GOLDMAN SACHS EUROPEAN FINANCIALS CONFERENCE WITH WILLIAM CHALMERS – PRESENTATION TRANSCRIPT
(amended in places to improve readability only)

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Benjamin Caven-Roberts, Equity Research Associate, Goldman Sachs (Moderator)

Benjamin Caven-Roberts
Well, good morning everyone, and thank you very much for joining us. It is a great pleasure to introduce our next speaker, William Chalmers, Chief Financial Officer of Lloyds Banking Group, a role he has held since August 2019. Prior to joining Lloyds, William held various roles in financial services including co-head of the Global Financial Institutions Group at Morgan Stanley. Thank you for being with us.

William Chalmers
Thank you, Ben. Very nice seeing you. Thank you for having us.

Benjamin Caven-Roberts
Brilliant. So, let us get started with a bit of a broad question. So how do you see the macro backdrop for the UK currently evolving?

William Chalmers
It is a good question and obviously an important one for us. I think overall, Ben, we see it as very resilient, and actually probably a touch better than our expectations. So, what do I mean by that? You will have seen at quarter one, we put our estimates for the year up a little bit. We saw some improvement in GDP, we saw unemployment coming down, at least our expectations for the year coming down at 4.3 per cent and we saw HPI going up about 1.5 per cent over the course of the year. Not much, but probably a touch better than we had previously expected. I think if anything, since then, Ben, we have seen the picture be a little stronger than we have previously thought.

So, you saw the GDP print for example in quarter one. That is pretty supportive. What's the impact of all of that? I think the impact is on asset growth, it is a touch better than we previously thought, on impairments, again, probably a touch better than we previously thought. So, I think overall that macro performance has been supportive.

The one point that has been a bit higher and a bit more volatile than we expected is of course term rates. We still expect bank base rates to come down over the period of time, but nonetheless, term rates have been a bit more sticky, I think on the upside than we had thought. What does that do? It slows down tangible net asset growth for us, not by much. We still expect growth, but nonetheless, the pace of it gets clipped a little bit by those term rates.

And then likewise, in our insurance business, we have a little bit of below-the-line volatility, which you saw a bit of in Q1. It is disconnected from capital, so it doesn't change capital outcomes and the like, but on the face of the P&L, it is a bit of noise.

So, I think stepping back overall, a supportive macro environment, which of course we are really pleased to see. We see that carrying on in 2024 and indeed going forward into 2025, and that is I think for us at least a conducive backdrop.

Benjamin Caven-Roberts
And I suppose if we tie that into NII, and you have guided average interest earning assets this year to be over £450 billion and a net interest margin over 290 basis points. So, could you just talk about some of the moving parts there, where are you feeling more confidence, particularly in terms of either the margins or the lending book?

William Chalmers
Three components really for net interest income. AIEA is number one, I will talk about that in just a second. Margin number two, and of course non-banking net interest income, number three.

AIEA first of all, it won't surprise you to know that given that macro backdrop, the AIEA performance has been pretty robust. We have given guidance for greater than £450 billion over the course of the year, and we feel very comfortable with that guidance as we stand today.

We saw £449 billion in quarter one, but do not forget that is because of a mortgage refinancing overhang that we flagged at the end of the year. So that is really not a surprise to us. It should not be a surprise to the market. Underneath that, what have we seen? We have seen mortgage growth, pretty strong. We talked about application volumes up 20 per cent in Q1. It is not going to be that strong year on year, but nonetheless, it is a good start.

Likewise, we saw some decent performance in unsecured and in motor. Personal loans and motor both had a little bit of a one-off effect in quarter one, dealer restocking in the context of motor, securitization catch up in respective personal loans. But again, strip all of that away and it is still a pretty decent performance.

Commercial balance is driven by repayment of government backed lending in significant part, and that is going to continue to be part of the picture for the next few quarters.

And underneath that, you have got still relatively slow SME overall demand. So the picture within commercial is probably a bit damper than it is within retail, but no real surprise. And overall, it doesn't undermine or challenge our confidence in the greater than £450 billion AIEA guidance for the year as a whole.

Second component, margin guidance of greater than 290 basis points for the year as a whole, and we feel very comfortable with that guidance as we stand today. You saw us print 295 basis points in respect of quarter one. That was down three basis points in the quarter, which itself is a significantly slowing down trajectory versus quarter four where it was down 10 basis points.

