LLOYDS BANKING GROUP PLC – 2018 RESULTS – TRANSCRIPT
(amended in places to improve readability only)

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LBG PRESENTERS:
António Horta-Osório, Group Chief Executive
George Culmer, Chief Financial Officer
Zak Mian, Group Director, Transformation

António Horta-Osório
Good morning everybody and thank you for joining us. I will go through the highlights for the year. Then Zak, our Group Transformation Director, will then update you on the significant progress the Group has made in our transformation programme since we announced the third stage of our strategy a year ago, before George runs through the results in more detail. We will then take questions at the end.

To begin, as the largest retail and commercial bank in the UK, our success is intertwined with the prosperity of the UK. We see this as a unique responsibility of the Group and as such we have continued to meet our core purpose of Helping Britain Prosper. While at present we are operating in a period of uncertainty, our support to the UK economy has been unwavering and will continue to be so, as demonstrated by our recent commitment to lend up to £18 billion in 2019 to UK businesses.

Moving on to discuss strategic and financial performance. We have made a strong start to the Group's latest strategic plan and have significantly increased levels of investment during 2018. We have also seen strong financial performance with continued growth in profits and returns, on both underlying and statutory bases.

As a result of this performance, we have delivered capital build of 210 basis points. This has enabled the Board to recommend a final ordinary dividend of 2.14 pence per share, and the 2018 total dividend of 3.21pence is 5 per cent higher than last year, in line with our progressive and sustainable ordinary dividend policy. The Board also intends to implement an increased share buyback of up to £1.75 billion over the course of 2019, reflecting our desire to return surplus capital to shareholders.

In total, the return to shareholders of up to £4 billion for 2018 represents an increase of 26 per cent on 2017. Our confidence in the future has also enabled us to reaffirm our overall guidance, as well as an improvement to operating costs, which we now expect to be below £8 billion in 2019, a year ahead of the original target.

Statutory profit of £4.4 billion was 24 per cent higher than 2017 while earnings per share has increased by 27 per cent. Underlying profit was up 6 per cent year on year.

We have also continued to build on our market leading efficiency position. The cost:income ratio has improved further to 49.3 per cent, or 46.0 per cent excluding remediation, despite significantly increasing investment.

Credit quality remains strong and we have seen no deterioration in the portfolio. The gross AQR is stable and the net AQR has only increased due to expected lower releases and write-backs.

The business continues to grow in targeted segments such as SMEs and Car Finance, with loans growing by £4 billion excluding the sale of the Group's Irish mortgage portfolio. Our good work in attracting new current account balances has continued, with balances £8 billion higher in the year, well ahead of market growth.

The Group has delivered an increased statutory return on tangible equity of 11.7 per cent, ahead of peers, and we remain on track to deliver 14 to 15 per cent in 2019, further enhancing the Group's market leading returns.

I will now look at the economy in a little more detail. The UK is experiencing a period of heightened political and economic uncertainty, but we observe an economy which is resilient and continues to benefit from unemployment at historic low levels, continuous GDP growth and the deleveraging that has taken place since 2008.

Particularly important, employment is at the highest level the UK has ever seen and is expected to continue to grow in 2019, while pay growth is now around 1 per cent ahead of inflation, both of which will support consumption and consumer creditworthiness.

Moreover, the UK is a large open economy, and global growth should continue in 2019 at around 3.5 per cent, supporting British exports. Therefore, and in spite of decreased business investment, we continue to expect UK GDP to grow at around current levels.

We also maintain our expectation of one base rate rise per year over the plan. This is predicated on an agreement being reached on Brexit but regardless of developments, we are well prepared and face the future with confidence.

I will now turn to the significant strategic progress in the year. In February last year we launched an ambitious plan to build on our existing strong capabilities and create new ones, transforming the Group for success in a digital world. During the course of the year, we have further extended our reach as the largest digital bank in the UK, now operating with 15.7 million digitally active users, while over 70 per cent of our products are originated digitally. This is complementary to our significant reach as the largest branch network in the UK, reflecting the strength of our multi-brand and multi-channel offering.

We have also launched our Open Banking aggregation capability to all of our mobile app customers, while our unique business model has enabled us to be the only provider to be able to show all of our customers' banking and insurance needs in one place with the launch of our Single Customer View to more than 3 million customers.

