BANK OF AMERICA GLOBAL FINANCIALS CONFERENCE WITH WILLIAM CHALMERS – PRESENTATION TRANSCRIPT
(amended in places to improve readability only)

Tuesday 24 September 2024 – 9.30am (BST)

William Chalmers, Chief Financial Officer, Lloyds Banking Group
Perlie Mong, Banks Research Analyst, Bank of America (Moderator)

Perlie Mong
I'm Perlie Mong from the Banks Research team. It's my pleasure today to welcome William Chalmers, CFO of Lloyds Banking Group. William, thank you very much for joining me today.

William Chalmers:
Thank you for inviting us.

Perlie Mong:
So William, like all banks, Lloyds have benefited a lot from the interest rate rises in the last few years. Now that we are past peak rates, I think there's a lot of attention on sustainability of returns from here. So strategically, you are aiming for a greater than 15 per cent ROTE. Do you think the UK economic environment is conducive to that?

William Chalmers
It's a good question, Perlie, and perhaps just before answering it, to say thank you very much indeed to everybody here for taking the time to attend this morning. Your interest is always really appreciated, so thank you. And thank you to Bank of America for hosting us and giving us the opportunity.

The question is around economics and whether that's consistent with our returns as a business and our aspirations for greater than 15 per cent by 2026. I think the first point is that the overall environment within the UK, as you know, has been probably more supportive than we would have thought a little earlier on this year and certainly last year, and has manifested itself in terms of us upgrading our economic forecasts in Q2. So they're not exactly glittering, but on the other hand, we put GDP up to 0.8 per cent expectation in 2024, 1.2 per cent in 2025. We've got similarly more benign HPI expectations. We expect unemployment to peak at a pretty low and pretty benign 4.9 per cent settling around 4.8 per cent again next year. And then off the back of that, a gentle rates reduction to 3.5 per cent by 2026. So all of that is a modest upgrade from where we were at quarter one.

And to your point, Perlie, that is a consistent, a stable, a relatively benign, and relatively constructive operating environment. I think it's worth saying that our return expectations, however, the greater than 15 per cent by 2026, depend also upon the various mechanics within the P&L. So I'm sure we'll talk more about them, but just to highlight one or two, in particular, the strengthening of the tailwind of the structural hedge, in particular, the kind of gradual abeyance, if you like, of the headwinds of the mortgage refinancing to an extent to slow down deposit churn, that all overall improves the income picture supplemented by the delivery of strategic initiatives as part of our transformation, Perlie. And that combined with a slowdown in new investment and continued commitment to managing costs very tightly allows the business to develop operating leverage. Now, much of that, particularly on the income side, headwinds and tailwinds, for example, is pretty mechanical. But the key point I think, Perlie, is that it's not just a stable constructive economic backdrop that allows us to deliver the greater than 15 per cent by 2026, it's also these mechanics within the P&L we expect to play out.

Perlie Mong
Yeah, that's very clear. You've talked about the income line, so I would just like to go a little bit further in that so you can help us a bit more with the way we think about the moving parts. So let's start with the net interest margin. Perhaps I can split that into two parts. And the first is on customer pricing. So do you see a risk to deposit spreads from here, now that we've had a first-rate cut and customers are noticing that their deposit rates are coming down, do you see any changes in that? And obviously, we have TFSME refinancing coming up and I would also love to hear your thoughts on the current pricing environment for mortgages.

William Chalmers
Sure. A couple of points there, Perlie. One is around how we see deposits evolving going forward, and the second is around mortgages and how their spreads are evolving over the course of this year. When we look at the overall deposit environment, it's actually pretty constructive and pretty benign right now. So what are we seeing? We saw deposits up £5.5 billion over the course of quarter two. Good development. That's a combined effort within savings, a little bit more stability within PCAs than we'd expected. And I think, Perlie, when we look at the developments in Q3 so far, a similar sort of pattern. Now you asked the question what are two of the factors that are kind of imminent, if you like, going to slow that down at all? Rates reductions, what effect could

they have? We'll look at rates reductions and how we translate that into the deposit base based upon the usual factors of value to our customers, how our competitors respond, and indeed, the funding structure of the balance sheet.