What's going on underneath that number? A couple of things really. Two big headwinds, one big tailwind. The headwinds that we have seen, deposit churn, I will talk more about that in just a second, and the mortgage refinancing headwind. Deposit churn is interesting. We are starting to see the beginnings of an inflection point. You saw deposit churn in terms of exits from PCA into savings, and exits from instant access into fixed term in quarter one, and I'd expect to see a little bit more of that in quarter two. But as the year plays out, we expect that to dissipate and attenuate, indeed, we are seeing signs of that in quarter two.

The mortgage refinancing headwind, we see mortgage completion margins right now around 65 basis points. The maturity yields and the mortgages that are coming off the balance sheet, however, are more like 120 basis points, and it is that combination which is the mortgage headwind, and that is going to take a little longer to play out. That will be there in 2024, it will be there in 2025, albeit slowing down in pace over that time, but nonetheless, still there.

Then of course the big tailwind is the structural hedge. So what's going on there? You saw some decent tailwind in quarter one. We do expect to see a pretty strong tailwind over the course of 2024. Bear in mind that quarter two will be a little bit of a drag, and that is simply because of the maturity yields on the hedges coming off.

But for 2024 as a whole, the structural hedge will be a strong tailwind and we expect that to be the same to a touch better in 2025, and again, better in the respect of 2026. So, some decent performance there in terms of the margin, which again gives us confidence in the overall greater than 290 basis points for the year.

And then of course, the third point that I mentioned is do not forget non-banking net interest income, it goes hand in hand with other income growth and you would expect it to tick up as other income growth activity levels increase in commercial, in transport and one to two other areas as well, Insurance Pensions and Investments, for example. So that is part of the picture, but it is there in part because of rate rises, but also in part because of good reasons relating to OOI activity.

Benjamin Caven-Roberts
And just touching a bit more on the structural hedge. So you have said that is a greater than £700 million benefit expected this year and picking up steam from then on. So to what extent should we consider some of those benefits as fully locked in now, and how sensitive would you see them relative to the path of deposits?

William Chalmers
Thank you for the question, Ben. It is an important one and it is an important part of our equity story, clearly. In a sense, when you look at prevailing rates, the bank is under-earning right now simply because it has a very large part of its deposit base parked in rates that are yielding much lower than market rates are today.

As we go forward, that under-earning comes out of the system, and that is what the structural hedge refinancing is all about. We saw structural hedge earnings of around £3.4 billion in 2023. We expect that to pick up by about £700 million in 2024.

We expect that to be similar or possibly a touch better in respect of 2025. And then we expect to pick up again in 2026, and that is because of the yields of the hedge that are rolling off and it is because of the prevailing rate environment that we have given guidance and an outlook on, number two.

So some pretty mechanistic trends , built into that structural hedge profile. In terms of the question that you posed Ben about how much of that is actually locked in, how exposed are we? Just to give a couple of comments on that.

We are pretty much done now for 2024 as you might expect, the further out you go, not surprisingly the less done we are, but just to give a bit of context around that, we are probably about four fifths done for 2025, and we are probably about two thirds done for 2026. So as you can see over time, as the years come closer, we are progressively locking in more and more of the structural hedge benefits that we expect to see and therefore that exposure becomes progressively less.

As we go forward, what are we exposed to in terms of structural hedge, two main factors, one is deposits. We have seen a little bit of deposit outflow from the structural in the course of quarter one, about £3 billion. We expect to see something probably fairly similar I suspect in quarter two, but then that should start to attenuate over the course of the year simply because we are seeing fewer customers migrate.

The deposit churn effectively slows over the course of the year as the rate environment changes, as the money that was going to move has already moved. And indeed, as things like inflationary pay settlements, which we are seeing in terms of the customer data come into play more and more in terms of the balances that are invested in the structural hedge. So that deposit churn becomes less of a feature as the year goes on, but we expect to see a little bit more of it in quarter two.

The second exposure is obviously rates. Then that has an effect upon the structural hedge earnings that you might be able to redeploy new hedges into in future years. But let us just step back a bit and recognize that actually those two exposures are offsetting - they go in different directions. So the more that you see rates go up, which in turn is consistent with deposits going out, nonetheless, the deposits that you retain on the balance sheet in the structural hedge, you're going to earn more from. So rates might go up that might encourage deposit outflow, but on the other hand, the deposits that you keep, you're going to earn more money from.