On building new capabilities, we continue to work closely on our innovation pipeline, like our investment in Thought Machine, and the announcement of our strategic partnership with Schroder's will enable us to create a market leading wealth proposition.

Finally, we have also made good progress in delivering targeted and personalised propositions to our diverse customer base, as well as extending our support to the UK economy. As part of this, we have increased net lending to start-ups, SME and Mid Market businesses by £3billion during the year, ahead of our target. As highlighted in February of last year, we will invest over £3 billion in strategic investments over the plan period.

Investment of this size, which shows our confidence in the future, is only possible due to our unique business model and market leading efficiency. As we continually invest in our business, we deliver improved processes and further productivity enhancements on one hand, as well as tangible improvements to our customer experience on the other. This process is continuous and so creates even greater capacity for future investment in the business, while supporting the delivery of market leading returns. We see this as a key competitive advantage.

Looking at each of these elements in more detail. In 2018, we have once again demonstrated the benefits of our relentless focus on efficiency, with a 4 per cent reduction in BAU costs more than offsetting our significant increase in investment. BAU costs have reduced at around 5 per cent per annum since 2011 and we will continue to deliver further improvements over the remainder of the plan.

At the same time, we have significantly increased investment across a number of our key strategic priorities, including a ten-fold increase in the amount we are spending on enhancing our Financial Planning and Retirement proposition. This combination will result in a cost base of less than £8 billion, which we now commit to delivering a year earlier, in 2019. We also continue to target a cost:income ratio in the low 40s as we exit 2020, including remediation.

We are spending more than ever before on technology, with our cash spend in 2018 equating to 16 per cent of our operating cost base and an increase of more than 20 per cent year on year. More than two-thirds of this was weighted towards enhancing existing capabilities and creating new ones.

We are also funding the largest ever investment in our people, with an additional 1.1 million hours of training delivered in 2018 to equip our people with the necessary skills of the future, with a total of 4.4 million hours to be delivered by the end of the plan. These investments are driving enhancements to our internal processes and allowing us to deliver change quicker and more efficiently. These benefits are expected to increase throughout the plan and Zak will provide more detail on this shortly.

As I have mentioned, we are the only provider able to serve all of our customers' financial needs in one place, supported by the launch of our Open Banking aggregation capability and our Single Customer View proposition. These illustrate the opportunity provided by the growth of digital channels to present our full range of propositions to customers, deepening our relationships and customer value.

We are making better use of our extensive data to deliver personalised propositions that customers value, including piloting a mortgage product for professionals such as doctors, and finding new ways for first time buyers to access the housing market.

Finally, we have also continued to make significant improvements to our digital functionality, driving higher satisfaction and engagement, with our Net Promoter Score increasing further year on year to 62.

Following this strong progress in 2018, I would now like to highlight a number of key opportunities we have in 2019 which will accelerate our strategic delivery. We will continue to further enhance the customer experience. Our Single Customer View will be rolled out to more than 9 million customers by the end of the plan period.

Having delivered strong net customer inflows of £13 billion in 2018, we will meet more of our customers' insurance and wealth needs, and expect to generate £15 billion of net inflows in 2019.

Our wealth joint venture, Scottish Widows Schroders, will be commercially branded as Schroders Personal Wealth and will be launched to the market by June. This strategic partnership will combine our significant client base, multi-channel distribution and digital capabilities with Schroders' investment and wealth management expertise. Our aim is to become a top three UK financial planning business within five years, with significant Assets Under Administration growth being incremental to our original plan.

We will continue to increase personalisation and deliver more targeted products that customers value. This includes the full roll-out of our 'Lend a Hand' mortgage proposition that allows first time buyers to get onto the housing ladder more easily, with their family or other sponsors receiving a leading savings rate in exchange for their support.

Finally, our Commercial Banking offering will also be supported by increasing levels of digitisation, enhancing credit decisioning and significantly reducing the time to cash for small business lending. We will also continue to deliver towards our 2020 net lending growth target of £6 billion across start-ups, SMEs and Mid Market companies.

