a little bit of rebuild in the contribution of the equity businesses, LDC, BGF as the two obvious cases. And it will not be huge, Robin, but I would expect the type of performance that we saw in OOI, particularly in H2 of '23, to strengthen a little bit off the back of that equity contribution during the course of 2024.

There is one other element that I will just briefly mention in NII, which I highlighted earlier on, is basically short-term hedging. Those short-term hedges have run off in the course of H2 2023, and they have therefore been able to refinance at more attractive rates. So what was previously a headwind because of short-term hedging, i.e. hedges that were put in place at lower rates than the prevailing market rates - that comes off in the second half of 2023. So in addition to the MTN point that I highlighted earlier on, that is also leading to the H1 versus H2 distinction that you highlighted in NII. We are seeing some benefit from that, I think now that benefit has washed through and we will see it more or less stable in '24.

Robin Down
So to cut to the chase, then, we should probably be thinking about annualising H2 on the NII side, but not annualising H2 on the OII side and allowing for a bit of, hopefully, recovery in the LDC business.

William Chalmers
I think you put it well, Robin. That's how I'd describe it.

Question 7: James Invine, SOCGEN
Hi. Good afternoon, William. Thanks for taking the question. I have got one on credit quality, please. I was hoping that maybe, as the UK's largest provider of personal current accounts, you could give us a bit of insight into the steady increase in direct debit failure rates, they continue to drift up. When you are looking at household budgets, it is feeling like more and more people are quite close to the edge, albeit just about hanging on. I think possibly what is most interesting about the direct debits is that, if you look at the utility ones, those are sextupled, and of course, a lot of the poorer households will be on prepay, so it won't even come into this.

So I know that your overall message on credit quality is quite comfortable, but are there any insights you can give on those failed direct debits? Do they typically get paid late, and how close are many of those households to defaulting on a loan, as well as just maybe their utility bill?

William Chalmers
Thanks, James, for the question. A couple of points to make, really. One is I'm not sure how much of a UK barometer we are because I think the books that we run, whether it is an unsecured, secured, or for that matter, in commercial, are skewed towards a better part of the markets, and deliberately so. As a result, I do not think that you can hold us out as a measure of how the UK economy is performing in terms of asset quality as a whole. You can hold us out as a measure of how the prime segments of UK asset quality are behaving - I think then you will get a decent read, but I do not think you can look at us as an indicator of the UK as a whole.

Second point, James, which may be helpful, as we look at our book, as you know, we look at a range of early warning indicators. On the liability side, you just mentioned the PCAs there, the closest proxy I can think of in terms of our early warning indicators are things like refused payment notifications. Refused payment notifications are where people have insufficient funds in their account, and therefore, that is what happened. That has been stable year-on-year. If we look back at what that was like a year ago versus what that is like now, it is pretty stable.

You are going to see month-on-month volatility, for sure. Sometimes that's because one month is longer than another in terms of day count, but when we look at it on a year-on-year basis to try to establish a trend, we are seeing stability. Likewise, unarranged overdrafts, again, you'll see month-on-month going up or down any given moment, but over the course of the year, stability. And so, the two closest proxies to the PCA performance that we see, portray that picture.

On the asset side, James, I know that was not quite your question, but on the asset side at least, as you know, we have seen stable new to arrears through the course of the year. We did have a tick up in mortgage new to arrears right at the beginning of the year from principally the legacy portfolios, but since then, the picture has been one of stability. And certainly, in the case of most asset classes, including unsecured, it is at or below pre-pandemic levels. So not only is it stability, but it feels comfortable.

I think, James, what's happening is that, while the pressures of things like interest rate rises are definitely accumulating, we have seen £88 billion of fixed rate mortgages run off over the last 12 months. We will see another £50 to £60 billion or so run off over the next 12 months. So those pressures are accumulating, but at the same time, people who are in employment are also getting inflationary pay rises, and those two, in significant terms at least, are offsetting each other. There is a lot more going on, clearly, but there's a couple of points right there. So James, as a result, I am not sure that we're the place to look for insight as to the UK as a whole. And as said, the performance that we have seen on both the liability and the asset side has been, as we said on Thursday, reassuring.

James Invine
Okay, perfect. Thank you very much.