Likewise, if rates collapse, deposits stay where they are. So there are two exposures there. Rates number one, deposit outflow is number two, but let us be clear, they are going in different directions.

Benjamin Caven-Roberts
That is clear. And while a lot of attention does remain on your NII, it is worth noting as well that over a quarter of your income in 2023 came from other income. So what are your priorities there as a management team and some of the key focal points?

William Chalmers
Yes, important area for us, Ben. Thanks for the question. The other income performance, as I imagine people in this room will know, for quarter one was £1.34 billion, so that is about 7 per cent up year-on-year. It is about 4 per cent up quarter-on-quarter, both of which I think are respectable growth rates.

What's going on there, underneath it there are two things driving that growth. One is recovery and activity, essentially. That is given the type of supportive macro trends that we mentioned earlier on. And then two is obviously the landing of some of the strategic initiatives that we have been seeing and investing in quite heavily.

Stepping back on a business line perspective, it is good to see that year-on-year, those growth trends are coming from across the business. So if you look at retail for example, you're seeing growth trends there from PCA. You're seeing growth trends there from cards. You're seeing growth trends there from transportation, although bear in mind that transportation has been somewhat offset recently by increases in operating lease depreciation as well, which we saw in Q1 and we are going to see it again in Q2 given the developments in residual values and car prices and the like. But overall, the picture within retail other operating income is one of good, decent, solid growth.

Likewise, commercial banking, we have been pleased with developments in trading and capital markets and the like, where we have seen growth in share, growth in levels of activity and correspondingly growth in revenues.

Thirdly, Insurance, Pensions and Investments. Some of you will have seen, we have been slightly refocusing our proposition there. We are investing heavily in places like workplace pensions. We have been investing heavily in things like improving the infrastructure in GI and we have seen some benefits of that flowing through in terms of the actual results from those earnings streams or from those propositions I should say in quarter one and expect to see it going forward.

The focus of the investments pretty much follows those lines. You will see the focus of investments in things like mass affluent in retail, and you will see it in transportation in retail, you will see it in workplace in pensions, you will see it in merchant acquiring, DCM, FX and the like in commercial. So the investments are producing results. They are then supplemented by some of the macro basis that we have.

And then looking forward, the type of growth that we saw in 2023, and in the first quarter of 2024, I would expect us to continue to see growth in other operating income going forward for reasons mentioned, Ben, obviously it will be macro dependent to be clear as a lot of things in our business are.

But nonetheless, with that macro environment, I would expect that growth to continue going forward. And when we look at our 2026 ambitions of an incremental £1.5 billion in revenues from strategic initiatives, around about 50 per cent of that should be other operating income inspired, driven by some of the factors that I've been mentioning.

Benjamin Caven-Roberts
And turning now to operating costs. So you guide to £9.3 billion for this year - plus the £0.1 billion Bank of England Levy. So how are you balancing investments and savings, especially as you move further forward to a sub 50 per cent cost to income ratio by 2026?

William Chalmers
Just to take a step back momentarily on that, as you will be familiar, we have guided to £9.3 billion over the course of this year per your comment just there, Ben. That now of course has the Bank of England Levy again, as you highlighted in your question of about a £100 million. We expect to meet that guidance. We give out cost guidance after due consideration, and we have got a decent track record at least of meeting expectations and commitments in that respect.

It is worth just very briefly pausing on that Bank of England Levy point, simply to reinforce the fact that it is net neutral from a revenue perspective. So, we are now getting remunerated on reserves that we were not previously getting remunerated on but were instead being used to fund the Bank of England supervisory activities. Now instead we get a cost for it, but equally we get remunerated on those reserves. So, it is net neutral from a revenue perspective.

Meeting targets on the cost front, referring back to £9.3 billion. It is frankly always hard. I wouldn't want to understate it, but as said, we have a decent track record.

In Q1 we got £2.4 billion in operating expense costs, as you will have seen. That included one or two doses of one-offs, the Bank of England Levy being one of them, excess severance, which we front-loaded in order to get the benefit through the course of the year being the second. If you strip those two items out, then you have effectively got about a 1 per cent increase in operating expense year-on-year as a result of that, which is not bad when you look at the inflationary environment that we are countering or having to deal with.

