Lloyds Bank plc

Q3 2016 Interim Management Statement

26 October 2016

BASIS OF PRESENTATION

This release covers the results of Lloyds Bank plc together with its subsidiaries (the Group) for the nine months ended 30 September 2016.

Unless otherwise stated, income statement commentaries throughout this document compare the nine months ended 30 September 2016 to the nine months ended 30 September 2015, and the balance sheet analysis compares the Group balance sheet as at 30 September 2016 to the Group balance sheet as at 31 December 2015.

FORWARD LOOKING STATEMENTS

This document contains certain forward looking statements with respect to the business, strategy and plans of Lloyds Bank Group and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about Lloyds Bank Group's or its directors' and/or management's beliefs and expectations, are forward looking statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will or may occur in the future. Factors that could cause actual business, strategy, plans and/or results (including but not limited to the payment of dividends) to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward looking statements made by the Lloyds Bank Group or on its behalf include, but are not limited to: general economic and business conditions in the UK and internationally; market related trends and developments; fluctuations in interest rates (including low or negative rates), exchange rates, stock markets and currencies; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the Lloyds Bank Group's or Lloyds Banking Group plc's credit ratings; the ability to derive cost savings; changing customer behaviour including consumer spending, saving and borrowing habits; changes to borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability, the exit by the UK from the European Union (EU) and the potential for one or more other countries to exit the EU or the Eurozone and the impact of any sovereign credit rating downgrade or other sovereign financial issues; technological changes and risks to cyber security; natural, pandemic and other disasters, adverse weather and similar contingencies outside the Lloyds Bank Group's or Lloyds Banking Group plc's control; inadequate or failed internal or external processes or systems; acts of war, other acts of hostility, terrorist acts and responses to those acts, geopolitical, pandemic or other such events; changes in laws, regulations, accounting standards or taxation, including as a result of the exit by the UK from the EU, or a further possible referendum on Scottish independence; changes to regulatory capital or liquidity requirements and similar contingencies outside the Lloyds Bank Group's or Lloyds Banking Group plc's control; the policies, decisions and actions of governmental or regulatory authorities or courts in the UK, the EU, the US or elsewhere including the implementation and interpretation of key legislation and regulation; the ability to attract and retain senior management and other employees; requirements or limitations on the Lloyds Bank Group or Lloyds Banking Group plc as a result of HM Treasury's investment in Lloyds Banking Group plc; actions or omissions by the Lloyds Bank Group's directors, management or employees including industrial action; changes to the Lloyds Bank Group's post-retirement defined benefit scheme obligations; the provision of banking operations services to TSB Banking Group plc; the extent of any future impairment charges or write-downs caused by, but not limited to, depressed asset valuations, market disruptions and illiquid markets; the value and effectiveness of any credit protection purchased by the Lloyds Bank Group; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors, including non-bank financial services, lending companies and digital innovators and disruptive technologies; and exposure to regulatory or competition scrutiny, legal, regulatory or competition proceedings, investigations or complaints. Please refer to the latest Annual Report on Form 20-F filed by Lloyds Banking Group plc with the US Securities and Exchange Commission for a discussion of certain factors together with examples of forward looking statements. Except as required by any applicable law or regulation, the forward looking statements contained in this document are made as of today's date, and Lloyds Bank Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward looking statements. The information, statements and opinions contained in this document do not constitute a public offer under any applicable law or an offer to sell any securities or financial instruments or any advice or recommendation with respect to such securities or financial instruments.

REVIEW

The Group recorded a profit before tax of £1,783 million for the nine months to 30 September 2016, a decrease of £394 million compared with the profit before tax of £2,177 million for the nine months to 30 September 2015.

Total income, net of insurance claims, decreased by £1,331 million, or 11 per cent, to £11,340 million for the nine months to 30 September 2016, from £12,671 million in the nine months to 30 September 2015.