Question 8: Guy Stebbings, EXANE BNP
Hi. Good afternoon, William. I have two questions. The first was on structural hedges and pre-hedging. I do not suppose you can give any sense of the quantum of pre-hedging that you have done, how far forward that goes, how those hedges might look relative to the prevailing swap curve, are they in the money, as it were, on those pre-hedges?

And then the second question on the capital target, can I just clarify the revision in the capital target, that none of that is predicated in any way on future reductions in regulatory requirements with RWA inflation potentially being compensated by further reductions in Pillar 2A or other requirements? And then conceptually, is your capital target driven by absolute view on what you think as a business that the right level of capital is, or is it the buffer above regulatory requirements you'd like to hold? Thank you.

William Chalmers
Guy, would you mind just repeating that third question again, just to make sure I caught it?

Guy Stebbings
Building on any change, the change to the capital target and how that might have been driven in anyway by regulatory changes, and I just, as you take a step back as a business and you think about what the right level of capital is, is it driven by the pound amount of capital, or essentially the amount of capital you think is right in absolute terms, or is it how much you think the buffer should be above whatever the regulatory requirement is?

William Chalmers
Got it. Thanks, Guy. On the structural hedge, I am afraid your fear is probably well-founded in the sense that we do not disclose the pre-hedging volumes that we do, but we do, do a fair bit. And it's the intention behind it, as you know with the structural hedge, you've got two objectives. One is to secure value, and the second, and perhaps, this is really the first in terms of order of importance, is stability of earnings. So it is about stability of earnings and it is about value. So we do pre-hedging in order to ensure that stability of earnings going forward, and indeed, although we manage within a pretty tight corridor on the hedge, nonetheless, where we see an opportune moment, we may pre-hedge, given that opportunity, but we don’t disclose the extent to which we do it.

I said earlier on that we have got an expectation of around £4.1 billion of earnings for the structural hedge this year. That is based upon the curves and the interest rate expectations that we gave you last Thursday. The significant majority of that is now locked in, but I won't be any more specific than that, Guy, for obvious reasons. When you then go further out, less of the hedge expectation is locked in, clearly, but nonetheless, there is a fair amount of pre-hedging that will be coming in, in '25, and indeed in '26. And so, a fair bit, therefore, is locked in, but it clearly starts to reduce as you go into outer years.

On capital targets, Guy, the capital targets are not reliant upon our, well, on any expectations as to reducing requirements for Basel 3.1, CRD IV and the like. And the best way to describe that is, as you know, our expectation on Basel 3.1 is that it will be broadly neutral and there is a bit of give and take within the various different elements of our balance sheet, but basically neutral. And our expectation on CRD IV is that we've probably got another circa £5 billion of RWAs to add on.

But bear in mind that some of those inputs, e.g. the CRD IV and I guess most of the Basel 3.1, as well, they all form part of the denominator in that capital ratio. So even if they come in, they are implicitly already taken account of when we fix our capital ratio based upon a percentage of RWAs.

So in short, Guy, there is not anything other than the expectations that you know about in setting our capital target of 13 per cent. It is predicated upon consideration as to business uncertainties and risk, and I described those a bit on Thursday, as to regulatory clarity, and I have just described that now, but it is hopefully very consistent with what you heard on Thursday. And then retaining our buffer of 1 per cent, which as you know is circa 2 billion of incremental buffer for any economic uncertainties that might be out there.

And then just linking to your third question, Guy, how do we set that level of capital? We look at the level of capital based upon BAU requirements, based upon MDA considerations and based upon stress considerations. Those broadly speaking, are the three metrics that we look very closely at when we determine what the right capital requirement is alongside, obviously, the ongoing growth requirements of our business. And so those are the types of considerations.

One point that might be worth making, there was an interesting question raised on Thursday around MDA and where did we stand versus MDA? And I said in that context that we felt very comfortable with the cushion against MDA based upon the stock of capital that we have. The point that I would add to that, and the point that is relevant to our capital target as a determination, is that we generate a lot of capital. So as you know, we generate circa 175 basis points over the course of this year. This year we are giving out around £3.8 billion of capital. So, when you think about our capital cushion versus BAU regulatory requirements, or versus MDA regulatory requirements, don't just look at 13 per cent versus BAU or 13 per cent versus MDA. Look at also the incremental circa £4 billion of capital that we generate in the year or on top of that. And I think the addition of those two makes us feel very comfortable about the type of capital buffers that we have to deal with any eventualities when we set a 13 per cent CET1 target.