In summary, we have made significant progress during 2018 in building new capabilities to transform the Group to succeed in a digital world. Our strong financial performance is reflected in increasing profitability, which has enabled increased returns to shareholders and increased guidance.

We continue to expect our market leading return on tangible equity to improve further, to 14 to 15 per cent this year, and to deliver ongoing capital build of 170 to 200 basis points every year. We expect a margin of around 290 basis points in 2019 and continue to expect it to be resilient through the plan.

And as I mentioned earlier, we have accelerated our operating cost guidance and now target this to be below £8 billion in 2019. And we continue to expect an AQR of less than 30 basis points through the plan, reflecting our high quality portfolio and low risk business model. Therefore, and in spite of ongoing economic and political uncertainty, we believe that our simple, low risk business model is the right one. Our strong investment will help build new sources of competitive advantage in the near future, to the benefit of our customers, colleagues and shareholders, while supporting our core purpose of Helping Britain Prosper.

I am now going to hand over to Zak who will run through the significant progress we are making on the Group's strategic transformation in more detail. Thank you.

Zak Mian
Good morning everybody, thank you António. As you've just heard, during 2018 we've continued to invest heavily in the business. I'm now going to spend a few minutes just talking over how we've used this investment to build great new features to improve the customer experience, but also change our technology and our processes to deliver things faster and more cost effectively.

Now as we presented about 12 months ago, GSR3 is very much a technology enabled transformation. As part of this, we have been focused on modernising and simplifying the architecture that we have and augmenting it with 'scale ready' technologies like cloud, big data and Machine Learning. We're also transforming the effectiveness of how we deliver through the use of agile techniques and DevOps.

In the channel area on the top right there we have already got a single, multi-channel platform for Retail customers and we've focussed our engineering efforts to speed up the deployment of simple digital changes.

We've also made progress on our mainframe and legacy technologies as well, with changes to our debit card platform which is mainframe based. Now typically projects always used to take 9 months. Now we are seeing some of the projects being delivered in 3 months.

On our infrastructure, we've also laid foundations for our cloud strategy, with 100 apps already migrated and this is going to ramp up during the course of this year by taking another 700 onto that new platform. That takes us halfway to our target over the plan period.

Much of this is also being enabled by the shift that we've made in the percentage of investment on new capabilities VS improving or enhancing existing systems.

But to support all this, we're busy also cross training the teams in Agile but also recruiting new strategic skills like engineering, data science and design. We've already hired 350 new colleagues and the plan is to treble this number during the course of the next 12 months.

Next I'd like to give you an update you on our mobile app. We saw the 2.3 billion mobile logins during 2018 that is a 30 per cent increase YoY. Customers are now logging in an average of 22 times every month. Across all our core brands, if we now include MBNA, we've got 9.3 million users on the app. Antonio mentioned earlier that over 70 per cent of banking products are now being opened online in the digital channel and we can now see over half of these coming via the mobile app. To give you some context, in 2014 that number used to be 7 per cent.

But now we'll just talk a little bit about some of the improvements we've delivered for customers during 2018 and over the course of 2019 what we have planned. So just on the top left behind me, we launched our Chatbot pilot in Q4 for Bank of Scotland customers and we've seen really great take up with a 10 per cent improvement in customer satisfaction and a 'containment' rate of up to 30 per cent, and that is where the Chatbot answers the query that the customer has without needing to refer it to a colleague.

We've also saved 780k colleague hours during 2018 by deploying robotics in the back office with some high volume activities. And this has freed up colleagues to time to spend more time with customers.

On the bottom left, as you may have seen, we also integrated Google maps into our (Android) version of the app, and it is already proving quite popular, with 1 million uses per month already. Again we've seen an improvement in customer experience and operational efficiencies 45 per cent drop in the number of times a customer is clicking on 'I'm unsure about this transaction' they are seeing on their statement and also the reduction in the number of resulting calls we are seeing into the call centre. On the bottom right behind me there, I'd also like to highlight the new branch based lending journey for business banking clients. In 2018 has been about making the process simpler for colleagues helping clients taking out loans. This week we're putting this online for our clients and we expect to see the time to cash drop from 6 days to 2 hours for simple, unsecured lending.

