LLOYDS BANKING GROUP PLC – 2018 STRATEGIC UPDATE PRESENTATION – BREAKOUTS

DIGITISING THE GROUP & TRANSFORMING WAYS OF WORKING – ZAK MIAN & JEN TIPPIN

WEDNESDAY 21 FEBRUARY 2018

Question and Answer Session

Session 1

Question 1

Ian Gordon, Investec

Can I have two please. Firstly, Open Banking. Could you just say a little bit more about how I should think about your proposition versus peers? And then, how do you think in terms of scale, and then threats as well as the opportunity?

And then my second question, and apologies as this is bit of a luddite question relative to the more sophisticated presentation you have given. Ongoing digitisation, simplistically, translates to less foot fall through branches. I know in the main presentation, António referenced change in the way you use branches, but I still struggle to see why there wouldn't be a very very substantial reduction, consistent with what you have outlined.

Answer: Zak Mian

Let me take the second part of the question first. So our philosophy with digital, in building that biggest digital franchise, and the thing we like best about it, is that although we have built that huge digital bank, which has this huge footfall of 3 billion logins a year, we have done it without discouraging customers to use a branch network. We have done it by offering a multi-channel proposition and letting customers choose which channel to use, as they need to. And there will be things that customers want to arrive in the branch to do, there will be things customers want to use via telephony and there will be things we want to do online. We have blended some things, some things like remote adviser, where we can have customers on the web and then video conferencing with colleagues. So we are introducing new capabilities all the time, but our philosophy is very much to follow the behaviour of customers, not just shut branches and give customers no option but to go online. And that will carry on over the next period as well.

In terms of Open Banking, we really see it as a huge opportunity for us. So, by having the biggest digital franchise but one, more importantly, that customers like to use. And evidence of the customer use is complaints are going down, customer net promoter scores going up. But equally if you look at our app store ratings, we have maintained a 4.5 star app store rating on Android and iOS over the last 2 or 3 years. And that gives us confidence that customers like the service that we are offering and they are happy with it.

But not to be complacent about it because we definitely see more competition. The service bar continues to go up, and that is really where we really see the innovation agenda within the transformation work. And that will be about looking at our journeys, looking to see where can we add new features to the mobile app that really help customers. Where can we, with Open Banking, look at a customer's other holdings that he has with other financial providers, bring those into a Single Customer View along with things like insurance from inside the Group and deliver financial planning and retirement. We are really well positioned as an organisation, probably uniquely so, to give customers that very joined up service.

Question 2

Raul Sinha, JP Morgan

Zak, so firstly, the 12 per cent number which is the cost base that is effectively going to move up to 70. Does that mean that 88 per cent of the Group is actually manual processes right now?

Answer: Zak Mian

No, it is less of a reflection of how much is manual versus automated. It is more saying that we took in the last three years the scope of our customer journey transformation, phase one. We picked 16 journeys that were important to customers and tried transforming them on this multi-channel basis. It was about trying these things out, the new ways of working, the new design techniques, and building those new organisational muscles. The success of those journeys has really given us the confidence to say: 'well, now let's look at all of the other things we do with customers over in Insurance, in Commercial, and broaden that agenda; and then further extend it by looking at the head office, central function journeys as well'.

Further question:
How much money do you have to invest to digitise a journey and then how much cost you save if you digitise a journey? Can you give us an indication of the magnitude?

Answer: Zak Mian
So in terms of the cost, that journey transformation is all part of the increase of up to the £3 billion. So I am not going to get into the specifics allocated to the investment. As a yardstick, we typically see from an efficiency perspective a 25 per cent improvement in productivity. Now the reason, sometimes it is variable, is that sometimes the journey is less about becoming more efficient and it is about making things better for customers. Sometimes it is about creating revenue opportunities as opposed to cost. But it is really always about being forensic about what is not working, where are the opportunities, how do we leverage new technologies, making it matter for customers, simplifying life for customers and then creating operational efficiencies at the back.

Further answer: Jen Tippin
And, of course, that reduction in costs is obviously seen in our guidance that we've given this morning around our operating costs being sub £8 billion. Remember that is a net cost reduction as opposed to gross cost savings.

<u>Question 3</u>
When you think about Open Banking and PSD2, is one of the inevitable outcomes of that a higher churn both in your deposit base and also your open book mortgages? And I say that because some of the competitive threats that are emerging, less from the other big banks but from start-ups and the like, seem to facilitate switching from customers and become the interface with customers, effectively disintermediating the large banks. So could you talk about how you think about that going forward and how you position in that environment?

