LLOYDS BANKING GROUP PLC – 2024 HY RESULTS – SELLSIDE ROUNDTABLE TRANSCRIPT
(amended in places to improve readability only)

Friday 26 July 2024 – 1.30pm

LBG:
William Chalmers, Chief Financial Officer

William Chalmers
Thanks very much, operator and thank you to everybody for joining today. I think we will go straight to questions on the basis that you heard from both Charlie and myself yesterday on our speeches and very happy to pick up any questions that didn't get addressed in the session yesterday or new ones that have risen since then. So, I will pass it over to the team on the call and thank you again for joining.

Question and Answer Session

Question 1 – Robin Down, HSBC
Good afternoon William, thanks for taking the questions. We spent quite a bit of time yesterday focusing on interest income. I was hoping that you might be able to talk a little bit more about the other income side within the business, which was quite strong in the first half and maybe if I could invite you to talk about it on a divisional basis.

I think Retail was up 14 per cent, but the comment there is that that's largely linked to motor finance, so whether that is a kind of run rate we should see going forwards or whether there is some seasonality there?

And then, if I look at the commercial banking side, that was up 11 per cent, but if I look at the disclosure on fees and commissions, it kind of looks like fees and commissions was reasonably stable. So, I'm assuming most of that growth was in the markets business. So maybe if you give us some colour about seasonality there and sustainability. I guess the conclusion is that Carla probably deserves a pay rise.

And then, finally on the insurance and investments division, I think there's kind of 9 per cent underlying growth there, but the CSM seems to have come down, so I am just wondering whether or not we should look at that 9 per cent as being a good level to work with going forward. So, whether there is any colour you could add on how you might see that developing. Thank you.

William Chalmers
Sure, thanks Robin, thanks for the question. Just a couple of thoughts then on that. As you know, H1 OOI was up 8 per cent, half one year-on-year, 9 per cent, Q2 year-on-year.

That, as you say, is a decent performance over the course of the quarter, £2.7 billion in terms of OOI for the half year as a whole, and continued progress from quarter one into quarter two. I think that was up about 4 per cent . What's going on behind that? I'll comment on a year-on-year basis and on a half-and-half basis.

So, what's going on behind that? Within Retail, as you pointed out Robin, there's a fair bit of transportation growth going on there. It's a combination of Lex autolease, markets recovering, it's still a bit of a post-covid recovery in terms of volumes, but that is augmented also by the fact that we bought Tusker last year. So, you're seeing effectively a full run rate benefit of Tusker in this half versus last half.

Just a brief word of explanation on Tusker. Tusker is a salary sacrifice scheme, which basically links into corporates and gives, ultimately retail customers, a tax advantaged product, often in electric vehicles, as I commented yesterday. That's a very profitable product from the Group's perspective, it's a very helpful product from the retail customer's perspective because they get the tax benefit. And not surprisingly, Robin, it grows at a reasonable clip. It's small, relatively speaking, in absolute terms, but it grows relatively strongly in a context where the Government is trying to encourage electric vehicle take up and corporates are playing their role in that, so that's one aspect of retail.

Alongside of that though, Robin is PCA banking revenues, which are also up on a year-on-year basis, so there's a couple of different things going on within Retail there.

One more traditional banking, one in the context for transport business. I think looking forward, it will ebb and flow a little bit. We want to make sure that we are suitably judicious in terms of our deployment of the transport strategy in the sense that we will make sure that we deploy it in the profitable areas, and we do not take undue operating lease depreciation risk in doing so. I will come back to the overall OOI picture in a second. But the transportation business, I do nonetheless expect decent growth over the course of the next half and beyond. And that's consistent with the comments that I made yesterday.

In terms of Commercial Banking, I won't comment on whether Carla needs a bonus or not, I am sure she thinks she does. But what we have seen within Commercial is a combination, really. Most of the growth has been concentrated in the C&I side of the Commercial business. And in particular what's going on there is trading and financial markets activity, activity increases, but also decent market share gains in things like FX for example, and things like sterling issuance for example. And then, alongside of that, decent growth within capital markets on a year-on-year basis. I mentioned sterling issuance, that probably falls more in the capital markets side of the fence to be fair.

But you will have seen John Winter and Carla's seminar on this just a few months ago and they gave you a good sense as to the market share benefits that we are enjoying in terms of some of the issuance activity there and some of the market space activity there. And that together is leading to a decent clip of growth within Commercial.

I would say it has been stronger than we expected in the first half of this year, and that is off the back of market volatility. It is also, however, consistent with our expectations for this team to be secure in the benefits of some pretty low hanging fruit, to be honest, Robin, that is to say we have traditionally underserved those segments where we have a bit of a right to own.

And some of the activity that we're seeing in the half is indeed just recognition and delivery on that front. So, what do I expect there for the second half? I think we expect continued progress within Commercial. It may or may not be quite as fast as the first half because I do think markets play a role in the first half, just as they did with some of the much larger investment banks who also saw some pretty healthy tick ups in terms of their market activity. So continued growth, let's see whether it's quite the same clip as the first half or not.

And then IP&I had two main things going on there within Insurance, Pensions and Investments, Robin. One is GI income, we are seeing a very healthy level of GI income activity there, which is primarily sponsored by the withdrawal of some of the more temporary capital entrants into the GI world, if you like, that were there during the last cycle. They basically backed off. We've therefore seen an environment of very attractive and indeed capital enhancing opportunities from a business point of view, and the business has reclaimed a lot of the market share previously conceded in a very profitable way, particularly within home.