Another key area of improvement we've made to the app is through the API enablement of Open banking. This is now already available to all Lloyds, Halifax and BoS customers and we have about 1000 customers/day signing up and 36k already now active. As we expected, this is a pretty gradual take up, but we do continue to think in the long term this will become a standard feature with relatively high usage. Later on in the year we are going to be extending the proposition to include cards and savings accounts as other providers make these API's available to us. But in parallel we've also focussed on related features that we really think will resonate with customers and really leverage the unique things that Lloyds Banking Group can do because of our business model.

And this is really about putting all of our financial needs in one place for the customers. We've extended the view of products a customer can see within their internet banking and so today 3 million customers can now already see their employee or their individual pensions, or their home insurance products, alongside their banking, and we see165k customers viewing them daily.

And we really think this is potentially game changing and is at the heart of our Financial Planning and Retirement strategy as we are really seeing a significantly increased customer engagement as a consequence of this way of seeing products. As I mentioned earlier, customers, on average now are logging in 22 times per month and if we contrast that with their normal way you would get an annual statement on your pension and some customers are telling us they've even forgotten that they have even have these pensions. So it is a big step change.

During 2019 we are going to move into supporting customers with pension top ups and the ability to consolidate their pension funds that they hold with other providers and we really think we've got a unique opportunity to help customers with their long-term savings and retirement needs. We're also going to continue to progress towards our goal of enabling up to 9 million customers being able to see all of these products in one place by the end of the plan period and this will be by adding long-standing pensions and share dealing accounts, and also extending it to the new Schroders offering as it launches later this year.

So just to wrap up. Where do we really see all of this going? So just behind me on the left there you can see an example of how we might deliver financial insights to a customer. And this is about better connecting customers with their finances by integrating our big data our Single Customer View with our digital channel.

In the second example, we have got a Chatbot session which is helping a customer with their budget and a potential house move, with the bot handing off to a branch based mortgage advisor and this is about introducing a new convenient channel for customers but in an operationally efficient way, leveraging Machine Learning but also the customer facing colleagues as part of an integrated multi-brand, multi-channel proposition. And all of this is then being enabled by a continued investment in technology, an uplift in colleague skills, and the use of scaled agile processes and DevOps to deliver these improvements faster and more cost effectively.

I'd now like to hand over to George to present the financials.

George Culmer
Thanks Zak and good morning everybody. I will now conclude by briefly running through the numbers.

As you have already heard, in 2018 the Group has delivered another strong financial performance. Underlying profit of £8.1 billion was up 6 per cent with net income of £17.8 billion up 2 per cent. Lower operating and remediation costs drove positive jaws of 5 per cent and a further improvement in the cost:income ratio, while the gross AQR was stable at 28 basis points with the expected increase in the net position.

Statutory profit before tax was £6 billion and up 13 per cent, due to the growth in underlying profit, as well as lower below the line items and a strong Q4, which was up some 32 per cent on prior year.

And finally earnings per share was 5.5 pence and up a very strong 27 per cent with the growth in profitability, a lower effective tax rate and a reduced share count.

Looking then at the individual line items. Net interest income of £12.7 billion is up 3 per cent, driven by both an improvement in the margin and slightly higher average interest earning assets. The margin improvement of 7 basis points to 293 basis points, was due to lower funding and deposit costs again more than offsetting continued pressure on asset margins.

And going forward, while we expect asset pricing to remain challenging, we expect the margin will be in line with our previous guidance of being resilient around 290 in both 2019, and the remainder of the plan.

In terms of the margin drivers, we will continue to optimise volumes and mix across both sides of the balance sheet, and we are not seeing any material change from the trends I outlined at the half year.

On the asset side, as just mentioned, mortgage pricing remains competitive and we will continue to focus on value and risk profile rather than volumes, and the book margin was down just 0.1 per cent at 1.9 per cent. At the same time, we continue to target growth in our higher margin segments. In consumer finance, where the margin is over 7 per cent, volumes are up £2 billion in the year, and in Commercial, SME and Mid Markets with a book margin of 2.4 per cent, are up a combined £3 billion.

On liabilities, we continue to target growth in current accounts which, as you've heard, are up £8 billion and the liability margin has increased from 0.3 to 0.4 per cent and offsets the asset pricing pressures.

