LLOYDS BANKING GROUP PLC – 2018 STRATEGIC UPDATE PRESENTATION – BREAKOUTS

LEADING PERSONAL CUSTOMER EXPERIENCE – VIM MARU & JAKOB PFAUDLER

WEDNESDAY 21 FEBRUARY 2018

<u>Question and Answer Session</u>

Session 1

<u>Question 1</u>
Clare Kane, Credit Suisse
When will the aggregation app be up and running and do you have any internal assessment of take-up or usage?

Answer: Vim Maru
So I think the first thing I would say is that when you look at the services that we want to offer in Open Banking, it is not going to be one Big Bang, it will come over time and there will be more and more builds over time. In the same way as we talk about agile capability, it is not a one Big Bang type approach. On aggregation, the important thing to realise is that through Open Banking, the only APIs that are available today are current account APIs. So for people who want to aggregate current accounts, you can aggregate current accounts, but it isn't the core thing that people want to aggregate. They want to aggregate with their savings and their credit cards. And that is why I talked about the regulatory standard that is coming in 2019. Over time there will be more APIs that cover savings, credit cards and that will allow us in our API only model to integrate that. So we need to see exactly when the Open Banking implementation entity extends that, and then integrate that. But what we are doing already is experimenting and working as we were the first to launch and it allows us to start testing and bringing some of the aggregation of current account services together and you will see more about that probably at the back end of 2018.

Further question
Could you do that working with your own brands, aggregate your own brands across products and services?

Answer: Vim Maru
You see on the video actually, one of the exciting opportunities for us as part of GSR3 is to bring a Single Customer View from an insurance perspective. So you see the little picture of the Scottish Widow there. That is one of the key planks of this which is to actually bring more of our brands together. We are not necessarily convinced that all of our Lloyds customers will want to see Halifax holdings. Actually the cross holdings in our multi-brand strategy are very low between Halifax and Lloyds so it is not as exciting for those customers. But bringing the insurance business together in a Single Customer View, and you will hear more about that from Antonio Lorenzo, is a really exciting opportunity already. But then there are things like MBNA that we could bring in etc. as well.

Further question:
Could I have one final question? On the £30-40 billion, can you just give us a bit of detail about what those balances are and which segments are represented? If that's part of your growth, how much of that is built in to your three year plan?

Further question:
Chintan Joshi, Abaco
And also, if I could add to that, what is the sensitivity around that as well?

Answer: Vim Maru
So I think we see it as a long-term opportunity and moving from a 17 per cent market share to a 19/20 per cent market share isn't something that you do overnight. The second thing to say to your question is that we will be disciplined about that as we always have been in that this is not at any cost, it is to make sure that we provide customers with what they want so that they bring more of their business to us. So I think those are the first couple of things.

The third thing to say is that we see the opportunity right across the balance sheet actually, we see it in mortgages, we see it in consumer lending, and we see it in deposits, right across the piece. And what we have got are customers who are at different stages in their life. Some people are borrowing, some people are deposit rich, and therefore when you look across that 10 million base that we micro-segmented, there are a mix of customers in there that we think we can actually, because we already have the relationships with them, the opportunity for us to grow our business with them, but in a disciplined way.

Question 2

Michael Helsby, BAML

If Open Banking works, it is going to reduce inertia which is going to be good for some people, bad for others. I'd just love to get your perspective as the biggest bank in the UK what you think of the opportunity but you have also got the biggest back book and you've also got some of the richest pricing, so how do you think about those challenges and balancing those two?

Answer: Vim Maru

Shall I repeat the question? So I guess there is a question about, I guess, the risk of Opening Banking and the risk to the back books as a result of Open Banking given, I guess, you are asserting that we have the richest back books there.

So I guess if I deal with that which is I think second part of that which is I think we have actually competitive pricing across the piece and therefore I wouldn't say necessarily that we have the richest back book. In fact things like our SVR rates are actually well below the market average and very competitive in the marketplace too. But I think the reason we think of Open Banking as a significant opportunity are the things that I called out. We already have the largest digital bank. We already have an app which we built with the best functionality in the market. And so adding to that and from a customer convenience perspective and a customer's view of security and trust, we think we could actually be a winner out of Open Banking and also offer them broader financial services needs as well.