So that gives you a sense of the GI income. Alongside of that, there's been longstanding benefits in some of the more traditional businesses within IP&I and a little bit within workplace as well, Robin. So, there is a couple of different engines within Insurance, Pensions and Investments. Those are the ones that I would highlight.

You asked about CSM, Robin. Effectively what is going on in the CSM, in short, is the combination of new business writing adding to the CSM, releases through the P&L as you would normally expect with the CSM, and then the exit of the bulks business, which is the third big piece within CSM.

So, if you look at the contractual service margin plus the risk adjustment, it currently stands about £5.1 billion. That £5.1 billion was down about £300 million because of basically the bulk sale added to which we released as we normally do a chunk of CSM into the P&L because that is what happens, as you know, every period.

So that is roughly what is going on in the CSM. It is pretty much in line with our expectations, Robin. We are seeing continued profitable growth build for CSM on an ongoing basis and we are seeing the recognition of that profitable store of value if you like, get bled through into the P&L on an as expected basis. But you do see this temporary bump if you like or adjustment because of the bulk sale that we did.

Robin Down
Okay, great.

William Chalmers
Thanks Robin.

Question 2 – Alvaro Serrano, Morgan Stanley
Hi William. I was going to try my luck with the structural hedge and yesterday you touched on this, but on the rollovers, I think you said £20 billion, the second half, £40 billion next year. I do not know if you can give us a bit more colour on what yields those maturing swaps are at.

Today, we have seen a surprise of some of those rollovers being materially lower yield. Just to get a sense, should we just look back five years as a guidance or is there any commentary that you can help us with? Thank you.

William Chalmers
Thanks Alvaro. As you say, we talked yesterday about the remaining maturities in 2024, which is about £20 billion. As you know, in the context of a structural hedge with a 3.5 year weighted average life, you are typically going to get about £35 to £40 billion maturities in any given year.

And I think that is not a bad pointer to what we would expect to see in 2025, but that is consistent with basically unwrapping a hedge of £240 billion or about 242 billion, as it is now, on a weighted average life of 3.5 years. The yield of the structural hedge, as said, within Q2 was about 1.6 per cent.

As you know, the structural hedge did not make huge contributions to the Q2 margin and that is because, as said, the impact of maturities rolling off and the impact to the extent that we put pre-hedging on to manage duration, the price at which those were coming on.

So, you can see by what happened within Q2, i.e. a modest contribution to the hedge, that the maturity yields and indeed any pre hedging they are going to vary a bit quarter on quarter.

But over the year as a whole, you can tell by the arithmetic, really, we are going to see about a £4.1 billion plus contribution from the structural hedge, i.e. just over £700 million pick-up versus the last year in terms of the structural hedge contribution for the year as a whole.

And as I said yesterday, the contribution of the structural hedge in quarter three and quarter four really starts to become more material. So, I am not going to give you precise details in terms of hedge maturities or yields on hedge maturities and the like Alvaro, but we have given you the contribution of the hedge over the year as a whole and obviously we stand by this.

What that means, if you kind of step back and think about that, is that the yield on the hedge is going to pick up as we go through the year.

So, we have had 1.6 per cent in Q2. That is going to pick up to a number, add another 10 basis points plus on for the full year contribution of the hedge. And that gives you an idea as to how the income streams might pick up. But you can arithmetically derive that anyway from the information that we've given you so far, not just in quarter two, but also in quarter one.

As you know Alvaro, we have talked then about a step up in respect to structural hedge earnings in 2025. And we have talked then about a further step up, a more significant step up in fact, in respect to 2026.

And so, you're going to see that progression of earnings. 2024 plus just over £700 million. 2025, a further step up from that in terms of the added contribution and then 2026 a further and more significant step up again in terms of structural hedge. So that gives you an idea. I appreciate it is not as exact as you would like, Alvaro, but it gives you an idea as to how we see the hedge building over time.

Alvaro Serrano
Thanks, William.

William Chalmers
Thanks. Alvaro.

Question 3 – Aman Rakkar, Barclays Capital
Hi William, I really want to ask you questions about the structural hedge, but I suspect I'm going to test your patience with that.

So, I might ask you about mortgage margins to start with, if that is okay. You have really helpfully given us a roll off profile of mortgage margins in coming quarters.

You have historically talked about getting to something like 80 basis points at year-end. But it does feel like for the last couple of quarters you have been kind shifting your expectations of this mortgage headwind into 2025 persisting for a bit longer. So, is there anything you could do to just kind of help us around the roll-off yields of your mortgage book through the course of 2025?

A year ago, I think we were very clearly talking about the mortgage margin headwind being done by the first half of 2025, and it really does not feel like that now, it feels like it's a 2026 thing.

So can you put some colour around that, please? And just to confirm, the roll off yields that you have historically talked about of 80 basis points at Q4, is that for the fixed rate book only? We should be adding to that some kind of estimate for SVR attrition or some other moving parts. Right? Such that the roll off yields is a bit higher than that.

William Chalmers
Sure.

Aman Rakkar
The second question, shall I give it to you in a minute or shall I give it to you now?

William Chalmers
No, go for it now and then I will take them in turn.

Aman Rakkar
Yeah, I just wanted to ask about costs really beyond 2024. So, I think you've been really clear and helpful around costs this year. And I know that you are probably a bit loathe to guide, but I think when yourself and Charlie announced the strategic update, there was a period of elevated investment with a view to pay off in the back end of the plan, and part of that was actually to get cost down.