But if I think about that, it's what led us to pass on, if you like, for around 50 per cent of the first-rate cut. And when we look at the overall market, actually many of the pass-ons within the market were well in excess of that, which I think, Perlie, indicates to us that actually deposit competition is pretty rational right now. Overall, pretty constructive from a pricing point of view. TFSME is an interesting topic. That combined with QT sometimes is thought of as a bit of a headwind to deposit development within the economy as a whole. A couple of points I'll make on that. One is actually deposits so far this year have probably grown by about double our expectations at the beginning of the year. So pretty good volume environment. And that's in the context of a well anticipated TFSME payback next year. We ourselves, as the audience, many of the audience will know, have around £30 billion of TFSME, about £21 billion of that is repayable next year.

Actually, that is absorbable within our BAU funding plans this year and next year and going beyond. And it's well anticipated. And we're not alone in that respect. That's where the market is. It has seen this coming for a while. I think it's absorbed it in the context of funding plans. And as I said, if you look at that in the context of what's going on in deposit pricing, it does not indicate that TFSME is going to lead to challenges within overall deposits competition within the market. So rate declines, TFSME volumes coming forward, we don't see that as fundamentally changing the picture much. And indeed, our experience so far in Q3 as to volumes and then deposits as to stability of things like the PCA balances has probably been a touch ahead, certainly in line with and maybe a touch ahead of our overall expectations, Perlie.

You asked about mortgage pricing there. Q2 as you know, 70 basis points overall completion margins within the mortgage business. I think then going into Q3 principally off the back of strong volumes within the mortgage market, probably prompted by rate reductions leading to increased levels of activity that then led to a widening of spreads early in Q3. Now, having said that, I think then subsequently what we saw is that some of the players who had seeded a bit of market share in Q2 and Q1 maybe, the first half, came back into the market a little bit. And that combined with a drop in stock spreads, which in turn led to a fall in mortgage pricing, put completion spreads perhaps back to where they were. So where does that leave us for Q3? I think it's basically back to where we started, Perlie. So we had 70 basis points in Q2. My expectation based upon those puts and takes in Q3 is that we'll have much the same in Q3 as we look forward.

Perlie Mong
And is this something different about your mortgage bill because you're still talking about asset margin compression from some of your older mortgages rolling off, whereas some of your larger peers have basically said that it's over. So what is different about your mortgage book?

William Chalmers
Well, it won't surprise you that I can't really comment on our peers' mortgage books, but I can obviously comment on ours. Essentially, ours is composed of a variety of vintages in the mortgage book and a variety of terms in the mortgage book. Some two years, some five year. Those are the two predominant terms. And we wrote a lot of business during the pandemic period in particular when spreads were really very wide. So as a result, we've got a fair bit of that rolling off within the mortgage book as we go forward. So at a time when others were perhaps a little bit more constrained in their supply, we were relatively strong in the market. And indeed, I would see that as a strength of the business. We are able to react to periods of time when spreads are wide in markets that we like from a risk-adjusted return perspective, and we'll enter those markets and we'll participate. We won't shy away from that.

That does then produce, obviously, a kind of fairly formulaic response in terms of the runoff profile in the book going forward. So where are we on that today, Perlie? We are looking at maturity margins within the mortgage book for around 110 basis points. We're looking at new business of around 70 basis points, as I said just now. That's around a 40 basis point headwind, if you like, as that turns over. That'll start to flatten off a little in 2025. But to be very clear, it actually really only gets eliminated by the first half of 2026. So that mortgage headwind, which is good in many respects because it's, if you like, testimony to the income that is coming off the mortgage book, nonetheless is a constraint in terms of margin development, which doesn't really play itself out until the first half of 2026. But by that time, combined with deposit churn combined with structural hedge tailwind, we think gives us a pretty solid development in terms of the overall net interest income line.