The combination of BAU measures, matrix management, organizational design, supplier management number one, that collection of BAU cost management techniques, plus some of the strategic investments that we have been making, which are in nature cost driven. So things like automation, digitization, decommissioning, for example. Things like trying to make the operating model for change cheaper, for example. Those are strategic investment-driven cost savings.

That combination of BAU and strategic investment is what is behind the cost objectives that we have, and indeed what should allow us to deliver on our gross £1.2 billion cost savings target that we have got out there, which in turn allows us to deliver on £9.3 billion cost target plus of course the £0.1 billion Bank of England Levy. That is what's behind it. That is what's going on.

Now you mentioned Ben in your question, what then goes on in respect to 2026. 2026 first of all is a cost-income-ratio target. It is not an absolute cost target. So naturally you would look both to income in that respect and also to costs. Briefly in income, we touched upon it in the previous question, so I shan't repeat but nonetheless, you have got two or three things going on in income.

You have got restoration of activity levels, again, supported by hopefully conducive macro environment, but not above and beyond our guidance that we have given, number one.

Number two, you have got the benefits of strategic investments coming through. Some of the £4 billion over five years that we are investing really starts to land by 2026, I mentioned £1.5 billion of extra revenues just a second ago. And then number three, within the BAU you have got the structural hedge refinancing and we discussed that in response to your previous question, Ben.

So that combination of activity levels, strategic investments landing, structural hedge, continuing to deliver, indeed growing significantly, that is what delivers the income profile. Now, against that, you have got an investment program, which let us face it, banks need investment so I'm not going to suggest for a moment that all of a sudden that is going to get eliminated, it isn't. But nonetheless, the type of cost growth that comes off the back of the investment program that we have got should over time start to slow.

And of course, with that then depreciation follows and you get a slightly more stable cost growth pattern than we have seen in recent years. And it is that combination of income growth that we expect and much of that is fairly mechanical, together with the continued cost discipline in the way that I've described, that delivers operating leverage within the business. And it is that operating leverage, which in turn gives us confidence in the cost-income-ratio of less than 50 per cent by the time we get to 2026.

So that is what's going on behind it. And I think a lot of that, as described, I'd love to say it is all about management virtues and management being amazing. A lot of it is fairly mechanistic.

Benjamin Caven-Roberts
Very, very clear. Okay, so turning to asset quality. So you guide for an asset quality ratio of below 30 basis points for this year. In Q1, I think you did 23 basis points if you exclude the MES release and 6 basis points on a headline. So how would you assess the quality of the loan book at the moment and how comfortable are you with that guidance?

William Chalmers
Thank you, Ben. The short answer is, as I suspect won't surprise very many people in this room, that we feel very comfortable with the guidance on the asset quality ratio. As you said, six basis points in Q1, I mean, let us face it, we got the benefit of about £192 million MES in Q1. But even if you strip that out and then you also strip a bit of modelling benefit that we saw in commercial banking out as well, you're looking at an underlying asset quality ratio of about 28 basis points, which is still comfortably within the guidance that we have seen, rather the guidance that we gave.

The full year guidance that we gave, as you know, is less than 30 basis points. Off the back of Q1 and on the basis of what we are seeing in Q2, we feel very comfortable in respect of that guidance, it gives us a lot of confidence.

Rest of the year, what's going on within that, that gives us that confidence. I think it is the positive portfolio performance. We talked about it a lot in the Q1 results, mortgage new to arrears, for example, are coming down, other assets within retail, performing at or below pre-pandemic type levels, number one.

Number two, early warning indicators. Really pretty benign. We are not seeing any signs of stress in terms of the customer base that we have. Minimum payers in cards, for example, pretty good. Overdraft utilization within SME, pretty good. Very stable early warning indicators.

As I think everybody knows, we have pretty prudent underwriting standards within the bank as a whole, so that gives us some degree of confidence again moving forward. And then on top of that, we feel very well provisioned. We have an ECL expected credit loss right now of £4.1 billion. That is about £600 million in excess of our base case ECL requirements.

Now that is produced by virtue of our IFRS 9 modelling to be clear, it is a formulaic output of the way in which we model IFRS 9 expectations, which include a dose of more adverse outcomes, and therefore producing an ECL in excess of base.