I think at the time we were talking about cost actually being down. I just wonder, I guess inflation is clearly running much higher than what you are expecting back then, but that cost profile beyond 2024, how should we think about it? Is it too unrealistic to think that costs could be flat beyond this year as you get the benefit of the efficiency gains and what have you, investment and depreciation falling away, please. Thank you very much.

William Chalmers
Sure. I will take those in turn. In respect of the mortgage book and the roll off, there may have been some confusion there, Aman, but I certainly do not think I have ever said that the tail off would be dealt with by the end of 2025 or mid 2025, as your comment suggested.

Indeed, this is a function of basically mortgage book was written in some cases on a five-year basis, in some cases on a two-year basis, but we have always had visibility of the expected roll-off of the mortgage profile, and we have always indicated that it would be starting to tail off in terms of the finality of it, not until 2026, but the pattern overall would be a bit less pressure as we go through 2025.

So just to be clear, Aman, the expectations for the headwind from the mortgage is the pressure will ease during 2025, but the full roll-off is unlikely to take effect, as I said yesterday, until around about half way through 2026. So, in the first half of 2026, you should be expecting it to come out of that mortgage headwind.

To give you some numbers on that, Aman, which hopefully will be helpful, as I said yesterday, during the course of quarter two, we have seen business rolling off at about 110 basis points, and we have seen it coming on about 70 basis points.

I think that 110 basis points is going to be pretty consistent for the remainder of this year, so we will expect that similar mortgage headwind that we saw in quarter two, more or less be repeated for quarter three and quarter four. Obviously, it depends a little bit on what completion margins are, but leaving that to one side, you should expect to see a pretty straightforward roll-off, and indeed, mortgage headwind quarter two, quarter three, quarter four, unless of course completion margins pick up considerably.

When we go forward into 2025. That pressure should come off a little bit, consistent with my comment just a second ago. How much does it come off? It is going to come off to below 100 basis points. I would not put a precise number on it, but it is going to come off to below 100 basis points during the course of 2025. And then again, it comes off a touch further in respect of the early part of 2026. And by the time you have got to the middle-ish of 2026, you are basically writing mortgages at a very similar rate to the rate at which they are coming off.

So again, 110 basis points quarter two, more or less the same for the remainder of this year, falling to a little bit below 100 basis points, and I do not mean 99, I mean a little bit below that for 2025, and then falling a little bit below that again in the first part of 2026.

So hopefully, that gives you a pretty good idea, without the sort of decimal places, Aman, as to how we expect the roll-off in yields to develop, and that is the timeframe within which we expect it to happen. Obviously, the completion margins that we see will have a significant impact upon the extent to which that is a headwind.

It is worth just commenting on your point there, Aman, you asked about any kind of split within the book. That is the whole lot. So that includes everything that I have just given you.

The cost point, the second question, it is a very fair question. I am not going to give 2025 guidance, obviously, in respect of costs, but I will give you some sort of thoughts which I hope will be helpful.

Overall, we would expect the costs trajectory going forward, off the back of the investments that we have made, to be flattening off. I am not committing to flat.

The business is, as you say, in an inflationary environment, the business is going to require ongoing investment, of course. You would expect that from us, but nonetheless, we have made significant investments to ensure that we manage the cost base effectively, and that sits alongside our BAU management of the cost base, the usual kind of optimisation within property, the usual kind of matrix management, the usual kind of third-party management, organisational design, all sorts of BAU sources of cost savings that we have.

And so as a result, I would expect the cost base to be flattening off the back of that, subject obviously to inflation. As I said, that BAU cost discipline is one point, investment, another point. But do not forget that we have got a depreciation lag off the last couple of years of investment that we have been making, and that clearly has to work its way through cost base. Having said that, strategic investments being delivered upon is clearly part of the story.

And so cost, as a result, again, subject to inflation, should grow a little bit slower than perhaps we have seen over the last few years, but we have yet to finalise our plans, and we will be guiding on that at the year end.

The result of that, as you know, is that we should see operating leverage build within the business. To be clear, a lot of that comes through in 2026, but we should see that as a gradual ingredient within the business. And then finally, Aman, as you know, at the end of the story, 2026, we have committed to a cost-income ratio of less than 50 per cent.

Aman Rakkar
Thank you, William.

William Chalmers
Thanks, Aman.

Question 4 – Guy Stebbings, BNP Paribas Exane
Hi, William, thanks for hosting the call. A couple of questions. The first one, just following on from the last question on mortgage spreads, did you just say that those maturing spreads that you referenced through 2025, 2026, that there was the whole lot, that includes the SVR book too, and if that is the case, could you just give some colour as to what you are assuming on pace of attrition in the SVR book, in terms of does it carry on in pounds terms as we have seen in recent periods, or does it start to slow as the book shrinks in totality?

And then, the second question was just on non-banking NII. I guess in Q2, it was sort of aligned to expectations, and you have kept the full-year guidance. I appreciate there's sort of an activity component and a rate dynamic at play. So, as we look forward to rate cuts, could you help us think about what sort of tenure the rate component is attached to?

I am just trying to better understand if we have to wait a while after policy rate gets cut before there is a benefit there, in terms of reducing the interest expense? I think consensus broadly has that line holding flat in the middle of that £450-£500 million you mentioned in future years. So presumably, people are assuming that activity continues to grow up and it gets broadly offset by lower rates, if that's a sort of fair way to think about it. Thank you.

William Chalmers
Yeah, thanks very much, Guy. Just in terms of those two questions there, the roll-off yield, sorry, I think I probably slightly misspoke in terms of the commentary on the yields. The only commentary on the yields that we can really give obviously is that in relation to the fixed-term book.