Perlie Mong
Thank you. And then the second part, and I guess the only topic that we have not discussed so far is the structural hedge. So you've given a lot of guidance on what you expect the benefit to be this year and next year as well, and coupled that with the deposit dynamics, could you comment a bit of what you expect to see in the next few years and how does the net interest margin can rise as policy rates fall?

William Chalmers
Sure. Yeah, it's perhaps worth starting where you just left off, actually, Perlie, which is to say it is indeed our expectation that the margin will rise as policy rates fall. So to be very clear, that is our base case. Policy rates fall, the margin nonetheless rises. What's going on there? It's really the points that you've highlighted, Perlie, which is to say we've got a combination of the tailwinds strengthening, principally the structural hedge, combined with the headwinds somewhat going into abeyance in the kind of chronology that I just outlined a second ago. Your question was focused particularly on the structural hedge. So maybe just to respond briefly on that. The structural hedge right now is around £242 billion, as you know. Those are deposits, equity, other components of structural hedge, which is yielding about 1.6 per cent. That is getting reinvested at a rate of let's say 3.5 per cent for term swaps. That's obviously a substantial tailwind, particularly when you think about it getting refinanced. It's about a three-and-a-half-year weighted average life, so arithmetically you can get to about £30 or £40 billion refinancing every year on that basis. That contributes significantly in any given year. We've said that in respect to 2024, we've got a structural hedge earnings that are going to be up about £700 million, or actually we've said in excess of £700 million. So it goes from £3.4 billion in 2023 to in excess of £4.1 billion from the structural hedge contribution in 2024.

We then said that we expect that structural hedge growth to be in excess of that again in 2025 and then to be materially in excess of that again in 2026. So you've got the structural hedge contribution, if you like, steadily building, 2024, 2025, and particularly into 2026. That combined with the other aspects of the story, Perlie, on the margin line at least, delivers us an expectation around the margin that if you like inflects in the second half of this year. We talked in the past about second half of 2024 being our expectation for the margin to start to increase. We see that pattern gently continuing into 2025, again, gently continuing into 2025, and then lifting quite more materially, if you like, in the context of 2026. So that's the overall pattern for the margin, Perlie, and indeed, just to again, bring it back to where we started, yes, that means that the NIM goes up when policy rates come down.

Perlie Mong:
And bringing all of that together, do you have a sense of what the sweet spot is in terms of rate to help Lloyds deliver the returns that you have outlined so far?

William Chalmers
Yes, it's a good question. I suspect everybody in this room probably has a different point of view on that, at least as far as the macroeconomy is concerned. For now, at least, as you know, our expectation is that rates go down to about 3.5 per cent by 2026. That's what's in our forecast that we put out for quarter two. We might be modestly ahead of the market right now, but obviously the market goes up and down at any given moment. That is very consistent with indeed conducive to a pretty stable income environment - in fact, a growing income environment per my comments just now - together with a pretty benign asset quality environment. So that's not a bad operating environment to be in.

I think to your point, Perlie, what is a sweet spot? By which I take it to mean what would be more stimulative, if you like, for GDP growth? Probably rates being a touch lower than that. I am not quite sure what the number is, but maybe 2.5 to 3 per cent, something like that might be more consistent with a bit more GDP growth that we all like to see within the economy. That's also a pretty benign operating environment as you can imagine. And that in turn is also consistent with our greater than 15 per cent ROTE expectations for 2026. In fact, if you track back to the year-end or Q1, that is indeed where our base rates were expected to end, i.e. 3 per cent I think was a number that we had at that time, and our targets were just the same.

In that environment, you might run a little bit more rates risk on things like the structural hedge, but equally you would expect a deposit churn to be a touch lower because you've got lower rates environment, allied to which you might expect activity levels and therefore asset growth and therefore asset margins to be a touch stronger. So I think on balance, what is the sweet spot? Maybe it's a touch south of where we are today, but for now our forecasts, as you know, are 3.5 per cent by 2026.