The growth in current account balances has also enabled us to increase the structural hedge from £165 billion at the start of the year to £180 billion, which represents around 40 per cent of eligible balances. And these hedge balances generated 0.7 per cent, or £1.4 billion, over LIBOR and £2.7 billion in total in 2018, and I expect the hedge to continue to provide strong support to the margin.

Looking then at other income. Other income of £6 billion is in line with the underlying result in 2017, and our guidance for the year. And the £2.9 billion for the second six months is also stable on recent years.

In terms of divisional performance, we talked last February about targeting new business growth in Insurance and Wealth, and in 2018 new business income was up 87 per cent at £526 million, largely driven by growth in workplace, planning and retirement.

Retail's other income was broadly stable at £2.2 billion despite the introduction of our simpler overdraft fee structure, while Commercial was down slightly at £1.7 billion, as a result of lower levels of client financial markets activity.

Gilt gains totalled £270 million for the year, in line with 2017 although Q4 gains were just £11 million compared with £74 million in Q4 last year and £67 million in Q3 2018. Going forward though we continue to have significant mark to market gains on the portfolio and we will continue to realise these gains, albeit at a lower level than in the last couple of years.

On costs, as you've heard, we continue to make good progress and operating costs are down slightly on 2017 at just over £8.1 billion, while remediation costs are down 31 per cent at £600 million.

As you know, our strategy is to drive down BAU costs while increasing investment in the business, to improve customer outcomes and further drive down those expenses. This is clearly evident in 2018, with a further 4 per cent reduction in BAU operating costs more than offsetting the expected 10 per cent increase in expensed investment and depreciation.

Total above the line investment in the year was £2.4 billion, of which around 60 per cent was capitalised, with about two-thirds of that related to intangibles, with both ratios in line with last year.

Going forward we will maintain our focus on costs while continuing to invest in the business. And as has António has mentioned, we're moving at a faster pace than originally envisaged, and now expect operating costs to be below £8 billion in 2019, a year ahead of our original target and without additional cost to achieve.

Going forward we also expect a significant reduction in remediation costs and, as previously guided, we still continue to target a cost:income ratio in the low 40s by the end of 2020.

Turning to credit. Credit quality remains strong and continues to benefit from our low-risk approach and prudent provisioning.
As mentioned, the gross AQR of 28 basis points is stable on the last couple of years, while the net position of 21 due to the expected lower levels of releases and write-backs. And while IFRS 9 undoubtedly introduces additional volatility, we continue to expect the normalised net AQR to be less than 30 basis points in 2019 and through the plan.

On the balance sheet, we are in a stable and prudent position. Stage 3 balances and coverage are in line with the start of the year at 1.9 and 24.3 per cent, respectively, while Stage 2 assets reduced, from 11.3 to 7.8 per cent, largely as a result of the sale of the Irish portfolio, model changes and portfolio improvements, while coverage is up from 3.5 per cent to 4.1 per cent.

On the implementation of IFRS 9 as a whole, we took a prudent stance that has been maintained over the year. Our Stage 2 balances are over 75 per cent fully up-to-date for customer payments and over 85 per cent comprise secured Retail exposures and the largely secured Commercial book.

Our overall economic assumptions have also always included both a 30 per cent weighting towards a downside scenario and a 10 per cent weighting towards a severe downside. And this severe downside which, for example, captures both peak to trough house prices and CRE falling over 30 per cent, contributes £0.6 billion to our total expected credit losses of £4.4 billion. And while going forward there will be some volatility to the ratio, this £4.4 billion currently represents around 4 years of net underlying write-offs, including about 5 years for the mortgage portfolio.

In terms of actual credit performance, as you've heard we continue to see no material change to trends. In mortgages, new to arrears remain broadly unchanged at around 0.4 per cent and we continue to see low LTVs, with an average of 44.1 across the book, and 38.4 in London, while our new business LTV remains low at 62.5.

In Commercial, the book continues to benefit from the economic environment, as well as effective risk management, including reduced single name and sector exposures.

Finally, in consumer finance, new to arrears in Cards remain low at around 0.6 per cent, having reduced significantly in recent years, and the MBNA book is performing in line with our expectations. And in Motor, we continue to price and reserve prudently and also continue to make a profit on sale of end of contract vehicles.