Net interest income decreased by £1,959 million, or 23 per cent, to £6,635 million in the nine months to 30 September 2016 compared with £8,594 million in the same period in 2015. This was due in part to an increase of £2,063 million in the charge within net interest income for amounts allocated to unit holders in Open-Ended Investment Companies (OEICs), from a credit of £365 million in the nine months to 30 September 2015 to a charge of £1,698 million in the nine months to 30 September 2016, as a result of improved investment returns in 2016; there was no significant impact from changes in the population of consolidated OEICs. Excluding this charge from both periods, net interest income was slightly improved.

The net interest margin on the Group's relationship lending and similar assets improved, offsetting a small reduction in average interest-earning assets, which principally related to a decrease in legacy lending balances outside of the Group's risk appetite and the mortgage portfolio, only partly offset by growth in other personal finance and SME lending. The improvement in margin reflected lower deposit and wholesale funding costs more than offsetting pressure on asset pricing, particularly mortgages.

Other income, net of insurance claims, was £628 million, or 15 per cent, higher at £4,705 million in the nine months to 30 September 2016 compared to £4,077 million in the same period in 2015.

Net fee and commission income was £106 million, or 8 per cent, lower at £1,258 million in the nine months to 30 September 2016 compared with £1,364 million in the nine months to 30 September 2015, principally as a result of the disposal of TSB and reduced levels of card and current account fees.

Other operating income was £649 million, or 63 per cent, lower at £376 million in the nine months to 30 September 2016 compared with £1,025 million in the nine months to 30 September 2015. In the nine months to 30 September 2016 the Group realised a gain of £484 million arising on the sale of its investment in Visa Europe Limited, there was a £139 million increase in liability management gains and an improvement in income from the movement in value of in-force insurance business; however these items were more than offset by a loss of £993 million arising on transactions related to Lloyds Banking Group's tender offers and redemptions in respect of its Enhanced Capital Notes which completed in March 2016 and a loss of £1,026 million which arose pursuant to a restructuring of the Bank's capital instruments in June 2016.

The items related to the Group's insurance businesses largely offset in the income statement, with a significant increase in net trading income, driven by the impact of market conditions on policyholder assets, together with the increase in insurance premium income, being largely offset by an increase in the insurance claims expense, and the impact on net interest income of amounts allocated to unit holders in Open-Ended Investment Companies.

There was a total conduct provisions charge of £1,610 million in the nine months of 30 September 2016 compared to £2,435 million in the same period in 2015. A further charge of £1,000 million has been taken in respect of PPI to cover further operating costs and redress, including the impact of the proposed June 2019 deadline. A charge of £610 million related to a range of other conduct issues and included £215 million in respect of arrears related activities on secured and unsecured retail products and £170 million in respect of complaints relating to packaged bank accounts.

REVIEW (continued)

Other operating expenses decreased by £444 million, or 6 per cent, to £7,416 million in the nine months to 30 September 2016 compared with £7,860 million in the nine months to 30 September 2015. The nine months to 30 September 2015 included a charge of £665 million relating to the disposal of TSB, adjusting for which costs were £221 million, or 3 per cent, higher at £7,416 million in the nine months to 30 September 2016 compared with £7,195 million in the same period in 2015. Savings from the Group's restructuring initiatives have been more than offset by the impact of annual pay increases, higher levels of operating lease depreciation following continued growth in the Lex Autolease business and higher levels of restructuring costs.

Impairment losses increased by £347 million to £546 million in the nine months to 30 September 2016 compared with £199 million in the nine months to 30 September 2015. The impairment charge in respect of loans and receivables was £186 million, or 82 per cent, higher at £414 million in the nine months to 30 September 2016 compared to £228 million in the same period in 2015. Credit quality remains robust with the increased charge largely due to a reduction in the level of provision releases and write-backs. In addition, there was an impairment charge of £146 million in respect of certain equity investments in the Group's available-for-sale portfolio.