Perlie Mong
That's very clear. Thank you. And staying on the topic of growth, as you've mentioned, there are pockets of demands coming through this year already, mortgages in particular. So do you see that continuing to build and what do you think would need to happen for growth in the commercial book?

William Chalmers
Yeah, it's a good question, Perlie. First of all, maybe just to start out at a suitably high level in terms of the question, the performance over the course of Q2 in terms of asset growth and deposit growth within the business, the balance sheet as a whole, if you like, has been pretty good. So what do I mean by that? We've seen £3.9 billion growth on the asset side within quarter two. We've seen £5.5 billion on the deposit side within quarter two, so pretty respectable. To be perfectly honest, would I expect the balance sheet to grow at 1 per cent loans and advances every quarter? No, I think that's probably a touch higher than I would expect on a run rate basis. But having said that, I do expect the balance sheet, and including on the loans and advances side, in

fact, in particular on the loans and advances side, to continue to grow in H2. So just to be clear, we do expect that growth pattern that we saw in the first half to continue into H2.

Now, what's going on beneath the surface? Retail, first of all. It's good to see retail on the whole actually be pretty balanced growth across the piece. So mortgages, for example, £2.3 billion within mortgages. Actually, if you add back securitizations, which as you know we implement both as a capital enhancement technique on an NPV positive basis as well as a risk management technique. If you add those back, it's £3.2 billion in growth in mortgages during that period. You look at loans. Personal loans, that is £0.6 billion growth in quarter two. You look at cars. £0.4 billion growth in quarter two. So some pretty pleasing numbers over the spread, if you like, of retail activities. And again, I would expect that to continue in H2. The only possible exception to that in retail is motor where we saw quite a lot of restocking in the first half. Naturally you would expect that to come off a little bit in the second half as dealers run their stocks down and so motor balances reflect that. But overall, I think a pattern of continued retail growth.

You asked about CB, commercial banking, Perlie, entirely fairly, quite rightly. Within commercial banking, we've got balances, as you know, of about just over £88 billion. We saw growth in commercial banking balances of about £0.3 billion in Q2, so quite a lot lower than retail. What's going on there is really two factors. One is within CIB, Corporate and Institutional Banking, we continue to build balances modestly, basically in pursuit of ancillary, typically capital markets-related business. So we're never going to chase lending for lending's sake within CIB simply because, as everybody in this room knows, the returns aren't there on that side of the business. But where we can sensibly do so in the context of building capital markets business, financial markets business, then we'll do a little bit of it.

The more interesting, more nuanced story is in the context of SME or what we call BCB, Business and Commercial Banking. And in there, there is a little bit of reduction actually in balances in quarter two, and specifically what's going on there is, number one, payback of government bounce-back lending. We started off during the pandemic with about £9.6 billion of bounce-back lending balances. We are now at about £3 billion. Those things are paying back on a relatively regular clip, and obviously that will slow down as we get into the last tiers, but that number stands at about £3 billion today.

And then the second factor, Perlie, is we're seeing relatively muted demand on an underlying basis. I think we've got a combination of relatively cash-rich SME clients, number one, and perhaps looking for a slightly lower rate environment, maybe a little bit more confidence before they significantly invest going forward. And I think then you add those two things together and you look forward and you say, 2025, that bounce-back loan repayment now down to £3 billion - that really ought to slow down a little bit for obvious reasons. Likewise, if we get a bit more confidence in the economy, perhaps in line with your first question, Perlie, you might see the underlying demand strengthen particularly as rates go down. That in turn we believe will lead to a different BCB performance, SME performance. But let's be clear, I don't see that as a 2024 phenomenon, and I think that's more going into 2025 as we go forward. And obviously, like everything else, it will be macro-dependent.

Perlie Mong
Of course. And staying on the topic of macro and growth, what are your initial thoughts working with a new government who has clearly got a pro-growth agenda? And we've heard about that a lot yesterday as well at the Labour conference. So do you have any expectations regarding what you might see at the budget?