And my second question for you would be around the investments you are making in employees. Clearly, employee retention is an important part of that here. Can you tell us about what your employee retention is, and how that is trending?

Answer: Zak Mian
So at one level, we have lived with price comparison sites, easier switching and intermediaries for many, many years. Open Banking kind of introduces further opportunities and challenges like that. But really the key to it, as I said earlier, if we can continue to be obsessional about customer experience design. We are blessed with a huge customer franchise, and one that we know, through the service ratings we are getting on mobile and more broadly across the channels, if we continue to deliver on that customer promise, customers will choose to stay with us. As long as we continue to deliver the great products that we have and the services, execute them brilliantly for customers, they are our best defence and that is our intention.

Further answer: Jen Tippin
Just to answer your question on retention. Our retention rates for colleagues are very good in fact. And attrition rates both in terms of first year attrition and overall across the bank are very low and benchmark competitively. The thing I would say is that and we are in no way complacent on any of this, but we do enjoy very high levels of engagement with our colleagues. Our strategy around being the best bank for customers and our purpose around Helping Britain Prosper resonate extremely strongly with our colleagues. That enables us to retain them. And, indeed, in terms of levels of engagement, we benchmark very well at around 3 points higher than the UK high performing norm. And that really helps us, but we are not complacent in any way. We know that we are going to continue to work hard on that as well as attracting new colleagues to the organisation going forward.

Further question
Could you just clarify when you say it's 3 percentage points higher than the…?

Answer: Jen Tippin
The UK high performing norm. That's in terms of engagement levels. Our engagement levels are 3 points higher than the UK high performing norm.

<u>Question 4</u>
You made a point about the importance of cyber security and protecting customers. How do you see that in an Open Banking context?

Answer: Zak Mian
We think key to it is making sure customers are educated about security. From our perspective, making sure we continue our big investments in cyber and fraud defences. Our belief is that APIs are the most secure way of using Open Banking, and that way we can make sure customers don't need to share credentials, that way they are comfortable, and they can transact safely and securely.

Session 2

Question 1
Claire Kane, Credit Suisse
Two questions please. First, you have little statistic there about freeing up a third of colleagues' time through AI and robots. So some people might consider that to be a potential reduction in staff numbers to that level. And we heard about freeing up capacity for more complex needs. So where do you see these complex needs opportunities arising that are not fulfilled currently? And what kind of opportunity do you see there for pricing to reflect that?

And then secondly, the perception about the incumbent banks is that you have lots of legacy, old technology. I appreciate that it's not perhaps the right thing to try to put in something new there. But how much of this £3 billion spend, or the spend before, is just trying to free up capacity on old systems rather than actually developing something new that is going to reduce costs or open up revenue opportunities?

Answer: Zak Mian
I will take the last question first. That £3 billion is really about strategic investment. That is not the core, keep the lights on funding. This is really about how do we move the business forward, how do we deliver great things for customers.

In terms of the question around use of AI and complex needs. We think by freeing up people time, colleague time by using these technologies, we give the customers the convenience of getting their simple needs, simple queries, answered more quickly, more effectively, in their channel of choice. But absolutely, part of the multi-channel offering we still have the branches and telephony and some customers will absolutely want to go into the branch and get that personal experience, and that is what they are there for. But we really see by enhancing, providing more choice, we then have opportunities to have agents to deal with more complicated or deep needs, more complex inquiries, but also some of these conversations around insurance, long-term planning and retirement. So in the earlier sessions, you may have heard Antonio talk about financial planning and retirement. That is really a classic area of where we see how do we use that capacity and how do we invest it to solve other customer needs more sensibly.

Answer: Jen Tippin
Or it could be in mortgages or protection, anything that is much more complex from a customer's point of view.

Question 2
Chris Cant, Autonomous
Two please. The 70 per cent of the cost base covered by journey transformations. How much of the Group cost base are we talking about digitising here and how much is in scope? Because you specifically mentioned in scope.

Answer: Zak Mian
Yes, so that represents that 70 per cent, frankly. So the first wave of journeys in the last period, we picked 16 key journeys that we did that were really important to us and that represented 12 per cent of the overall cost base. This broadening and deepening, by looking at the other customer journeys like general insurance claims, other things in commercial, and we're then also looking at our central colleague journeys as part of central functions broadens that scope out to 70 per cent of the cost base.