I think if you look back in history we have always embraced competition and competitive moves. So whether you go back a few years to the ISA changes that came, we embraced that. We put the ISA promise out there. We put the prize draw out there, in fact actually we grew rather than shrunk as a result of more competition in the market. Same with the switcher market; another one where more competition, 7 day switch, great for customers. We did well out of it. So I think we have got a track record of embracing competition and delivering for customers.

Question 3

Alastair Ryan, BAML

Thank you, two please: the key outcomes in 2020 and the £30-40 billion opportunity. Is that how much your deposits go up by, by the end of 2020? And number 2, how many of your mortgages today do you sell through your branches? And once you fix your branches as you'd like them, how many mortgages will you sell through your branches?

Answer: Vim Maru

I will do the first one and Jakob will pick up the second. I think the first point is that yes this is an opportunity; it isn't a target for 2020. We see us working our way towards that as part of the 2020 plan and as I have said earlier, this is on both sides of the balance sheet, deposits and asset growth as well that we see in the opportunity here. And I will let Jakob just talk about branches.

Answer: Jakob Pfaudler

On mortgages, it is fair to say our primary channel for mortgages is the intermediary channel at the moment, just like the entire market mix. We resemble the market mix – so about two-thirds of our mortgages go through the intermediary channel. Having said this, we are very keen to make the best use of our branches and we do believe that we have a real opportunity in our branch channel. So if anything we would like to grow the weight on the branch channel.

Session 2

Question 1

Ed Firth, KBW

I have a couple of questions. The first one is about the Open Banking marketplace product, which I think is a very exciting shift we are seeing in the market. Can you just clarify when are you actually launching that?

And secondly, what are your thoughts about pricing in that environment? When customers can actually see on one sheet what their balance with Lloyds is paying is 0% and their one at Atom is paying 1%. Are you concerned that this is going to result in much greater sort of fluidity in terms of fund flow and people optimising pricing?

Answer: Vim Maru

I think I will deal with your first one and then I will come back to your second one. So from an Open Banking launch perspective, there isn't a Big Bang. We will be launching enhancements to our proposition throughout this year and next year. So there isn't a Big Bang, in the same way as you will hear about digital and Agile. We are not trying to do one Big Bang. So we will see progressive improvements to this proposition over time.

So if I think about the aggregation services, today the APIs enable you to aggregate current accounts. So those are the only APIs that exist in the market today. That was what was launched on 13th January. Therefore as the APIs come for savings and credit cards, that will add further opportunity. And one of the things we discussed in a previous session was, and I am sure you will hear about this from Antonio Lorenzo as well, that the other opportunity we have is actually to aggregate and have a Single Customer View within our own organisation; so bringing Scottish Widows. You saw hopefully in the video, Scottish Widows being integrated into that app as well, so you can see all of your financial needs in one place. And that is actually a here and now opportunity before the APIs are ready in other products over time as well.

And then if I think about your pricing point. I think firstly we see this as an exciting opportunity for us to serve our customers what they want and need. The second thing is that actually I think we have always embraced competition. Whenever competition has come, we have welcomed it and embraced it. If I look back a few years, you know, people thought the ISA transfer process would materially change that market. We have competed well, we launched the ISA promise, the savers prize draw and that has allowed us to compete well. The current account switching service: the 7 day switch. We have embraced that. Halifax has done really well through that switching process and service, so we have always embraced competition and raised our game whenever new developments come. Which is why we are embracing Open Banking and we want to make sure we serve our customers really well.

<u>Question 2</u>

Robert Sage, Macquarie

[Inaudible – question relating to £30-40 billion balance opportunity]

Answer: Vim Maru

I will repeat the question. So what are the £30-40 billion balances? So they are balances on both sides of the balance sheet, they are deposits, so assets and liabilities. And obviously across that 10 million customer base where we see ourselves under-represented, there are different components in that. Some people are asset rich, some people are liability rich. And so actually the approach for this is going to be different for each sub-segment of those customers but we see opportunities on both sides of the balance sheet here when you look at that. They would be balance sheet, yes.