But it also makes us feel pretty comfortable in terms of provisioning the balance sheet. It is a high-quality loan book. Ben, I would be very happy to quote statistics and so forth backing that up. But just to give a small dose of them, you got mortgages with about a 43 per cent LTV, for example, less than 2 per cent of the mortgage book is greater than 90 per cent LTV, of which much of that is government guaranteed because of the way in which the mechanics work in the UK.

We have got an unsecured book, which is very prime in its orientation. We have got an SME book, which is more than 90 per cent secured. We have got a C&I book, Corporate and Institutional book, which is more than 80 per cent investment grade.

So, we have got, what we consider to be a very high-quality loan book out there, which again supports our expectations around asset quality. So, as we step back, the environment that we are seeing, the macro forecast that we have got, then we feel very comfortable as to our asset quality commitments that we have put out there and we should be comfortably below a 30 basis points.

Benjamin Caven-Roberts
Okay. And wrapping all the P&L together, now, you have given us some very clear moving parts. So, you guide for around 13 per cent return on tangible in 2024 and greater than 15 per cent in 2026. Could you just help us with what drives that improved profitability at a high level and then where you see through cycle returns stabilizing?

William Chalmers
A couple of questions in there, Ben. I will take them maybe just one by one. First of all, in terms of 2024 RoTE guidance, as you know, we have guided to circa 13 per cent in respect of 2024. We again, feel very comfortable with that guidance as we stand today. We saw a 13.3 per cent delivered in Q1. Now you might say, "Okay, but you saw the benefit of £192 million MES release during that quarter one", that is true. But on the other hand, we also saw the Bank of England levy. We also saw excess severance. We also saw volatility and if you add all of that together, that together is around or actually greater than £200 million. So that offsets the MES benefits that we have got and makes the 13.3 per cent that we saw in quarter one, look pretty robust.

Looking at the rest of the year, you're familiar with the macro assumptions that we have got. We have talked a lot about income. We have talked about the cost commitment of £9.3 billion plus the Bank of England levy. We have talked about the macro environment, the impairments point.

Overall, you can see in the context of a rising TNAV, which we still expect to see, despite my earlier comments about term rates, that gives us confidence in the circa 13 per cent RoTE for this year. Your question, Ben, is then, looking forward, how does that change as we go into 2026?

And again, just like the cost-to-income ratio really, it is worth bearing in mind that there are both income factors here at play and also cost factors here at play. So, stepping back, people are aware of the macro guidance that we have given. We are looking towards a pretty stable, frankly, not very exciting, but nonetheless pretty stable macro backdrop against which we expect to perform. The banks are robustly positioned to be clear if that doesn't pan out, but nonetheless, that is the background assumption.

What's going on, on the income side? Again, I shan't repeat, but there's three dynamics going on. Business as usual activity, structural hedge and landing of strategic investments. There's a fourth point which is in the mix there, which I didn't mention earlier on, but it is the elimination of one or two of the headwinds.

I mentioned deposit churn, which we expect to see settling down in the second half of this year, supported by some of the early evidence that we are seeing in quarter two. But also, by the time we get to 2026, the mortgage headwind just mechanistically comes out. That refinancing headwind of 120 basis points of old assets being swapped for 65 basis points of new assets, that is played out by the time you get to 2026. So that is another feature of that 2026 income story.

And then as said earlier on, you have got a cost base, which is still growing, I would imagine, because we'll continue to invest within the business, but it is growing at a more moderate race as the investments are slowing in pace, but also the strategic investments that we have made to reduce the cost base, the points I was making earlier on, those come home, and as a result, delivery in 2026 shows a slightly more stable cost outlook.

That is the operational leverage that delivers a big part of the story. Now as said, because we get the structural hedge maturing and because we get additional pension contributions and the like, we also expect to see TNAV growing over this period. So we do expect a reasonable pace of TNAV growth over the period of between 2024 and 2026. And when you put those two together, the P&L comments that I was making, together with the TNAV comments that I'm making, what we see is effectively a decent and indeed stronger return off the back of a rising and higher TNAV.

It is that combination of a stronger return and a higher TNAV that we expect to see off the back, by the time, I should say, we get to 2026. And as said, a lot of that is relatively mechanistic in its orientation.