Further question:
So, it is 70 per cent of the total, not 70 per cent of the sub-set of the total?

Answer: Jen Tippin
No, 70 per cent of the total.

Further question
And the other question is on the £3 billion of change spend. It looks from the pie on the slides like you've got about two thirds of the budget towards the digitisation projects. How do you expect that to be spent over the coming years, what is the distribution of spend over time as you see at the moment?

Answer: Zak Mian
Within that digitisation, it is those changes to the architecture, creating those enablers for things like artificial intelligence and machine learning, upgrading data architecture, and then, journey by journey, looking to see what needs to be done, looking for the interventions to do those upgrades of customer experience and drive out those operational efficiencies. So we don't have a kind of granular breakdown of it is this much to this, because really the whole method is about understanding what our customers want from us, where are the opportunities and how do we leverage technology. And that is the overall envelop that we are looking to invest over this plan period.

Further question
So do you have a sense of the distribution of the spend over the planning period as opposed to on specific projects? I understand you might not have a set amount allotted for each specific project you're going to do over time, but how do you expect that amount of money to be spent over time? How much is in 2018 versus 19? In a previous session we heard the deadline of 2019 around the PSD2 technical standards is a big event, so is it all going to be spent ahead of that?

Answer: Zak Mian
We need to do all of this transformation safely and securely. This is about managing our execution risk. This is not around saying we now need to get whole armies of external consultants in to spend all our money in year one because it is just not sustainable. So this is about progressively, consistently over the plan period applying this investment.

<u>Question 3</u>
You said you had one front end platform across all brands, clearly it's very well regarded. In terms of your core banking systems, how many core banking systems do you have across various different brands? That would be my first question. Second question is around the shift towards Agile development. To what extent is the core banking system still a constraint to that? Attached to that - what is your minimum viable product? I guess it's proved [….] still some way to go.

Answer: Zak Mian
For our core retail major brands, so Lloyds, Halifax and Bank of Scotland, we have one core banking system. This also supports our commercial customers, and it is 24/7. It is available all the time, and we run our digital bank on top of that, and over the last six years we have continued to maintain its scalability and resilience. And so it is absolutely fit for the future. Sorry, the second part of the question?

Further question
It was just about how this may be a hindrance to the Agile development? The minimum viable product, so on and so forth.

Answer: Zak Mian
As part of our Agile work, we are also doing an engineering transformation. And this is really looking at each of our core platforms, whether they be channel platforms, or the core banking system, payments platforms, and looking to see how can we develop more automation of our software engineering processes. How do we use DevOps techniques to automate productivity, automate testing where we can, so that way we make those processes simpler. And we are really looking to achieve that 30 per cent improvement that Jen talked about by moving some of these things around and making change deliver faster by platform. Instead of delivering every quarter, making these platforms move onto a monthly cycle. On the digital platform it used to be monthly, we are getting those down to weekly. And those software engineering improvements are all a key part of this shift towards becoming more and more agile.

<u>Question 4</u>
Alvaro Serrano, Morgan Stanley
I am going to ask the same question as previously, but in a slightly different way to try to get a sense of what you are doing versus competition. In terms of the £3 billion spend, if you had to give a flavour of how much of that would be introducing new functionality, customer journeys, something the consumer will benefit from straight away versus back office processes which will lead to better cost efficiency. Could you give us a sense of that £3 billion, is it £1 billion front - a rough idea? I think it is important because some of these challenger banks which are, in theory, using newer systems without legacy costs, are obviously spending money, but probably nowhere near as much as you guys are. So a general flavour on that?

Answer: Zak Mian
It is very hard to break down. We are really looking: these are the journeys, let's look for the opportunities, drive out those customer experience improvements, leverage these new technologies. Part of the reason we are doing the ways of working improvement is, how do we sweat each investment pound better. And this is why we are doing the engineering transformation, the shift towards Agile, make sure we get the most value out of each pound we spend. But making sure we deliver both customer experience improvements as well as operational efficiency.

Session 3

Question 1
Patrick Lee, Santander
In the context of your multi-brand strategy, do you notice any observable difference in terms of customer digital behaviour across different brands? Do you get higher risk customers more ready to use applications than lower risk customer, for example? And going forward do you see this as a way to fine tune your customer base or to attract the right customers? Do you think this is a tool for you in future?