The tax charge for the nine months to 30 September 2016 was £834 million (nine months to 30 September 2015: £562 million), representing an effective tax rate of 47 per cent (nine months to 30 September 2015: 26 per cent). The higher effective tax rate reflects the impact of the change in corporation tax rates on the net deferred tax asset, the banking surcharge and restrictions on the deductibility of conduct provisions.

Total assets were £26,189 million or 3 per cent, higher at £844,093 million at 30 September 2016, compared with £817,904 million at 31 December 2015. Trading and other financial assets at fair value through profit or loss were £21,278 million, or 15 per cent, higher at £162,427 million compared to £141,149 million at 31 December 2015 due to positive market movements on policyholder investments and the inclusion of the Group's investments in OEICs which are no longer consolidated. Derivative assets were £13,064 million, or 45 per cent, higher at £41,986 million compared to £28,922 million at 31 December 2015, principally as a result of movements in exchange rates. Loans and advances to banks were £17,833 million, or 71 per cent, lower at £7,284 million compared to £25,117 million at 31 December 2015 as a result of a number of OEICs no longer being consolidated following change in control. Loans and advances to customers increased by £1,590 million from £455,175 million at 31 December 2015 to £456,765 million at 30 September 2016; excluding reverse repurchase agreements, lending was down as growth in unsecured personal finance and SME lending was more than offset by reductions in mortgage balances, as the Group concentrates on protecting margin in the current market, and in the portfolio of lending which is outside of the Group's risk appetite. Available-for-sale financial assets were £24,587 million, or 74 per cent, higher at £57,619 million compared to £33,032 million at 31 December 2015; the Group has reviewed its holding of government securities classified as held-to-maturity (£19,808 million at 31 December 2015) in light of the current low interest rate environment and they have been reclassified as available-for-sale.

Customer deposits increased by £6,919 million, or 2 per cent, to £425,245 million compared with £418,326 million at 31 December 2015. Derivative liabilities were £14,271 million, or 54 per cent, higher at £40,618 million compared to £26,347 million at 31 December 2015, again largely due to exchange rate movements. Other liabilities were £7,673 million, or 20 per cent, lower at £30,736 million compared to £38,409 million at 31 December 2015, principally as a result of the OEICs that are no longer consolidated.

Shareholders' equity decreased by £398 million, or 1 per cent, from £46,962 million at 31 December 2015 to £46,564 million at 30 September 2016 as the retained profit for the period of £873 million and the positive impact of other reserve movements, in particular in relation to the cash flow hedging reserve, were more than offset by total dividend payments in the period of £3,040 million.

The Group's transitional common equity tier 1 capital ratio decreased to 14.9 per cent at the end of September 2016 from 15.2 per cent at the end of December 2015 and the transitional total capital ratio decreased to 22.1 per cent (31 December 2015: 22.2 per cent).

REVIEW (continued)

Capital resources (transitional)	At 30 Sept 2016 £ million	At 31 Dec 2015[1] £ million
Total equity excluding non-controlling interests	**46,564**	46,962
Deconsolidation adjustments[1]	**1,022**	578
Other adjustments	**(4,623)**	(2,708)
Deductions from common equity tier 1[1]	**(9,729)**	(10,791)
Common equity tier 1 capital	**33,234**	34,041
Additional tier 1 instruments	**7,181**	4,761
Deductions from tier 1	**(1,331)**	(1,177)
Total tier 1 capital	**39,084**	37,625
Tier 2 instruments and eligible provisions	**11,870**	13,783
Deductions from tier 2	**(1,564)**	(1,756)
Total capital resources	**49,390**	49,652
Risk-weighted assets		
Credit risk	**171,118**	172,006
Counterparty credit risk	**9,526**	7,981
Contributions to the default fund of a central counterparty	**351**	488
Credit valuation adjustment risk	**1,028**	1,684
Operational risk	**26,123**	26,123
Market risk	**2,929**	3,775
Threshold risk-weighted assets	**11,998**	11,963
Total risk-weighted assets	**223,073**	224,020
Ratios		
Common equity tier 1 capital ratio	**14.9%**	15.2%
Tier 1 capital ratio	**17.5%**	16.8%
Total capital ratio	**22.1%**	22.2%

[1] Deconsolidation adjustments relate to the deconsolidation of certain Group entities for regulatory capital purposes, being primarily the Group's Insurance business. The presentation of the deconsolidation adjustments through common equity tier 1 capital has been amended during 2016 with comparative figures restated accordingly across deconsolidation adjustments and deductions.