Third point that you asked, Ben, is around, "Where do we expect returns to go over the medium and longer term for the industry?" I think it is safe to say, it won't come as a surprise to anybody that a lot depends upon the rate environment that we are in. We have just seen 10 plus years of very low rates and there's no doubt in my mind that that led to a subdued outcome in terms of bank profitability.

Equally, the rate environment that we are in right now is much more conducive to stable and better profitability within the bank sector. Now it is our expectation that rates come off as I think, probably the market consensus would suggest the same. That is to say we expect base rates to come down. We also expect term rates to come down with them over the course of time. It will take a little while to play out, but we do expect that. You have seen our medium-term rates landing zone, is now around 3 per cent or so. I think the market's probably a touch above that, but we are around 3 per cent.

That is an environment that is conducive to decent profitability within the sector. Now when you compound that, in our case, with a business model that is specifically focused on, if you like, the more attractive areas of banking, retail and commercial banking focus, obviously you have got the insurance business alongside of that, then a conducive macro environment is compounded by a business model that is focused on the more attractive areas of banking and I would expect, in that context, to deliver attractive returns on a sustained basis going forward.

Benjamin Caven-Roberts

Okay, and your points about TNAV, I think, twin quite nicely into thinking about capital development. So, you have highlighted that you expect to pay down to around 13.5 per cent by end 2024 and 13 per cent by end 2026. So how are you prioritizing there between returning capital to shareholders and pursuing growth?

William Chalmers

Thank you for that question. It is clearly an important area and as I imagine people in the room will be aware, we reduced our capital target by the time we get to 2026 to 13 per cent, moving slightly away from our longer-term capital target we have had for a few years now of 13.5 per cent.

So why did we make that move? First question. And I will talk subsequently about capital generation a little bit. The move was really driven by three factors. One is a significant de-risking of the business that we have seen over recent years and I think has intensified since I got here, since Charlie arrived and so forth.

What do I mean by that? Well, it is evidenced across a number of different areas. Retail, for example, the heritage Mortgage book, which goes back to mortgages written in the 2000s, 2008 type period, that is steadily exiting the business. It is now down to around £28 billion or so. It has come down sharply during the time that I've been here. And indeed actually the asset quality performance of that book has been very benign. I mentioned earlier on, new to arrears where the mortgages are dropping, that business has been a big part of that fall, behaving very well even in the current environment. That is in retail.

Within commercial, we have a relatively modest CRE book, for example. We have an SME book, that as I mentioned earlier on, is very secure and it has been performing exceptionally well. So, on the balance sheet, a significant de-risking. That is been accompanied by de-risking across areas that are non-balance sheet related. When I came in, we had a £7.2 billion pension deficit. The actuarial pension deficit for us right now, as of the latest triennial is zero.

So we have eliminated not just balance sheet risk, but we have also eliminated a lot of non-balance sheet risk and therefore the business has been materially de-risked over the last few years.

Second point is the regulatory picture going forward looks a lot clearer than it did just a couple of years ago. So specifically, what do I mean by that? We have seen CRD-IV, which is basically the mortgage risk weighting rebalancing driven by some of the PRA requirements. We now have a pretty good picture as to where that is going to go.

We expect about another £5 billion of RWAs to be added onto our RWA account by virtue of the CRD-IV mortgage modelling, but we know more or less what that is. It might be a touch more than £5 billion. It might be a touch less than £5 billion, but we know it is roughly speaking going to be in that landing zone. We'll know more as models get finalized, and of course we'll update accordingly.

Likewise, Basel 3.1. The timing is a little uncertain, but we kind of know it is going to be roughly net neutral for the business. Retail is going to go up a little bit, commercial is going to go down a little bit. Overall net neutral.

As a result, the timing uncertainties around Basel 3.1 do not terribly much matter to us because you have got that neutrality in terms of the outcome. And then finally, in respect of regulatory clarity, Pillar 2A charge, which is clearly a core part of our regulatory capital requirements, that is been pretty stable and it is been pretty modest over the last few years. Now, it will move around a little bit from time to time, for sure. But nonetheless, stable and relatively modest is the overall expectation, the overall picture, which overall I think doesn't mean that all areas of regulatory certainty are perfectly in place right now. It doesn't mean that.

But on the other hand, it does mean that the clarity is greater today than it was even as recently as a year or two ago. Now that is the second point. The third point in terms of our reduction in our target CET1 ratio to 13 per cent is that we have very much kept our capital buffer in that overall capital target.