<u>Question 3</u>

Fahed Kunwar, Redburn

I just wanted to follow on from Ed's question. As far as I can see, everyone is a price taker on the asset side of the balance sheet, on loans, I don't see much evidence that brands seem to give you the ability to charge more to mortgage / credit card customers, correct me if I am wrong. So Open Banking I guess doesn't enhance the ability to charge more. One of the things the big banks have is a funding cost advantage quite clearly. I am still, not sure I really understand how Open Banking will enhance that funding cost advantage and your examples are very good. PCA switching seemed to be something that would do that. But the truth is no one switches, no one uses it and that's why it hasn't broken that funding cost advantage. So why won't Open Banking reduce that funding cost advantage big banks have?

Answer: Vim Maru

If I just deal with that one particular point about nobody switches. I think people don't want to switch from us because we provide them with a great service and things like Open Banking are embracing services that the customers want and need and are now available. And that is what we think about, which is how do we provide a leading customer experience so that people want to stay with us and stay with us longer because they want to – not because they have to. I think that service proposition and the multi-brand strategy to your earlier point, I think helps us massively to be able to use all of our different brands, in different ways, in different markets to do that. That requires significant capability to manage a business like that. But I think we have shown over the past few years that we do have that capability to manage that and we will continue to do so in the future. I think you are right to say for example, on the asset side, the market is competitive. But we have always looked at both sides of the balance sheet. António I think went through that earlier, which is that we look at both sides of the balance sheet holistically at a very senior level every week to make sure that we manage that.

Further question:
OK, so in your view Open Banking will mean your funding cost advantage, big banks' funding cost advantage will stay intact? Because Virgin Money seems to think that is an opportunity to tap that.

Answer: Vim Maru
I see Open Banking as a great opportunity for us to serve our customers well. It is not a: I can change the funding costs etc here. And if we serve our customers well, they will want to stay with us and they will want to stay with us longer. That is the way I see it.

<u>Question 4</u>
Jason Napier, UBS
I just wonder if you can talk a little bit about how GSR3 is different from GSR2, the budget that you have, the focus on front versus back book, the functions and so on. Does this represent a sort of series break in the life of the business you run, or is it an evolution from what people have observed over the last 3 years?

Answer: Vim Maru
I think it is a great question, and probably one that we should come back to with António and George when we get back into plenary, to talk about why is GSR3 different to GSR2. I think it is a great question, which we will come back to and most definitely answer – and Douglas, if I could just log that question with you, to make sure that we do that.

Session 3

<u>Question 1</u>
John Cronin, Goodbody
The open API video that you showed gives an opportunity that Lloyds sees in that context but I suppose the question is on competition and your market share targets. How do you think about the threat that that also poses in terms of other operators' opportunity to penetrate some of your customer base, and I appreciate that is a long question.

Answer: Vim Maru
So I think I'd say two things. Firstly for us, Open Banking plays to our strengths. I think I have set that out in terms of our position and what our customers are expecting of us so it is about delivering for our customers. They expect us to be able to enhance the proposition for them and provide more of these services. And so I think it is a customer led strategy.

The second thing is we have always embraced competition and transparency. So if you look back, you know when ISA switching starting a few years back, everyone said that would be the end. We embraced that, we had the ISA promise out, the saver's prize draw out and we embraced competition and actually grew our business. Similarly with the 7 day switching in current accounts, again we embraced that and we have actually seen us do really well. And that is the power of multi-brand, multi-channel and the ability to make sure we stay customer focused, and that is why we see it as an exciting opportunity.

<u>Question 2</u>
Raul Sinha, JP Morgan
Under the new divisional structure, you obviously merged consumer finance and retail together. If you look at the loan to deposit ratio, there is obviously quite a big gap between deposits and loans, 134%, I think, within Retail. And then you have got a big surplus in the commercial business that obviously makes up for some of the gap. This £30-40bn, am I right in thinking that you are actually looking to prioritise deposit growth in Retail? And do you have a sense of where the 134% would go?

Answer: Vim Maru
So the question is more loan to deposit ratio in the new retail business and how we think about assets and liabilities there. So I guess the first thing is, I think as António answered, we think about assets and liabilities holistically. And certainly when we think about funding we look at it holistically and you have seen our experience over the past couple of years where we have looked at commercial deposits versus retail deposits. And we optimise accordingly to that. So I would not say this is a shift in anything from a Group strategy perspective. The £30-40 billion opportunity we see here is across both sides of the balance sheet: assets and liabilities. And here it is more about making sure we serve all of our customer needs rather than it being a balance sheet driven approach.