STATUTORY CONSOLIDATED INCOME STATEMENT (UNAUDITED)

	Nine months to 30 Sept 2016 £ million	Nine months to 30 Sept 2015 £ million
Interest and similar income	**12,694**	13,382
Interest and similar expense	**(6,059)**	(4,788)
Net interest income	**6,635**	8,594
Fee and commission income	**2,297**	2,319
Fee and commission expense	**(1,039)**	(955)
Net fee and commission income	**1,258**	1,364
Net trading income	**16,491**	(450)
Insurance premium income	**6,422**	3,181
Other operating income	**376**	1,025
Other income	**24,547**	5,120
Total income	**31,182**	13,714
Insurance claims	**(19,842)**	(1,043)
Total income, net of insurance claims	**11,340**	12,671
Regulatory provisions[1]	**(1,595)**	(2,435)
Other operating expenses	**(7,416)**	(7,860)
Total operating expenses	**(9,011)**	(10,295)
Trading surplus	**2,329**	2,376
Impairment	**(546)**	(199)
Profit before tax	**1,783**	2,177
Taxation	**(834)**	(562)
Profit for the period	**949**	1,615
Profit attributable to ordinary shareholders	**824**	1,541
Profit attributable to other equity holders[2]	**49**	-
Profit attributable to equity holders	**873**	1,541
Profit attributable to non-controlling interests	**76**	74
Profit for the period	**949**	1,615

[1] In addition, regulatory provisions of £15 million (nine months to 30 September 2015: £nil) have been charged against income.

[2] The profit after tax attributable to other equity holders of £49 million (nine months to 30 September 2015: £nil) is offset in reserves by a tax credit attributable to ordinary shareholders of £14 million (nine months to 30 September 2015: £nil).

STATUTORY BALANCE SHEET (UNAUDITED)

	At 30 Sept 2016 £ million	At 31 Dec 2015 £ million
Assets		
Cash and balances at central banks	**70,090**	58,417
Trading and other financial assets at fair value through profit or loss	**162,427**	141,149
Derivative financial instruments	**41,986**	28,922
Loans and receivables:		
Loans and advances to banks	**7,284**	25,117
Loans and advances to customers	**456,765**	455,175
Debt securities	**3,502**	4,191
Due from fellow Lloyds Banking Group undertakings	**3,581**	11,045
	471,132	495,528
Available-for-sale financial assets	**57,619**	33,032
Held-to-maturity investments	**–**	19,808
Other assets	**40,839**	41,048
Total assets	**844,093**	817,904
Liabilities		
Deposits from banks	**18,937**	16,925
Customer deposits	**425,245**	418,326
Deposits from fellow Lloyds Banking Group undertakings	**3,629**	5,926
Trading and other financial liabilities at fair value through profit or loss	**53,603**	51,863
Derivative financial instruments	**40,618**	26,347
Debt securities in issue	**85,158**	82,056
Liabilities arising from insurance and investment contracts	**114,338**	103,094
Subordinated liabilities	**21,628**	27,605
Other liabilities	**30,736**	38,409
Total liabilities	**793,892**	770,551
Shareholders' equity	**46,564**	46,962
Other equity interests	**3,217**	–
Non-controlling interests	**420**	391
Total equity	**50,201**	47,353
Total equity and liabilities	**844,093**	817,904

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The statement can also be found on the Group's website – www.lloydsbankinggroup.com

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