So at the moment we have a regulatory capital requirement on a BAU basis of 12 per cent. Any stress basis on which we measure our capital requirements are in fact lower than that 12 per cent. So the biting point for us is the 12 per cent BAU capital requirement. Our 13 per cent target deliberately maintains a 1 per cent buffer to accommodate for macro uncertainty.

Now we are also a profitable institution as you know, in fact quite a profitable institution. Therefore, there's buffer from the kind of BAU flows, but quite apart from that, there's buffer within the stock of that 1 per cent, which for those have already done this maths in their heads apologies, but nonetheless, it is somewhere between two to two and half billion of buffer by virtue of that 1 per cent.

So overall we feel very comfortable with that target capital ratio reduction, 13.5 per cent to 13 per cent. For those debt investors in the room, do not worry because actually, because of the increasing RWA intensity within the business by virtue of CRD IV for example, the actual capital within the business is going up during that time and that is simply because RWA density is going up. So even if you drop the ratio slightly, the capital invested in the business continues to go up despite that de-risking point that I made earlier on. Hopefully, therefore it is good news for all stakeholders.

Looking forward as we allocate capital, perhaps to move slightly to the second point and stop there, as we allocate capital, we are going to be looking at three things really. One is how do we make sure that we continue to maintain and indeed build the competitive position of the bank. Alongside of that reward our colleagues appropriately. Alongside of that grow the business. So that is a big part of our capital allocation and that is got to be the start point for any consideration.

A second is, and it is a kind of sine qua non, it is non-negotiable, we maintain strong capital ratios, and I hope my points around 13 per cent have vindicated that and supported that point. Strong capital ratios go without saying they are a necessity for the business and they simply won't be compromised on.

And then thirdly, strong shareholder distributions. Whether it is by dividend growth, we grew 15 per cent for example in dividend last year, or whether it is by buyback, we have got a £2 billion buyback in operation right now, we expect to see sustained strong capital distribution to shareholders.

So, the capital allocation framework is going to look across those three points, Ben. We are going to look across how do we sustain business best going forward, how do we maintain strong capital ratios, how do we maintain strong shareholder distributions.

And I think by virtue of the business model, by the setup that we have, by the scale that we have, by the customer service that we have, by the efficiency in both costs and capital, we should be able to triangulate, forgive the term, between all three of those and satisfy all three constraints in any given year.

Ben
Very clear. So, we have a few minutes left if anyone from the audience has a question. I would just request that you wait until a microphone gets to you and then state the name of yourself and your institution. So, here in the front please.

Dirk Becker – Allianz Global Investors
Good morning. It is Dirk Becker from Allianz Global Investors. I was wondering, do you have any comments on this motor finance investigation that is going on in the UK? You took this early provision. Is that the first indication? Is that the second PPI or what's going on there?

William Chalmers
Thank you, Dirk. It is a very relevant question, a very fair question to ask. Couple of points maybe to make. One is, let us just view it in context for a moment. Motor finance is finance that is used to fund somewhere around 80 per cent of car purchases in the UK. So, whatever the solution that is arrived at, it has to be a solution that is consistent with an enduring and supportive approach to the role of motor finance within the UK.

That I think is why the FCA intervened. It does not want a disorderly outcome to what is going on. It needs to have an outcome that again, is supportive to a significant part of the UK economy and secures an ongoing role for motor finance within the UK. Hence, it intervened to ensure that we get to an orderly position.

Third point, the FCA is looking for evidence of misconduct and customer loss. From our perspective, we complied with all the relevant regulations at the relevant time, and therefore as we look at the business, we have not found evidence of misconduct or customer loss.

Now of course you might say, "Well, okay, why did you then provision?" And we provisioned off the back of two things really. One is to take account of administrative impacts that of course we will see. The FCA has launched this investigation. We are gathering data. By its very nature, we are going to incur some administrative costs.

But also we then put in place a series of scenarios to see how this might play out. And some of those scenarios took an adverse view of the regulatory determinations. Things like they find, I suppose, some signs of customer loss and therefore a need for redress. And off the back of that, they do not allow any commission, zero commission basis. That is an adverse outcome versus a reasonable commission basis.