So to be clear, apologies if my comment earlier on suggested otherwise, but the yields that I mentioned in terms of the roll-off, the 110 basis points, for example, that below 100 basis points, for example, and then, if you like, more below 100 basis points in 2026, that is the fixed-book roll-off. That is, referring back to my earlier commentary, the five-year business that we wrote, two-year business that we wrote, it's simply because we obviously cannot really forecast to accuracy within that the SVR impact.

We do so internally, but that is not within the overall margins of roll-offs that I just gave you. So that is question number one.

Question number two, the non-banking net interest income performance, as you know, quarter one, £105 million, quarter two, £124 million. And so that overall is ticking up a little bit. It is ticking up a little bit off the back of refinancing rates, number one, i.e. higher interest rates, and growth within the business, number two.

Now, as you look forward, bear in mind that some of that new business is turned on a three-year basis, for example. The automobile business is on a three-year basis, and so that is turning over as we speak, but this year and indeed next year, there is still more of that to be turned over that was written a year or two ago.

And so, when you look forward for the impact of non-banking net interest income, we have guided to what it is going to be this year, £450 to 500 million. I would not guide to what we think it is going to be next year, but you should bear in mind that there continues to be roll-off of three-year finance business in what is a higher-rate environment versus when that three-year finance business was written.

That is in particular in reference to the automobile business, transportation business, but that is a good chunk, circa 40 per cent, of non-banking net interest income. So, expect that headwind to be a little more persistent.

Having said that, some of the shorter-term funded stuff, particularly within the commercial banking area, that is basically funded on an overnight basis often enough. And so that will be more sensitive to the roll-off within rates, base rates, swap rates, swap funding rates, and the like.

So again, I am not going to forecast or give guidance on 2025 non-banking debt interest income, Guy, but it is that combination, if you like, of some of the longer-term stuff, refinancing at higher rates, some of the shorter-term stuff, refinancing at lower rates, with transport being an example of the former, Commercial being an example of the latter.

And that, depending upon your outlook on the rate environment, are going to be the ingredients for non-banking net interest income, alongside activity growth, which we do expect to continue to grow both this year and next. And going back to Robin's question at the beginning, to continue to fuel other operating income growth, again, this year and next.

Guy Stebbings
Okay, perfect. That all makes sense. And on that second question, it sounds like, realistically, we are talking beyond 2025 before the interest rate component is sort of helpful to that line, in terms of the interest expense line?

William Chalmers
Well, again, I would not comment too much on 2025, Guy, but I will say that it is our expectation that we will see continued other operating strengths, as activity continues, and frankly, as our strategic initiatives come home. And that combination is going to drive both other operating income growth, and it's going to be a factor in non-banking net interest income, together with, as I say, the kind of rotational aspects on new and old rates that I mentioned earlier on.

Guy Stebbings
Okay, thank you.

William Chalmers
Thanks, Guy.

Question 5 – Chris Cant, Autonomous

Good afternoon, thanks for taking my questions. I just wanted to come back on the hedge, if I could, I understand you are not going to give us numbers there. I mean, it is obviously a very important part of the story, and one of your peers is giving very full disclosure there, so it might be something to consider just in terms of the understandability of your NII dynamics.

But if I take a step back from asking for specific numbers, I guess one of the surprises today with that peer bank is that they have revised down their guidance on the maturing hedge yields, and the reason they have done that is because they have been shrinking the hedge quite aggressively.

I guess, in your case, you have not had to shrink the hedge as much, and I think you have been managing it more through just not reinvesting maturities, whereas in their case, they have been taking out netting swaps, which has reduced the prospective yield.

So in terms of us trying to come up with our own estimates as to your future hedge yield, are we going to be more correct if we try to look back at the phasing of when you expanded the hedge and historical swap rates in those periods, or are we still just going to be way off base, because actually, you have been netting, or re-profiling, or doing something?

I mean, is it actually possible, from the outside, to come up with anything close to the actual numbers, which I presume you know? Is it actually that it could be a bit like one of your peers, where the numbers are very different to what we might have expected because of actions you have been taking as rates have been going up? Thank you.

William Chalmers

Thanks, Chris. Well, I obviously cannot comment on peers or peers disclosure, and certainly not on their hedges, but I can comment on ours, and hopefully give you some thoughts that might be helpful, Chris, recognising, as you said, that I am not going to give you the full breakdown of the hedge, and I am not going to guide to precise numbers for 2025 or 2026 at this point.

In terms of the hedge makeup and the notional of the hedge, as you know, right now, we have an invested amount of £242 billion. We have weighted average life for three and a half years. We have a hedge, which as you know, is significantly made up of Retail. It may be that it is more heavily weighted towards Retail than perhaps other peer groups are.

As we roll forward, one of the characteristics of that is that we have been slow to invest that money in the hedge, because we wanted to make sure that it is truly sticky, and sticks around, if you like, in a post-COVID environment. But then, when we become convinced of that, we also become convinced that it is just that, i.e sticky and the hedge, as result, is more resilient.

When you add that onto deposit gathering, instant access for sure, PCA for sure, but also a share of limited withdrawal products that has been, as you know, quite a significant and successful product. Those are deposits that, in turn, make a contribution to maintaining, and perhaps in the future, building the notional value and the invested value of the hedge.

We see, as you know, from our own performance, a relatively resilient deposit picture, and that includes many of the hedge investible categories. We also see, in the context of a reasonable GDP outlook, combined with things like wage settlements of the types that we have seen, a relatively solid deposit market in which we are operating.