Guy Stebbing
That's very helpful, thank you.

Question 9: Jonathan Pierce, NUMIS
Hi William. Two quick ones please. The first is on the insurance company and the solvency II ratio, which is pretty high again. To what extent are you willing to run that down to ensure you get to the 175 basis points of capital generation?

William Chalmers
Sure. As you say, we have got an insurance solvency ratio which shows, I think it's a headline number of about 185, 186 per cent, that's pre-dividend, it's worth bearing in mind. So you can take £250 million out of that to get to a post-dividend solvency ratio of more like 175 or thereabouts. That is still ahead of where we might choose to run it. I mean, we have not disclosed the precise number around which we run it, but nonetheless it is closer to 150 than it is to 175 and so that does suggest meaningful excess capital.

We will look at that over time. I mean, I think we want to make sure that the insurance business has the capital it needs to build the business. As you know, it is determining its strategy right now and therefore we will run it over time at something much closer to the 150 per cent. But at any given moment it may operate slightly above that and that will help us with, a) capital management within insurance, but also, b) dividends that come out.

Ultimately Jonathan, we are not shy about taking dividends out of the insurance business. The policy across the Group for all subsidiaries is to run those subsidiaries based upon their capital needs and any excess capital gets dividended up to the holding company and then ultimately owed to shareholders. That is the principle, and insurance is no different.

Jonathan Pierce
Okay, that is helpful. Thanks for that. The second question, how much more securitisation do you think you are going to have to do this year potentially to keep the Group RWA within your guidance range? And do you have a rough rule of thumb as to what the net interest income impact is of securitisations of unsecured, retail mortgages, that sort of thing?

William Chalmers
Thanks Jonathan. We operate within a corridor of what do we expect optimisations to deliver us. And it is worth saying in describing that, Jonathan, that securitisation is only one tool in the optimisation cupboard. So, optimisation also includes regulatory interpretations where this organisation has, in the past, taken a pretty conservative overall line. It also is around things like collateral management, and it is also things like heavily risk-weighted assets that don't earn any yield in the back end of our commercial portfolio. And all of those things, those three examples, are other forms of optimisation. Securitisation is only one of a set of tools.

As you know, Jonathan, we did two securitisations activities this year. One was securitisation of a bunch of primarily legacy-related mortgages and the other was a securitisation of personal loans in the fourth quarter. The first one was about £2.5 billion. The second one was about just a shade over that, about £2.7 billion.

The first one, not surprisingly, had lower income impacts than the second one because, clearly personal loans are higher margin than mortgages. So, the way I'd look at it, Jonathan, is not to attach a particular income stream to securitisation, full stop. I would look at it in terms of the income stream attached to the form of securitisation that we are doing at any given moment.

The other point that I would consider is, as you know, these securitisations are always NPV positive. We will not securitise anything that is not NPV positive. And hopefully it is clear what we mean by that, which is to say that the price that we get for the assets plus the RWA release compensates us for any income reduction that we might suffer. So that NPV positivity is key.

You will be aware, I am sure, that when we securitise a book of legacy mortgages, not only are we foregoing a bit of income, but we are also de-gearing the asset quality charge. Because those are legacy mortgages, and as you know, a big part of our mortgage provision, in fact a big part of the ECL on the balance sheet for mortgages is basically the legacy mortgage book. Same thing with personal loans, which have a slightly higher run rate in terms of the AQR hit. You get rid of that when you securitise them, so it is not just an income impact and again, look at the particular asset that is being securitised, but it is also the relief that you might enjoy in terms of the impairment charge that you would otherwise incur.

Jonathan, for the sake of completeness, we have talked about optimisation. The other aspect of optimisation that we have been quite heavily engaged in is significant risk transfers in particular around things like the CRE book and the like. So, I just mentioned that for say completeness because I think often enough optimisation gets used in a interchangeable way with securitisation and it is not, it is much broader.

Jonathan Pierce
Okay, that is really helpful. Thanks William.

Question 10: Andrew Coombs, CITI
Good afternoon. One new question and one follow up. On the new question, Barclays obviously came out with their investor update last week, and one of your former management team presented and as part of that they were looking at opportunities to grow lending market share, so they talked about the opportunities in unsecured, the opportunities in business banking, but also the opportunity in high-loan-to-value mortgages.