Looking next at statutory profit. Statutory profit after tax is £4.4 billion for the year and up 24 per cent with the 6 per cent growth in underlying profit and a 10 per cent reduction in below the line items. And in 2019 we would expect to see a much more significant reduction in these below the line charges.

In terms of the individual lines. Negative market volatility and asset sales of £50 million includes £236 million of negative insurance volatility in the fourth quarter, reflecting weaker equity markets and wider credit spreads, some of which has already been recovered since year end.

Restructuring of £879 million includes severance costs of £247 million, as well as the costs of our non-branch property rationalisation, ring-fencing and the integration of MBNA. As already guided, in 2018 ring-fencing cost about £0.3 billion and MBNA about £0.1 billion, and as both of these programmes fall away, these costs will obviously significantly reduce in 2019.

The PPI charge of £750 million includes £200 million in Q4 with higher average redress and administrative costs, and our improved capability to identify valid claims, offset by lower reactive complaints which were around 12,000 per week, and inside our assumption of 13,000.

The effective tax rate is 26 per cent, and 7 points lower than last year due primarily to lower conduct charges, and in line with our long term expectation of around 25 per cent.

Finally, as you've heard, our statutory return on tangible equity is 11.7 per cent and already significantly ahead of the sector, and we continue to expect this to increase to between 14 and 15 per cent this year, with strong underlying profitability and reduced below the line charges driving increased statutory profits.

Turning then briefly to the balance sheet. Loans and advances are stable at £444 billion with targeted growth of £6 billion offsetting the £4 billion sale of the Irish portfolio and a £2 billion reduction in the closed mortgage book. The open mortgage book was broadly flat at £267 billion as we maintained our focus as I've mentioned on value and risk profile, over volume, in a highly competitive market.

SME growth at 3 per cent remains ahead of the market, and we continue to target growth in our unsecured portfolio.

RWAs are down £5 billion at £206 billion, primarily reflecting the sale of the Irish business, the lower closed mortgage book and ongoing optimisation in Commercial where RWAs are down £2 billion in the year.

Turning finally then to capital. As you know, the Group has built 210 basis points of CET 1 in the year. Underlying banking operations and the insurance dividend delivered 220 basis points and the Irish sale a further 25, partly offset by a 38 basis point charge for PPI. And as you've heard, this has enabled the Board to recommend a total ordinary dividend of 3.21 pence per share, up 5 per cent, and a share buyback of up to £1.75 billion which will be completed over the course of 2019.

The Group's capital target of around 13 per cent with a management buffer of around 1 per cent is unchanged, and our pro forma CET 1 ratio after the buyback is 13.9 per cent.

And going forward we continue to expect capital build of 170 to 200 basis points per year, and this is after allowing for RWA inflation and increased pension contributions.

Finally on net assets, TNAV per share increased 4.4 pence or 9 per cent before dividends, driven primarily by the strong statutory profits.

So, in summary, our strong financial performance is seen in our increased profitability and higher returns to shareholders. And our confidence in the future is reflected in the guidance you've heard this morning.

Our low risk business, cost discipline and targeted investment and growth continue to provide competitive advantage. And while 2019 will present obvious economic and political uncertainties, we face the future with confidence knowing our strategy is the right one.

That concludes my presentation and we can now go to Q&A.

Question 1 – Chris Manners, Barclays Capital

Thank you. Good morning. It's Chris Manners from Barclays here. Just a couple of questions if I may. The first one was on capital and capital generation. It is good to see the £1.75bn buyback. I think that is a bit better than what people were looking for. As we look into next year, the 14-15 per cent return on tangible equity, that you are targeting, that is an all in number. To me that would look like you should be able to generate closer to sort of 250-300 basis points of capital rather than the 170-200. So could you remind us what drags you are factoring in there? I guess you've got pension. Maybe there is some risk weighted asset changes. But just to let us know what is going to stop that and stat profit?

António Horta-Osório

George will provide the detail, but just to make a comment because sometimes people confuse these numbers. This is not capital generation, this is free capital generation. So after uses of capital which is quite important. So this is the capital that we have in excess of the applications of cash. So like an industrial company, you call free cash flow after investment. This is free capital generation which is quite important. So George will tell you what other things that are included which makes that the RoTE can go up. But if you have extra uses of funds we can keep the capital generation guide

George Culmer

I think you have both answered that one. So what is your second question?