William Chalmers
It's the million-dollar question, isn't it really, right now? I suppose a couple of points. One is maybe just stating the obvious, which as everybody knows, Help Britain Prosper is our purpose. We have a vested interest in the success of the UK, which should be very clear. That's where our focus is, that's where our investment is, and we'll do everything we can to support it. That obviously means that we are in fairly active dialogue with the government. We're also in fairly active dialogue with the opposition at any given point in time. We want to see the UK succeed. We have a vested interest in it. We have a role to play in its success.

When we interact with the government, we, just like everybody else, I think, recognize that growth is the imperative. Growth is the mandate of the government. And we believe, and I'm sure many in this room likewise believe, that that is sincerely held. I think what we hope to see coming off the back of that, is some manifestation of that ambition in terms of the policy implementation that we might see in the October budget, for example, or alternatively the spring spending review. We'll be looking for signs of that commitment to growth to be manifested through concrete measures, if you like, in respect of the budgets and the like.

There's a lot of talk right now about tax as part of that and what impact is that going to have, where is it going to hit, which sectors. Which individuals, I suppose. And in that context, the question as to bank tax and so forth comes up. A couple of points I'll make on that, Perlie, and maybe to respond to your question. One is we have no particular insight into exactly where the government will go in October of this year. We have good government dialogue, but we have no particular insight into the October budget, to be clear. Having said that, as said, we do believe that their attachment to growth, the imperative of growth is indeed sincerely held. We also believe that they fundamentally believe in the value of stability as an underpin, if you like, of that growth. And we also believe that the tax agenda needs to be stable with it, again as an underpin of that growth. And I think that is relatively broadly understood. So again, we have no particular insight into the October budget and what that might throw out. But we do have very constructive conversations with the government consistently on the need for stability, on the need for a stable and predictable tax regime, and the importance of banks in particular, in helping promote the growth agenda within the UK. From those conversations and the sentiments around it at least, we do draw some comfort.

Perlie Mong
That's great. Can I just ask you about capital in the context of growth then? So, you are doing 175 basis point of capital generation near term and that's going to go over 200 basis point as your strategy delivers. So, how should we think of a distributions in that context, your past two 13 per cent CET1, and how are you thinking about M&A when you think about capital usage?

William Chalmers
A lot of questions there, Perlie, good questions and of course, at the end of the day what the bank is about, is about generating stable, predictable, and growing capital returns to our investors. That is the mission that Charlie and I set out to achieve with Lloyds Banking Group. It goes back a long way with Lloyds Banking Group, as you know, and is responsible for the way in which the business has developed, the focus of the business model, and the like. Your question, Perlie, is right at the heart of what we're trying to achieve with the group.

Specifically in terms of where we're at, as you said, 175 basis points of capital generation is our expectation for this year. So far, as of Q2, 87 basis points year-to-date, so we're well on track for that and we expect to achieve that 175 basis points for the year as a whole. That then grows to greater than 200 basis points by the time it gets to 2026.

And behind that, as per your earlier questions in our discussion, is the operating leverage that we seek to get within the business as income grows and costs stabilize. And off the back of that, it delivers the ROTE in excess of 15 per cent and the capital generation in excess of 200 basis points. Those are commitments that we adhere to and stick with and repeat it again at Q2, just as we have in pretty much every year through the strategy of limitation.

Your question, Perlie, about what do we do with that capital. Again, at heart is a commitment to give the capital back to our investors, to our shareholders. There are two particular ways in which we do that, as many in this room will be familiar with. One is the progressive and sustainable dividend. And that is an absolute commitment to ensure a steady, reliable income stream to investors.

As you know, we put the dividend up by 15 per cent at the interim. When I look at our earnings projections for the business going forward and our expectations, I think there's plenty of room for that to grow in future periods. So, we remain confident in our ability to stick with that commitment and deliver on it.

Above and beyond that, we have a capital target of 13 per cent by 2026, and along the way, 13.5 per cent by the end of 2024. That in turn, means that from the organic capital generation and a little bit from de-stocking the existing stock of capital, we are likely to have the ability to give back more capital above and beyond that relatively stable dividend. That'll be a matter for the board as it always is at year end, to be perfectly clear.