Alternatively, they go back right the way to 2007 versus let us say alternatives like 2014. Likewise, proactive versus reactive type of inputs. And we looked at those different scenarios, some with good outcomes on those key points, some with more adverse outcomes on those key points. And in our overall £450 million provision, we looked at those scenarios and took more or less a weighted average of what those scenarios might imply.

And therefore, administrative expenses, number one, potential address outcomes number two equals £450 million provision at the year-end.

As we stand today, Dirk, it is our best estimate of the right provision. So, there's no change. We expect to see some developments over the course of this year. The FCA is committed to publishing something by the third quarter. It is not clear to us whether that will be determinative of the outcome, full stop, or whether that may kick it into things like financial test cases into the law courts number two, possibly, in which case things will go on for a little bit longer.

But as said, right now, £450 million is our best estimate of provision based upon that type of scenario planning that I mentioned earlier on in an industry that everybody recognizes has got to be a critical part of the UK's future going forward.

Ben
That brings us right to time. So, William, thank you so much for joining us.

William Chalmers
Thank you very much indeed, Ben. Thank you.

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. Words such as, without limitation, 'believes', 'achieves', 'anticipates', 'estimates', 'expects', 'targets', 'should', 'intends', 'aims', 'projects', 'plans', 'potential', 'will', 'would', 'could', 'considered', 'likely', 'may', 'seek', 'estimate', 'probability', 'goal', 'objective', 'deliver', 'endeavour', 'prospects', 'optimistic' and similar expressions or variations on these expressions are intended to identify forward-looking statements. 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Factors that could cause actual business, strategy, targets, plans and/or results (including but not limited to the payment of dividends) to differ materially from forward-looking statements include, but are not limited to: general economic and business conditions in the UK and internationally; acts of hostility or terrorism and responses to those acts, or other such events; geopolitical unpredictability; the war between Russia and Ukraine; the conflicts in the Middle East; the tensions between China and Taiwan; political instability including as a result of any UK general election; market related risks, trends and developments; changes in client and consumer behaviour and demand; exposure to counterparty risk; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the Group's credit ratings; fluctuations in interest rates, inflation, exchange rates, stock markets and currencies; volatility in credit markets; volatility in the price of the Group's securities; tightening of monetary policy in jurisdictions in which the Group operates; natural pandemic and other disasters; risks concerning borrower and counterparty credit quality; risks affecting insurance business and defined benefit pension schemes; changes in laws, regulations, practices and accounting standards or taxation; changes to regulatory capital or liquidity requirements and similar contingencies; the policies and actions of governmental or regulatory authorities or courts together with any resulting impact on the future structure of the Group; risks associated with the Group's compliance with a wide range of laws and regulations; assessment related to resolution planning requirements; risks related to regulatory actions which may be taken in the event of a bank or Group failure; exposure to legal, regulatory or competition proceedings, investigations or complaints; failure to comply with anti-money laundering, counter terrorist financing, anti-bribery and sanctions regulations; failure to prevent or detect any illegal or improper activities; operational risks including risks as a result of the failure of third party suppliers; conduct risk; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; technological failure; inadequate or failed internal or external processes or systems; risks relating to ESG matters, such as climate change (and achieving climate change ambitions) and decarbonisation, including the Group's ability along with the government and other stakeholders to measure, manage and mitigate the impacts of climate change effectively, and human rights issues; the impact of competitive conditions; failure to attract, retain and develop high calibre talent; the ability to achieve strategic objectives; the ability to derive cost savings and other benefits including, but without limitation, as a result of any acquisitions, disposals and other strategic transactions; inability to capture accurately the expected value from acquisitions; assumptions and estimates that form the basis of the Group's financial statements; and potential changes in dividend policy. A number of these influences and factors are beyond the Group's control. Please refer to the latest Annual Report on Form 20-F filed by Lloyds Banking Group plc with the US Securities and Exchange Commission (the SEC), which is available on the SEC's website at www.sec.gov, for a discussion of certain factors and risks. Lloyds Banking Group plc may also make or disclose written and/or oral forward-looking statements in other written materials and in oral statements made by the directors, officers or employees of Lloyds Banking Group plc to third parties, including financial analysts. Except as required by any applicable law or regulation, the forward-looking statements contained in this document are made as of today's date, and the Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained in this document whether as a result of new information, future events or otherwise. 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