So, I think two things are going on, Chris. One is we have got a relatively solid deposit market, and two is we think we have been doing a reasonable job of building share within that market. And alongside of that, we have got a hedge that is composed, as you know, of a bit of Commercial, a bit of equity, but also quite a lot of Retail deposits, which tend to be sticky and long-standing.

So as a result, we feel, I am not going to predict for you exactly what the invested balance of the hedge is in the future years, but we feel relatively comfortable with the position of the hedge. We have given you an idea as to where we might take the notional this year. There might be a billion or two more to come out, let us see.

But nonetheless, it would not be terribly different to what we saw last year, and we feel kind of comfortable, based upon our expectations of the deposit churn, for the structural hedge, in its invested quantum, on a look-forward basis. When we then combine that with the rate outlook, as you know, five year SONIA , or five year forward, I think they're around 3.8 per cent, 3.9 per cent right now. Over time, the yield on the hedge, which as I said, at Q2, was 1.7 per cent for the full year of 2024, by the end of the year, it's about 1.9 per cent. That's just arithmetic, you will be able to figure that out yourself.

That should converge, over the weighted average life of the hedge, to that 3.8 per cent that's out there in the moment, for roughly five years. That gives you some idea of the earning dynamics of the hedge.

So, the only question that you really have, therefore, is the staging of it. The staging of it, as you know, is greater than £700 million up this year, a touch greater than £700 million up this year, I should say, over the last year. Takes you to about £4.1 billion plus. We then said that we expect that earnings to be more than, greater than £700 million, we have not put a precise number on it, but it will be a step up in 2025, and then it will be a significant step up in 2026.

So that combination of, if you like, quantum of invested balances, rates outlook together with the types of increases I just mentioned hopefully gives you a reasonable idea for looking at the hedge.

Chris Cant
Thank you.

William Chalmers
Thanks, Chris.

Question 6 – Aman, Rakkar, Barclays Capital
Hi, thanks very much for letting me ask a follow-up question. I cannot help but ask one. So sorry, I am going to have to ask on the hedge.

I know that you might not want to give specific numbers, but your hedge tailwind in H2 is very, very strong and that gives people like me and I suspect others confidence around NIM trajectory through the course of this year, but I am thinking about the shape of your NIM or the trajectory of your NIM off Q4 this year, because the kind of sequential pick-up in hedge income that I think that you will benefit from Q4 is going to be providing a very material full-year benefit into next year.

So, if the hedge tailwind in 2025 is a bit more than £700 million, you might actually be picking up the best part of that just from the Q4 maturities. I guess the inference then being that there is not much of an incremental hedge pick-up in Q4. So, could you just tell me whether that is wildly wrong or not?

And the reason I ask that is because I then layer on top of that the mortgage margin headwind that you have persisting through 2025 and potentially rate cuts coming. And I am just worrying a little bit about whether we should actually just expect a flattening profile next year on what is likely to be a better Q4 exit this year. Now, I do not know how you answer that without giving a guide for next year, but anything you can do to allay my fears or concerns here would really appreciate that.

William Chalmers
Sure, thanks, Aman. And sorry for not being clearer on your question earlier on mortgage roll-off yields. The profile for this year, I will start with 2024 on hedge, which may be helpful, as you know, we have given you the expectations for the increase in the hedge income 2024 over 2023.

We said it's going to be a touch over £700 million. That takes you a touch over £4.1 billion for the hedge income in 2024. You also know that our hedge income so far this year, I think we have put a number on it, but it is around £1.9 billion, thereabouts in terms of half one. So you have a pretty good idea as to what half two is going to be for the hedge. I have also given you an idea of the yield of the hedge both on a 2024 average basis, 1.7 per cent, or just a shade above actually.

And then at the end of 2024, I think it is quarter four, we are looking at around 1.9 per cent thereabouts. So that is giving you quite a lot of information, if you like, to model out the hedge during the course of this year.

2025, as said, we then expect a step up in the hedge earnings, which is going to be a step up versus the greater than £700 million gross that we have seen in respect to 2024. So, it is a step up beyond that. We do have the mortgage headwind as you say, and hopefully the numbers that I gave you earlier give you a good basis on which to think about the mortgage headwind over the course of this year and next and into the first half of 2026.

I am not sure there is terribly much more that I can say beyond that other than the missing ingredient that we have not talked about there is obviously the slowdown in the churn, which we expect to be taking place in the second half of this year, and then ongoing movements, if you like, within other asset and liability spreads, which so far have been relatively modest in terms of their overall impact on the margin.

We would not guide to 2026 in respect to the P&L. We will give you, as you know, fulsome on that at the end of the year, as we always do. You have got our expectations as to what the 2026 performance is going to look like as a whole, which is hopefully a good indicator as to where we expect things to go.

And as committed to yesterday, we have continued confidence in those outcomes. It is not a perfectly linear trajectory between 2024 through 2026, to be clear. There is, as I have indicated around the hedge, a pick-up in respect to 2026, but nonetheless there is a bit of information there that I hope is useful to you as you seek to model the business.

Aman Rakkar
Thank you so much, I really appreciate it.

William Chalmers
Thanks, Aman.

Question 7 – Edward Firth, KBW
Afternoon, William. Can I ask you about wholesale funding markets? And in particular, there has been a lot of press comment and a lot of speculation about a specific instrument, the Bank of England's short-term repo facility, which has seen this massive increase in the last three months in terms of the usage, which I guess could be related to QT in some way.