But so far at least, we've chosen to manifest that commitment and to deliver on it through a buyback mechanism. As you know, for the last three years we've had a £2 billion buyback every year. Why have we chosen that mechanic? That, in turn, is done because we see a compelling value case in the stock, to be clear.

Number two: Our investors see it the same way. When we talk to our investors and say, 'How do you think about excess capital and how would you like to see it returned?' They answer in the way that you can imagine, and it's very consistent with our own user value. There's a lot of value on the table, so buyback makes an awful lot of sense.

And then number three: The buyback affords a degree of capital flexibility, which is always useful when you're managing an institution like a bank. So, continued commitment to give back excess capital above and beyond the dividend. So far at least, it's been in the form of the buyback. I don't see that value case changing as we stand here today. I'd like to think it does change as we progress going forward, but nonetheless today we think there's lots of value in the stock which, if you like, vindicates that stance. And we'll continue down that path.

What does it mean in terms of the capital position? The strength of the capital position is obviously paramount to us as an institution. Nonetheless, we have a target of 13 per cent by the time we get to 2026, which we believe is entirely consistent with that commitment, if you like, to capital strength. I think, therefore, as we move forward one should expect to see again progressive, sustainable capital turns back to shareholders.

In that context, Perlie, you mentioned M&A at the end of your question. First and foremost, the strategy is organic. You'd expect me to say that, but it is genuinely true, and I think our record probably lends testimony to it. Having said that, where we think we can add scale, where we think we can add capability, we'll take a look at M&A.

How does that get applied in practice? It basically gets applied through three principle filters. If it can add scale and capability, we'll take a look at things and figure out whether they can add value in a way that exceeds our organic alternative. We'll figure out whether it can do so at a pace, at a speed which is more effective or quicker to resolution, if you like, versus our organic alternative. And perhaps most importantly, in some respects at least, we'll figure out whether we can do so within acceptable risk parameters, again versus our organic alternative.

So those three inputs of value, speed and risk, Perlie, will always be used as hurdles, if you like, that any M&A has to surpass. Again, our strategy has been, continues to be, and likely will be primarily organic, but it's not to say that we haven't done M&A. So, where have we done it? We've done it with Tesco mortgages, when I first came in. We've done it with Embark, which is an investment platform. We've done it with Tusker, which is a salary sacrifice motor finance platform. And in each case, first one has been scale, second two have been capability.

The hallmark, I think, of our M&A strategy to date though is that it's been a.) occasional, i.e., not very often, and b.) relatively modest in size. And that much I don't really expect to change.

Perlie Mong
That's very clear. I think this is a good time to open up the floor to any questions. If you have any questions for William, please raise your hand.

Okay. I don't think there is an immediate question for you, so I will just carry on for the time being.

You've mentioned Embark, you've mentioned Tusker. A lot of that will be feeding into the fee income growth. You've held a series of seminars in the last couple of years, focus on revenue diversification and specifically fee income growth as well. Can you remind us what the key areas that will help you deliver stronger revenue growth, especially in a falling rate environment?

William Chalmers
Sure, there's a couple of points, maybe implicit, in your question there, Perlie. One is just around overall revenue growth, and the second is around OOI in particular within that revenue growth. As you know, we set out in 2022 to deliver a strategy over the course of, first of all, chapter one, three years, chapter two then going to five years. Coming to the end of chapter one, clearly, during the course of 2024.

During that period, as your question said, Perlie, we have delivered a range of seminars to help people understand how we're developing that strategy going forward. Those seminars have sought to give insight on, basically, developments within the business, particularly in the income line, as it relates to the particular business unit being focused on. And that growth, in turn, Perlie, has focused on a.) BAU income development and b.) strategic initiative income development. The latter being fuelled by our incremental investments of £3 billion in chapter one of the strategy, and £4 billion over chapter one and chapter two of the strategy.