Further question

Right okay, so well the second question was just on the mortgage growth. So it seems that the mortgage open book shrank in the fourth quarter. Maybe you could just tell us a little bit about how you see competition, pricing and your ability to actually grow in line with the peers in the mortgage business? Thanks.

George Culmer

Okay on the capital as I said, I mean as António mentioned, you know the 170-200 is free capital, without repeating everything that has been said. And so as we've previously talked about, you will see in our business that rise in statutory profits as you say underlines as strong below the line items drop away, statutory profit grows, underlying capital generation if you like grows. I then as you point out, spend some of that on things like pension deficit, fundings will step up in the walk that we show on the screen in terms of my slide. Actually the pension deficit funding is actually in that other of about 0.3. Within there you have got some pension deficit funding. You have also got offsetting that some structural dividends that will be taken out for insurance and we've done things like move some of the pension scheme out of insurance. This is all to comply to ring-fencing, into the ring-fence bank. We also did an adjustment in terms of fees paid etc. So that is netted off in there.

So going forward, and I think we disclosed in terms of the step up in terms of the deficit payments. So the sort of 468 in terms of hundreds of millions. So that steps up. The RWA density pick-up, yes there is targeted growth, but there is also as you say, RWA density. You see some of that coming through. You see some of that in Q1 and things like IFRS16 which will pick up about a 10 basis point charge from that. That's simply because the asset that goes onto the balance sheet requires funding. I have then got things like securitisation that will come in in 2020 and then obviously we have got the various mortgage headwinds again in 2020 where you have got things like the definition of default which is a 180 down to 90 which is a drag, but then going against the other way, I have got moving from, in terms of through the cycle and the hybrid through the cycle point in time which should offset a portion of that which will bring it back down again. Then you have got things like when it comes in the EBA repair programme and ultimately moving into the Basel IV type stuff.

So in all our expectations as we look out is that the statutory profit and that additional capital generation pays for those below the line items while still going to António's point being able to generate that free cash flow. That is the sort of delta between the line that goes up and the line that stays flat.

And then in terms of the mortgage market. Yes it has been competitive and we've seen people price down you know 10-15 basis points etc. You know our strategy which you've heard many times we are not going to change you know across the business. You know we look to generate value for our shareholders and we look to generate a value for our shareholders through a return on capital and by generating capital. And we think the right thing to do to deliver that aim at the moment is to standoff that market and we are not going to change our strategy whilst the market looks like that. In terms of managing the business, we have a number of levers that we can pull. We have a number of business lines under our control. And if I am defending mortgage I can be more aggressive in consumer finance, I can be more aggressive in SME and more aggressive in Mid-markets. But I can flex my product offering and I can flex my balance sheet to the circumstances at the time. And we think and we still continue to think the right decision for us and for our shareholders is to be defensive within the mortgage market. So if that changes and if pricing relents then you know we can change that strategy and we can flex with very rapid response.

But at the moment the right thing to do is, given the back book, given the risk profile given where we are inin the cycle, given pricing, given the nature that a lot of that business is being written, that we are quite content with the mortgage strategy is right. We still account for something like 16 per cent of new business. Yes I've got my back book running off at a couple of billion, but that front book, we were hoping to be marginally above, we are about 0.4 below in terms of where we ended up in Q4. But it's a tough market, but in terms of managing the overall Group, you know we're more than a one product company and we use both side of the balance sheet, we can utilise our product range to drive the RoEs and to drive that capital generation that we talked about.

Chris Manners
Thank you.

Question 2 – Alvaro Serrano, Morgan Stanley
Hi. Good morning, Alvaro Serrano from Morgan Stanley. Two questions. António you mentioned that there's a lot of uncertainty, but Lloyds is well prepared in that uncertain scenario. In particular when I think about the 2.9 NIM guidance for this year, you build in 25 basis points per year. If that rate hike doesn't come through, how should we think about sort of that margin guidance?

And if we look a bit more medium term, obvious there are uncertainties, what cost flexibility do you have to make you well prepared in the event that revenues don't come through? Obviously you have surprised positively in Q4 the guidance?