But I just wonder, you are a huge business. You operate massively in this market. I would just welcome any thoughts you had about what is driving this. Is this something that you are using? Is it symptomatic of people struggling to finance, perhaps buying some of the treasuries elsewhere? Because I do not see any stress anywhere else in the market and yet you are suddenly seeing this £30 billion increase, which is a big number in the context, even of the UK funding markets as a whole.

William Chalmers
Thanks, Ed. I do not think you will find any banks that actually comment on the usage of the short-term repo facility or not because as you can imagine, it's just a kind of sectoral thing the Bank of England prefers that we all do not talk about too much.

But I would say that the funding markets have been extraordinarily benign for us over the course of the last period. And so, I mentioned yesterday that actually our wholesale funding needs have been a touch lower than we have previously expected. And indeed, the wholesale funding that we have done, about £8 billion, touch over £8 billion, has been conducted at spreads inside of what we expected.

And so, the wholesale funding market from our perspective at least has been a good market to operate in, not only in our ask, if you like, being less, but also our spreads have been cheaper. So, all of that is good.

I do think that what the Bank of England has to do as a, if you like, source of systemic stability is about making sure that markets remain liquid at all times. We have all been through crises. Many of us went through the 2008-2010 crisis. And one of the issues there was the lack of confidence, if you like, in ongoing market liquidity, which then caused the types of exaggerated reactions that we saw during that time.

The Bank of England, including Andrew Bailey, most notably, have, as all of us have, learned a few lessons from that. And it is about confidence and it is about maintaining liquidity and therefore the short-term repo facility is to ensure that that is at all times met.

It is of course more necessary in an environment where you see the type of quantitative tightening that we are seeing right now. And therefore, the role of things like the short-term repo facility clearly becomes greater where you have got a situation where the Bank of England is trying to sell down its bond portfolio because clearly in those markets, you are going to have slightly more testing conditions from a liquidity point of view.

But as I say, from our perspective at least, we just, like any other bank, we are not going to comment on that type of area. But the backdrop against which we operate has been one of frankly pretty extraordinarily benign wholesale funding conditions, and we are pleased to see it. I do think that that is one of the areas, for us at least, of competitive advantage.

Edward Firth
Great, thanks so much.

William Chalmers
Thanks, Ed.

Question 8 – Robert Sage, Peel Hunt
Thank you. I have got a question actually on your capital returns priorities because obviously your share price has risen quite significantly and I guess the benefits of buybacks diminish as that happens and you are now clearly trading at a useful premium to TNAV.

And I was wondering whether this reduces your enthusiasm for buybacks relative to other uses of capital at all, or might there be a level we should expect to see at which point buybacks do become less beneficial for you?

William Chalmers
Thanks for the question, Robert. Perhaps one place to start there is the commitment of the board and the Group to capital return to shareholders, that is an unequivocal commitment.

It has manifested as you said, Robert, in two ways. One is the dividend where we have got a commitment to a progressive and sustainable dividend, and you saw that in evidence yesterday when we declared 15 per cent growth in dividends. It is also manifested, as you point out, in buybacks, and that has been a regular feature, a regular recurring feature, of our capital distribution policy. We have, as you know, a £2 billion buyback in action right now. That is pretty much what we had last year, pretty much what we had the year before. And so, you can see recurring evidence of that.

Your question is around how price-sensitive is that? A couple of comments that I have made. When we look at the overall value of the business as we see it, as I see it personally, for example, you can see my share holdings in the annual report, there is a lot of value within the business and therefore I do not see the current trading conditions of where we are at to be, if you like, a fair reflection of the value of the business.

You can see I vote with my feet. I am sticking in the stocks. And so that point, if you like, we obviously have board discussions around that point, but I think we collectively see value in the business that is comfortably in excess of where the current trading price is.

We are also encouraged by the fact that our owners see it the same way. So most importantly, when we go around our investor base and talk to them about capital, they obviously want to ensure that we maintain the primacy of capital distributions, but they are also strong supporters of the buybacks. And again, I think that indicates that they too see value in the stock.

Alongside of that, we have, as you know, an expectation that TNAV is going to grow within the business. We've got TNAV at 49.6 pence per share right now, which I think is at that level partly because of where rates are and the impact on the cash flow hedge reserve, partly because of the distributions that we pay out, including one or two technical features in relation to accruals and the like, partly because of an AT1 headwind whereby we exercise the call on AT1 at the tail end of quarter two, which obviously cost us. But in a sense that's all where we are at now and to a degree history.

When we look forward on the TNAV per share, we do expect, as I said yesterday, material growth in TNAV per share over the course of the second half of this year and indeed beyond. And why is that? It is based upon attributable profits. It is based upon growth in the business that obviously will attract capital. It is based upon the interest rate scenarios that we portrayed to you.

And as a result, we see TNAV growing in a material way for the bank this year and indeed beyond. And therefore, the price of TNAV type reference that you are making, that is a moving target. So, I think in sum, when we look at the distribution point, Robert, two points. One is capital distributions are an absolute imperative for the Group. Two is the buybacks continue to have a very important role in that.

Question 9 – Gary Greenwood, Shore Capital
Hi, William. I just had a bigger picture question really. I mean, we talk a lot about the trajectory for interest rates and what might happen there. I was interested, you mentioned quantitative tightening in response to Ed's question earlier. So, I was just wondering if you could talk a bit about how you think of QT from a business planning perspective, how you think that's going to play out over time, what the implications will be for, I guess, the size of the overall deposit market and pools of liquidity and what challenges that might create. Thank you.