As we sit here today, we've committed to an incremental £0.7 billion of revenues per annum from those strategic investments by the time we get to the end of 2024, £1.5 billion per annum by the time we get to the end of 2026. And we feel very comfortable, very confident in the delivery of those commitments. So, that's all going so far, so good. To your point, Perlie, where is that coming from? Where are we seeing particular strengths?

I would look across the different business lines and the strategic ambitions that we've, if you like, come forward with in that context. What does that mean? In the context of retail, for example, we've committed to a mass affluent strategy. In the context of mortgages, we've committed to a so-called home hub strategy where customers are able to visit not just for a mortgage but for the ecosystem of products, to give the cliché, around that particular area.

How does that manifest itself? We're seeing significantly improved performance from the mortgage product and the protection product, basically having a relationship together. That is to say, when a mortgage customer comes, they typically would like some sort of protection product from the insurance side to accompany that. And we're seeing a much more successful product integration indeed, customer service proposition from that.

Within Corporate and Institutional banking, we're seeing significantly improved capital markets capabilities across rates, across FX, across DCM. It's not to say that we will necessarily be a wholesale bank anytime soon. That's certainly not the ambition, but let's face it, where we started in 2021 was a relatively low bar and I think just getting the bank back into the shape that it needs to be, has yielded significant enhancements. In fact, OOI within the CIB area is up 35 per cent, 2021 through 2024. So there are some gains there. Likewise, BCB the SME franchise, merchant acquiring, IP&I, General Insurance. So my point is, Perlie, is you can look across the different business units, spot the strategic initiatives that we have launched in respect of each of those business units and see some pretty good signs of progress.

We are not going to hit the board 100 per cent of the time, but nonetheless, there are some pretty good signs of progress in each of the material areas that we seek to grow in. Again, that leads us to be confident in terms of the revenue delivery for the incremental revenue delivery, I should say, for the business, which in turn is a contributor to the ROE ambitions of the business as a whole.

I think ultimately, what I'd say, is all of this is driven by the strategic ambition. Indeed, the purpose led ambition to be more to our customers on a broader basis and on a deeper basis, and that's what's really informing those strategic initiatives, that investment, the seminars that you commented upon Perlie, and hopefully, the success that we'll see going forward.

Perlie Mong
That's very clear and I guess an investment case for Lloyds is also very clear as it always has been. I guess the only slight hesitation I have is on the regulatory front and specifically, thinking about the motor finance issue. So the FCA has delayed its next steps. I don't think you can comment very much on that specifically. But in terms of the operational side of things, in terms of the complaints you are getting, is that consistent with the £450 million provision that you've taken last year?

William Chalmers
It's a fair question, Perlie. I think the start point as ever with this is to acknowledge the importance of motor finance industry to the UK. Something like 80 per cent of new car purchases are financed, that in turn means that the UK economy has a few problems frankly, if motor finance is not there to serve customers in an appropriate way.

I think that is what is behind the FCA's determination to get a speedy and an orderly resolution to the motor finance issue. And indeed we welcome that. When we look at it, the FCA's focus is very much upon misconduct and customer harm. Now, as you know, Perlie, and we've said before that we've obviously been through our records and we believe that we have complied with all relevant regulation and relevant times and therefore we don't see it.

Now having said that, we've put in place say, £450 million provision as you know, and that is targeting two things. One is the inevitability of administrative expenses. I'd love to say we weren't going to approve them, but we already are. So we might as well face reality and provide for those appropriately.

Two is the risk of, and again just to underline the risk of, redress that might come out of that, and we've plotted a variety of scenarios to come out with, in total, £450 million provision that we've seen. The expectation, if you like, is that that is the base case provision that will be sufficient. And when we look at the FCA delay, there's nothing in the FCA delay that substantively changes our view on that. There's nothing in there that allows us to, if you like, better inform any particular provision either up or down, frankly. So it's a delay and to be clear within this room, it won't surprise anybody, it is unwelcome as a delay.