Answer: Zak Mian
Yes, digital really helps with our multi-brand strategy. The power of the multiple brands is that it gives us huge amount of coverage, we can see benefits of having a common platform to serve all the brands, but you do see small differences within each brand. So Halifax as an example, is a challenger brand perhaps. We tend to see a slightly higher level of digital usage within that brand than we do within the Lloyds brand. But overall this all adds up to a massive digital franchise. We think that by having these multiple brands - and now we've now got MBNA within the family of brands which is a more direct and digital brand - they create lots of opportunities for us to be trying new things with different types of customer through these different brands and create an overall great proposition.

Question 2
Robert Sage, Macquarie
I take your points in terms of what you are going to be doing with the workforce in terms of recruitment and the investment. But I was wondering also, in view of the cost targets for 2020, what actually do you expect in terms of staff numbers?

Answer: Jen Tippin
In terms of headcount levels, we are not disclosing any specific targets today. And the reason for that, is not because we are being coy, the reason for that is really in the world in which we are now living, we are seeing shorter planning cycles, we are having to re-prioritise much more. And in a world where the only certainty is uncertainty in fact, and that is definitely the environment in which we are living, we really believe that we need to be led by our customers. And as we see changes in those behaviours then we will adapt accordingly. And that is the reason why we are not setting any public headcount targets at the moment.

And we also fundamentally believe that one of our enduring competitive strengths is around the quality and capability of our people. Which is why we are making this biggest ever investment in our people today, to really make sure that we have the skills and capabilities for the future.

Question 3
If I was to frame it, you are looking to reduce the costs for the Group down to £8 billion by 2020, roughly a delta of £200 million and it is a £3 billion plus investment. I sort of look at that as a return on investment of 6.5 per cent. Is that the right framework?

Answer: Jen Tippin
You are only looking at one side there, obviously looking at the cost side. And clearly as our plans outline, we do expect to grow our income over the plan period as well and achieve a cost:income ratio down in the low 40s. So we believe that delivers a good return for our shareholders and will continue to establish our competitive advantage versus our peers.

Answer: Zak Mian
And unashamedly, some of this is about absolutely driving customer experience improvements. So customer's expectations continue to go up and we need to respond to that by delivering great customer experiences across all our products, our services, and by providing more and more features and capabilities across our channels. And as you can see with things like Open Banking, the landscape doesn't stand still. So new channels arrive, new expectations will come with them and new opportunities for us.

Question 4

Ed Firth, KBW

As you go through this, which obviously is a massive change in the world of banking, what do you see as the biggest two or three risks, as the head of the digital side, that keep you awake at night? And specifically, are you more worried about the delivery of it and, potentially, the system breaking down at some point and customers not getting their money. Or are you more worried that a Facebook, or an Apple, or even an Amazon comes up with something that is pretty much the same, and they obviously have got the fire power to max that. Where are your key one or two concerns?

Answer: Zak Mian

I think, our investment in cyber, is, how much do you spend, how much do you need to do? We need to absolutely get ourselves to the level of investment where we continue to feel comfortable, but that is, if there is anything that keeps me up at night, it is how to respond to the thing you don't know what we don't know. And the threat landscape continues to evolve. So we absolutely continue to stay vigilant on that front.

In terms of the other, this is a massive change execution challenge for us. But as I said earlier, the thing that gives me huge confidence is that we are not putting all our eggs in a single basket. So this is not about taking a particularly huge bet on one particular vendor or one particular technology. It is absolutely dispersed. And we upgrade our architecture on a case by case basis to make the most of these new opportunities.

From a customer perspective, we think we have already got a huge digital franchise where we feel really great about the fact that customers are telling us they like our service. Having a 4.5 star app rating in both Android and the Apple store, gives us confidence people like what we are giving them and this plan is about continuing to do more. And we think that is absolutely what we should focus on, because if customers like what they are getting, it continues to be available, it is a great service, then they will stay as part of our core franchise.

Question 5

James Irvine, Soc Gen

You have got 30 per cent, or up to 30 per cent improvement in efficiency on your slide there, what would the average number be across that 70 per cent of cost base?

Answer: Zak Mian

They are actually slightly different things. So the 30 per cent is in our delivery of projects. We think we can, for the investment pound, we think we can get 30 per cent more effective in the delivery of projects. And that will manifest itself by projects going faster, by using more automation techniques, more agile techniques, getting to the problem faster through test and learn etc.

Then in terms of the 70 per cent, that represents the cost base of the organisation. 70 per cent of it is now within the scope of our end to end journey transformation. And that is our chosen technique, I guess, our secret sauce of how we think we can deliver great customer experience improvements but also get scale improvements in cost efficiency.