fastFT **Lloyds Banking Group PLC**

Lloyds warns profitability to fall as low interest rates take toll

Bank chief António Horta-Osório faces 29% pay cut as part of shift to new remuneration model

Nicholas Megaw in London FEBRUARY 20 2020

Lloyds Banking Group has warned its profitability will drop in the next year despite signs of an improvement in the UK's economic outlook, as competition in the mortgage market and low interest rates weigh on revenues.

William Chalmers, chief financial officer, said: "There's no question that the environment presents its challenges, principally in the context of the low interest rate environment. But we do see our business model being the right one."

Lloyds, the UK's largest retail bank, said it expected to report a return on tangible equity (ROTE) of between 12 and 13 per cent this year, compared with its previous targets of 14 to 15 per cent.

The warning followed a similar update from rival Royal Bank of Scotland, which last week said it would be unable to reach its previous return target for the foreseeable future.

Profit margins have been falling across the retail banking sector for several years due to a combination of record-low interest rates and rising competition, which has been exacerbated by legislation that left HSBC and Barclays with billions of pounds in excess funds that could be used only in the UK.

However, Lloyds' lowered ROTE forecast was still higher than the top end of RBS's new target. It has been more resistant to margin pressure than many of its high street peers, offsetting weakness in the mortgage market with growth in higher-returning areas such as unsecured consumer lending and car loans.

The company's full-year results were affected by £2.5bn of previously announced provisions to deal with the end of the payment protection insurance scandal, pushing its ROTE down to 7.8 per cent. On an underlying basis, however, the figure was 14.8 per cent, down from 15.5 per cent the previous year.

António Horta-Osório, Lloyds chief executive, said: "We see the future with prudent optimism", after last year's election result helped to reduce political uncertainty and encouraged a recent improvement in business and housing market activity.

Mr Horta-Osório, previously the country's highest-paid banker, suffered a significant cut to his pay in 2019 because of the impact of PPI. The Portuguese chief received total pay worth £4.7m, down from £6.5m in 2018.

Stuart Sinclair, chair of Lloyds' remuneration committee, said the bank had shown that "performance and conduct do have material consequences".

The chief executive's maximum future pay was also reduced by 29 per cent — or £2.8m — as part of a shift to a new type of long-term pay model. Mr Horta-Osório's potential long-term bonuses will be halved, while the expected short-term payouts will increase.

Mr Sinclair said the removal of the "complex" old system would "give management clearer line of sight and greater alignment of interest to long-term share price performance".

Lloyds reported full-year revenues of £17.1bn, down 4 per cent year on year. Net profits dropped 33 per cent to £3bn.

Despite the challenges, Lloyds' shares rose 3 per cent on Thursday morning, encouraged by a lack of changes to the bank's capital guidance. Many analysts had feared regulatory changes would force it to increase the target for its common equity tier one ratio, a key measure of balance sheet strength.

Such a move could have damaged its ability to return capital to shareholders, but the bank kept its target steady and increased its dividend by 5 per cent.