William Chalmers
Thanks, Gary, it's a good question. I mean, overall QT at some level is inevitable, isn't it? It's just a question of whether it's passive or active really. We have been through a period of extraordinarily benign quantitative easing. Of course that has to stop at some point.

And as said, then the question is, what does the Bank of England do with the existing stock of its bonds? Does it just let them roll off? Or does it actively sell into the market? At the moment, it has chosen to sell them into the market. And so, as a result you have a slightly more exacerbated form of QT than you might otherwise have if it had been more passive as central banks have been in other countries.

What does that mean? I mean, the impact on the overall deposit market, or liquidity market, is felt most immediately at the wholesale end of the spectrum and indeed within the corporate sector. And so, the transmission mechanism, if you like, from QT into the market as a whole is most immediate and most obvious there.

And you've seen some tightening up of conditions as a result of that. I do not think it's been anything particularly stressful, frankly. Otherwise, you would have seen evidence in things like overnight SONIA and the like, which you really have not.

And so, you are seeing that transmission mechanism at that end of the sector, but at the moment, it is being dealt with and absorbed in a pretty orderly way, I would say, by the capital markets, which is obviously good.

I think then the question is what is the transmission mechanism into other parts of the market, most obviously retail? I think that is a much more complex picture, Gary, because whatever transition mechanism you might have being worked through the system corporates down is offset by a whole host of other factors, things like GDP growth, things like inflationary wage settlements, things like government payments direct to consumers.

All of these types of things have been significant factors behind the development of the retail deposit market and I suspect will continue to be, that have at least offset and in some cases more than offset the effects of QT through the activities the Bank of England have been pursuing.

So, it is not to dismiss it, Gary, but I think it is to say that we see many factors within deposit markets, particularly those that are most relevant to us, which are acting as countervailing pressures, if you like, versus QT. And it's partly that, I think, that has helped deposit markets shape up in the way that they have done. It is partly that that has helped us be a major player in those deposit markets. And indeed, we expect to see the deposit market continue to grow in the second half of this year and into next.

Gary Greenwood
Okay, that's great, thanks very much.

William Chalmers
Thanks, Gary.

Question 10 – Raul Sinha, JPMorgan
Afternoon, William, thanks very much. Did not want to let you go off early. We have got some questions here. Just on securitisation, I think you securitised £0.9 billion of loans in the second quarter. I was just wondering if you could talk a little bit about, conceptually, what you are looking to achieve from your capital management initiatives this year.

Obviously, the businesses absorbed the £0.3 billion AT1 refinancing hit and you've re-traded your 175 basis point capital generation targets, and I actually have not managed to find your pillar three yet. But when we think about the capital or the RWA moving parts, is there anything else you think in terms of RWA management actions that you might look to do in the second half of the year? I am just thinking about buyback capacity.

And then related to that, any thoughts on when the PRA firstly might give us an update on the Basel end game? I thought it was due. And whether or not if they were to perhaps change their mind on SME exposures, whether or not you might actually get a benefit to your RWA in terms of how you look at it. I think you have talked about no major changes, but you actually get a net benefit when you do actually transition? Thank you.

William Chalmers
Thanks, Raul, two or three questions there. First of all, in respect of securitisation, you are absolutely right. We did do, just recently in fact, a securitisation of Bank of Scotland self-certified mortgages in quarter two, that was about £0.9 billion. I think that was the number actually that you mentioned, which is correct.

That is, from our perspective, a very positive NPV transaction. We get the benefit in that context of the RWA coming off. We obviously can release the provision because it is now in the hands of the investors. It is in turn something that plays back the benefit of our ECL as well. So, the combination of capital markets being strong, the RWA relief that we get, results in a net present value positive transaction for us. It follows on the heels of one or two other securitisations that we have done.

As you know, we did one first quarter, I think it was of last year also in relation to a legacy mortgage book. Similar rationale. And then we also did one for personal lending tail end of last year, which was around £2 to £2.5 billion securitisation. Again, from an NPV perspective, very positive.

That is only one part of our overall optimisation activity, so if you look at our optimisation in this half of the year, it has probably been around £3.7 billion. As I say, we have done within that a securitisation of £0.9 billion. We have done a risk transfer transaction within Commercial as well.

But actually, the majority of optimisation, the majority of that £3.7 billion, has been a number of effectively hygiene factors, housekeeping factors, in terms, as I said yesterday, of interpretations, in terms of collateral management, in terms of taking care of off balance sheet revolving commitments and the like, which together result in a more efficient balance sheet.

When we look forward in the second half of the year, Raul, I would expect similar sort of patterns, that is to say you should expect to see securitisations here or there from us. That is what we are in the routine of that, once or twice a half year. But also, you should expect to see the other part of our overall optimisation objectives being met by hygiene factors, by housekeeping of the type that I have just mentioned.

That is the kind of backdrop against which we are operating around, and hopefully that gives you a sense as to what you might expect. You put that in the context of capacity, if you like. Excess capital capacity. The one point I have made there is 175 basis points is our commitment to capital generation. We stick by that. And as you know, we are going to be bringing the CET1 ratio down to about 13.5 per cent at the end of this year, so there is a couple of data points that hopefully are relevant.

Basel 3.1. Raul, it is a good question. As you know, the PRA basically put Basel 3.1 on hold while the election got figured out. As I understand it, they're now in a place where they have a proposal for Basel 3.1. It's a question of whether or not the politicians are ready to go with it or not. And beyond that, obviously I will leave it to the regulations and the politicians.