<u>Question 3</u>

Ian Gordon, Investec

First a pedantic question, in terms of your 21% branch market share, are we going to say a micro-branch is a branch? And then the real question – in terms of the absolute cost reduction from that transitional exercise, is the majority of the activity related to headcount rather than the Group structure and of that, are you willing to give us a pounds shillings and pence target, or should we just back it out of what you have said on the slide?

Answer: Jakob Pfaudler

OK, so let me answer the last one, we are not going to give you a pounds, shillings and pence answer, you wouldn't have expected that, I think. So the pedantic answer, yes micro branch is a branch. Wherever we have a physical outlet that is a branch and that in our view counts towards the branch market share.

The middle part of your question is: it is a combination. So the property aspect of our branch footprint is less than a third of the cost. So the cost drivers therefore are multiple ones. There is productivity gains, the number also includes our telephony service. So we do see further productivity gains and technology driven efficiency there. I don't want you to do a read across a 15 per cent into anything really.

Answer: Vim Maru

And I think there is also as we said, there is an opportunity to refocus as well. So the 30 per cent more in complex needs is in effect a reinvestment where we see opportunities for growth, whether that be in insurance, business banking etc.

<u>Question 4</u>

Just to clarify what I am hearing, it sounds like you are actually playing to the top line and not to the cost line. That repurposing the branches is a more costly endeavour, higher salaries. You are playing to the top line growth and not on savings. Is that fair?

Answer: Jakob Pfaudler

I don't think that is fair, it is a mix across all the different levers. And the trick here is, as we said earlier, to transform quite a few of the branches into smaller cost effective ones, but maintaining the reach on the high street and providing access to advice via remote advice. And then reinvesting some of that gain back into the larger branches to be able to serve complex needs better. So it plays on both levers.

Further answer: Vim Maru

And I think the other important point just to build on that is that we are very much customer led. So if customer behaviour changes, then we will adapt and adjust the approach that we have. So that is I think a really important consideration for us, we will continue to watch, follow. As you have seen in GSR2, the shift to digital has been at the top end of the 50–70 per cent range that we were expecting on simple needs. And so we will continue to adjust accordingly.

<u>Question 5</u>

In terms of the £30-40 billion, how do you think about deposit costs? Do you anticipate continued savings to [….] change in mix? Or actually with the rate outlook, do you see that potentially flat-line or even going up?

Answer: Vim Maru

So I think George answered it to some extent earlier that if we look at the 2018 horizon then I think we see still some opportunities in deposits where there are certain parts of our book where we are priced above the market and so we still see some opportunities. That is clearly part of how we balance the competitive pressures in the mortgage market at the moment which is why you know our NIM guidance is what it is. The longer term outlook and looking at this £30–40 billion. I think as you would expect, we are going to be disciplined about this. This is not going at growth with no eye on margins and so on. And as we have always done, we have always considered very carefully volume and margins. But we see some opportunities here for us to be more targeted and more segmented, for us to try and grow without having to see a big move in the deposit cost as a result of our approach here.

<u>Question 6</u>

Can you say about the key areas where you see that £30-40 billion opportunity? A bit of a cheeky question, but presumably there are some areas where you are perhaps over represented and therefore actually API could be a threat to you in taking some of your customers away.

Answer: Vim Maru

You are right, when you look at natural market shares and you look at micro segmentations, there will be some where you are above and some where you are below. In fact, we need to make sure that we continue to hold the shares in other segments where we are above our natural market share. And actually I guess when I look back at time, we have got a pretty good track record of doing that. But when we have done this we have seen opportunities across the whole of the balance sheet, Justin. It is mortgages, it is deposits, it is current accounts, it is consumer lending. It is right across the piece. And if you look at it over a longer period of time, there will be customers who might start in consumer lending who move to deposits, through to mortgages as they move through that cycle. And actually one of the key elements of our proposition is to think about that holistically for customers. So you think about it, how do I help you over the 3–5 year cycle that gets you to your final aspiration? And that is why the mix will shift over time at a customer by customer level.