Obviously, previously you have had a margin over volume strategy and now that has shifted somewhat. You have talked about maintaining mortgage market share. I would like to ask, what do you consider to be your approach on high loan-to-value mortgages? And more broadly, what proportion of your mortgages are over that 85 per cent threshold? I had you pegged as being similar to the 6 per cent that Barclays put out, but they were saying that peers were 12 to 14 per cent, but intrigued to know where you think you stand.

And then second one, just to follow up on motor finance; apologies, it's a follow up to Ed's question where you went to some of the technicalities. Your point about the FOS case - now, what I'm just trying to work out is exactly where the remit of the FCA and FOS stretches under the FSMA regime versus how much is still under the Consumer Credit Act and legal legislation. So, when you are thinking about the final outcome here, and I appreciate what you said about it depends on whether the FCA decides to put something, essentially through law, I guess, or attempt to with some formal test cases. But were the terms of those CCJs or the terms in which they were being appealed, very different to the FOS case, which is very much about the commission arrangements? Perhaps you could elaborate? Thank you.

William Chalmers
Sure. I will give you a view on the second point, Andrew. But again, I think you are getting into legal technicalities, which are not my area of expertise. On your first question on Barclays, Andrew, we obviously noted the announcements from peers over the course of the result season. Barclays was one of a number.

As you know, the mortgage market in the UK has been subject to repeated entry market share gains over time from various different players at any given moment. And so the market ebbs and flows is my point. Competitors come in, they come out, Barclays is now going in. The question, I think, is just what does that all amount to in total? Barclays is only one of a number of players. As you know, there are others who are important in terms of flow and stock within the mortgage market. So I would not single out Barclays as necessarily setting the tone for the UK mortgage market. They will be a player, but so will many others.

Our typical approach, as you know, has been to balance value and share in mortgages. And overall, I think that has led to a reasonably successful outcome. In the context of quarter four, I think we are around 17 to 18 per cent or thereabouts share of flow, that is typically where we tended to operate at. That is what has produced the circa 60 basis points completion margin that we have seen.

I do think that going forward, at least the earliest signs in '24 are that the mortgage market is growing, a touch, and therefore you would expect in a growing market, there will be more new business for people to go after. Retentions will be a little bit easier. You might see some easing, in terms of competitive conditions and possibly completion margins off the back of that. Let’s see, I mean, I think it is too early to call it right now, but I do think as a general matter, an increasing market size, which is what we are seeing in mortgages right now, is probably overall a benign indicator for where spreads will go in this business.

You asked about our book in particular. I am not going to give you the 85 per cent number, but just to give you some shape around it. We have got just shy of 3 per cent, 2.9 per cent to be precise, of greater than 90 per cent LTV within our book. But the majority of that, just for the sake of completeness, is covered by government guarantees. When you look at our share of greater than 80 per cent LTV, it's about 10.7 per cent. So hopefully that gives you some shape for that question, Andrew. It is not 85 per cent, but it gives you either side of that.

And then in terms of your second question, FOS versus CCJ. There is a question which I think the FCA will have to consider as to the basis on which its review will be conducted. It will have different indicators, different inputs, to make those judgments. One of them will clearly be the FOS, the other will be the Consumer Credit Act, the other will be the county court cases. It is going to have to draw upon all the available information out there and decide what its appropriate conclusion should be.

And I, in a sense, I wish I knew exactly where it will land, but I do not think we do, and we just have to have a bit of patience and see how it works through.

I think we are actually a little beyond time now, so we might just call it a day. If there are questions, please do feel free to call. Douglas and the team will certainly be around. And indeed, I look forward to our engagement over the course of the coming weeks. So for now at least, I just want to say thanks very much indeed to everybody for taking the time to join. And again, look forward to continuing the dialogue. Thank you, indeed.

END

FORWARD-LOOKING STATEMENTS

This document contains certain forward-looking statements within the meaning of Section 21E of the US Securities Exchange Act of 1934, as amended, and section 27A of the US Securities Act of 1933, as amended, with respect to the business, strategy, plans and/or results of Lloyds Banking Group plc together with its subsidiaries (the Group) and its current goals and expectations. Statements that are not historical or current facts, including statements about the Group's or its directors' and/or management's beliefs and expectations, are forward-looking statements. 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