From our perspective, so far at least, the dialogue has indicated that the PRA does not favour the SME scaler being maintained in the way that it might be in Europe, but rather they are seeking to exit that.

If they were to maintain it, if the SME scaler was to get maintained in the same way as perhaps it might be in Europe, that would be, to your question, a positive for us from an RWA point of view.

As it is, if you leave that point aside, what is the effect of Basel 3.1 for us. The bottom line is the effect of Basel 3.1 for us is somewhere between neutral to mildly positive.

What is going on underneath the hood there, we are getting the benefits basically in Corporate, from foundational IRB benefits. That is off the back of a largely standardised Corporate RWA setup, and that is offset against some headwinds that we have principally within Retail. And so, the net of that, as said, is basically neutral to mildly positive, but it is a bit of a benefit on the Corporate side. A bit of a headwind if you like on the Retail side, resulting in that in sum.

Raul Sinha
Got it, thank you very much.

William Chalmers
Thanks, Raul.

Question 11 – Chris Cant, Autonomous
Thanks for taking a follow-up. Like Raul, I did not want to let you off too easily this afternoon, William. We do appreciate your time.

The other income line. I actually joined the call five, six minutes late. I think you were just answering another question from Robin on other income, so apologies if this has already been asked. But in terms of the other income expectations into the second half, you previously talked about a single digit probably a bit less than it was last year in terms of year-over-year growth.

It was a strong 1H print and you called out markets within Commercial. Could you give us a sense of how big markets was within commercial in the first half and what that might look like on a more normal run rate basis? I am just conscious that you told us high single-digit, and to get there, I guess we need to make an assumption around what is happening with that markets business, which we do not get much visibility on. Thank you.

William Chalmers
Thanks, Chris. The Commercial and other income within half one, as you know, is around £950 million or so. That is out of the £2.7 billion print for OOI within half one. When you say markets, Chris, I would split it up between a couple of different markets categories that we have.

One being financial markets, basically the public side, and the other being capital markets, basically the private side. We do not then split within Commercial between what is Corporate & Institutional versus what is BCB or SME for want of a better phrase. That split is not disclosed.

I am probably not going to add to the disclosures that we have today. On a look-forward basis, Chris, the second part of your question is the performance in the first half is pretty strong. The performance in the second half, the commercial team at least are telling me that markets are not going to be quite as lively, but every time they tell me that, Chris, they then go on and beat their forecast, which I am sure has something to do with my expectations management being done by them.

So, we will see how we go. I think the overall point for OOI in the second half and such is that we have had good progression 8 per cent year-on-year. Overall, without putting too precise a number on it, we think that progression is going to more or less continue into the second half and it will be a function of activity across the piece.

I have no doubt some of it in Commercial too, despite what they say, as well as strategic initiatives continuing to build towards the £0.7 billion that we expect for 2024. That combination, Chris. So, I think OOI, we feel comfortable about the remainder of this year. As I say, not totally dissimilar to what we see in the first half of this year.

Chris Cant
I guess relatedly, the central and other was negative for the first time in quite a while, and I know that is by its nature quite lumpy. But your 8 per cent year-over-year for the first half, that includes a fairly weak print within your equity investments business.

How should we think about that into the second half? Is that going to remain in a dry spell or are you expecting that to recover?

William Chalmers
Yeah, I think on that, Chris, there is a bit of noise in central I am afraid. And the reason why there is that noise in central is because central, as you know, gathers together a number of different things. One is internal treasury and funding adjustments, and then the other is the underlying equity businesses, which are things like LDC, which are things like housing growth partnership and so forth. And those are a very important part of central, but they are only a part of central.

When you look at it, therefore, you can expect reliable ongoing business proposition growth within the equity businesses that I just mentioned. LDC, for example. Housing growth partnership, Citra, is another example. And you would expect to see that grow pretty consistently over time, albeit it might ebb and flow a little bit from time to time. LDC, as you know, has some quarters that are good from a realisation basis and some quarters that are weaker from a realisation basis.

That is the way of things within private equity businesses, I suppose. But overall, there should be a pattern across the cycle of growth within those businesses. The other aspect of central though, as said, is treasury charges and the like. And effectively, a couple of points to highlight there. I think I might have spoken about this at year-end or possibly Q1.
Within that item is medium-term notes. Medium-term notes are effectively a funding device for the bank, about £5 billion or so, and they cause a bit of volatility in central items.

Typically, in a rising rate environment, they add to net interest income and they subtract from other operating income within central. But that's one source of volatility which from a Group point of view does not actually make a lot of difference. It is a funding instrument at times quite an advantageous one, but it's a bit of noise for central.

The second bit of noise is that within that central item is the benefit or cost of the short-term buffer on the hedge, and as you know, we keep a buffer on the hedge. We also keep maturities within three months on the hedge, and that is the way in which we manage the risk on the hedge.

During the course of 2023, we effectively ended up with that short-term buffer costing us a little bit. It then started to benefit us a little bit in reverse in 2024, but again, it causes a little bit of noise in terms of that overall central items charge. And so that is what is going on within there, Chris.

To put it very simply, as you look forward, should you expect that to materially change in H2? You should expect a little bit of an improvement over the minus 10 that you saw in H1, but it will be relatively modest. It will go into positive territory, that is our expectation, but it is not going to make a huge difference.

Chris Cant
That's really helpful, thank you.

William Chalmers
Thanks, Chris. I think we will call it a day at that and thank you very much indeed for taking the time to join. Again, as ever, the interest and the questions are really appreciated. I hope you all have a good summer and look forward to resuming our conversations in August or September.

End

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