We would like nothing more just like all of our investors than to get through this and to move beyond it, but for now at least we've got to deal with a delay. There's nothing substantively new in that delay, so we've just got to deal with it.

You asked about inquiries, complaints and the like, Perlie, and are those tracking in line with or not? I think basically yes. Otherwise, we would've altered the provision. The more nuanced answer underneath that is that complaint volumes tend to go up and down when certain prolific writers are in the press at any given moment we'll see a surge in complaints when they're not, we'll see a significant decrease in complaints.

So complaint volumes will go up and down over any given period. But in short and answer to your question, Perlie, it's not outside of the parameters of our expectations, if you like, and the provision therefore we stick with.

Perlie Mong
That's very clear. Thank you very much. So we're about five minutes left in this session. Are there any more questions for William?

Speaker 1
Hi, William. I wanted to ask you a 'Blue Sky' question - I could ask exactly the same question of any of the UK banks. Obviously, UK banks now are quite profitable but very still very dependent on net interest income, very dependent on mortgages and very dependent on capital levy businesses.

Does the bank have any idea on how to differentiate its revenue streams to increase the quality of earnings moving into capital lighter areas, payments, asset management, creating over time a much, not only more diverse, but capital lighter revenue stream? Thank you.

William Chalmers
It's a very good question and the short answer is yes, absolutely. The longer answer is when we stepped back in 2021 and developed the strategy, we were very conscious of a bank that was probably 70 plus per cent dependent upon their interest income in an environment where, let's face it, rates have been low for over 10 years at that point, and that's a challenging place to be because there's no doubt there is a correlation between low rates and relatively thinner margins.

Now the reverse is all also true as perhaps we're seeing today. But trying to work our way through that dependency was a key strategic objective of the business. It is in the context of the overall strategic ambition and indeed purpose of the organization to be, as I said earlier on, more to all of our customers and indeed more to the UK going forward. So that's the context in which it's couched, but out of that, absolutely is an ambition to diversify and strengthen the business and over time, reduces net interest income dependency.

Now what does that translate as? Again, if you go through our business units, you'll see in each individual case a fee-related ambition that in turn is intended to enhance other operating income over time. As long as we get the customer proposition right, we don't take anything for granted - if we don't get that right, nothing else happens. But if we're successful in our ambition to better serve our customers off the back of mass affluent in retail, off the back of merchant acquiring in BCB, off the back of some of the capital markets points that I mentioned a second ago in CIB.

You should see the other income lines start to grow off of those activities investments accompanying them, without a doubt. BAU-dependent, without a doubt. But nonetheless, other income growth. And what we've seen so far, I think broadly vindicates that. So if you look at our quarter two for example, other income is up around 9 per cent quarter-on-quarter or rather year-on-year and quarter two other income is up 8 per cent within the first half, again year-on-year.

So we're seeing some pretty encouraging signs within other operating income that in turn vindicate the approach that we have taken. And looking forward, I would expect that other income to continue to grow, that fee income to continue to grow. Again, all hinging upon our delivery of the right customer propositions. But so far, at least, so far so good.

Ultimately, by the time we get to 2026, we expect there to be an incremental £1.5 billion in revenues from the strategic investments as we call them, and of that at least half should be other operating income. So you can see embedded, if you like in the overall incremental income target is another operating income ambition.

Final point perhaps, having said all of that, interest rates have risen quite a bit during that time. So whether you arithmetically look at the overall proportion of our income and say this much was NII, this much was OOI in 2021 and see a very significant change by the time you get to 2026, that will be driven in part by where interest rates are and the recognition that obviously our interest income has benefited significantly, as you pointed out in your questions, Perlie, from the interest rate cycle that we have seen.

So at the same time as we're lifting other operating income, we're also seeing NII increase and as said earlier on, I expect that to continue and indeed develop despite policy rates going the other direction.

Perlie Mong
That's very clear. Thank you very much for a very insightful session. It's been a pleasure to host you.

William Chalmers
Pleasure and thank you very much indeed for listening.

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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