António Horta-Osório
So George will answer the first question. And in relation to the second, yes we have significant cost flexibility because as you saw in our numbers and given our confidence in the future on delivering for customers, we are significantly ramping up investments. And of course if circumstances change and we see that the paybacks of those investments will be more delayed or there are circumstances that will determine, we can obviously reassess it as we go. So apart from the fact that we are going quicker than we thought in terms of our overall cost plans, and therefore will deliver less than £8 billion a year ahead of target, should circumstances in our plan change and our plan as you say is for one point rate rise a year in the next two years of the plan. And for an orderly transition into Brexit we can always obviously re-evaluate the plan depending on the circumstances and we have significant investment programmes which have significant flexibility. Of course we are doing them because we are confident in the future and we see as we showed you when Zak gave some very clear examples on how many benefits, intangible benefits they are bringing to customers.

George Culmer
And then to your first question. The simplest answer is that if the rate hike doesn't come through I don't envisage us changing our guidance for 2019. Our planning assumption was always that the rate hike would be back end of the year. I think when you look at the report and accounts you will see that we talk about an income sensitivity, now it is about £75 million for every 25 basis points and never one to rubbish numbers in my own report and accounts. But I always think it is probably an indicative number at best. It depends upon liquidity passed through, etc, a multitude of various things. But we plan as you said, one rate rise back end of the year. If it doesn't come though. Obviously rise in rates we would prefer the scenario in terms of things that it enables us to do. If it doesn't happen, going back to comments António's made and also what I was talking about in terms of how we manage the business, I am sure we would set ourselves the challenge of making up any lost income that we hadn't got from a rate income and I would back our chances to be able to achieve that.

António Horta-Osório
And just clarify something. The guidance on NIM is exactly the same that we gave you here a year ago. We said around to 290 resilient throughout the plan. We did a little bit better than we thought last year to 293 but basically we are repeating the guidance we gave you last year.

Question 3 – Rohith Chandra-Rajan, BAML
Thank you very much. It's Rohith Chandra-Rajan, Bank of America Merrill Lynch. Just actually following up on that resilient margin comment and trying to put that together with net interest income outlook. So as you say, it is in line with guidance you know as Chris and Alvaro highlighted. There is pressure in the mortgage market, some more I guess uncertainty in both the short and medium term interest rate outlook, but you've got the confidence today to reiterate your margin guidance. So I was wondering in terms of what are the additional levers you found you can pull to offset what looks like a more challenging environment?

So firstly, slide 21 in terms of the liability side, how much of that is repeatable? You have talked before about high cost deposits you can refinance, wholesale funding costs coming down. So it would be really interesting to know how much of that is repeatable?

And then I guess in terms of volume growth, if the open mortgage book is going to shrink a little bit, how shall we think about the overall balance sheet size? Is that going to be offset in commercial and consumer? Thanks.

George Culmer
Okay Rohith, I don't think I said the open book was going to shrink. I also may not have said it was going to grow. I didn't say it was going to shrink. So look, well dealing with the second one first. Yeah in terms of the balance sheet, there is some of it that "is in our gift" to a degree in terms of I would expect to see SME grow, I would expect to see mid-markets grow, I would expect to see consumer finance grow. Not to shoot the lights out, but probably in line with market expectations in terms of the 2-3 per cent in terms of consumer finance type stuff. As I say mortgage market pricing doesn't amend in the market. I expect to see a continuation of our defensive, it does not necessarily mean shrink though. But what you've got is, we will remain defensive mortgage, targeted growth in terms of those areas I have outlined. And then going the other way, you will still have our run-off books, you will still have, you'll lose a couple of billion from the closed mortgage book coming through. And then within the other bits of the commercial market, we have said this before as well, it will depend where the prices are in terms of some of the bigger ticket commercial business. And we don't like to set the targets for those things.

And then in terms of the resilience, look it is not about finding sort of new ways, it is about perpetuating things that you know you can do and you know are core competences. And you know you have sat through this many times over the last few years, but being able to manage the spread, being able to manage the business, you know there are still more things we can do in terms of the liability costs. So the question always get asked in terms of you know the blended savings costs, it was something like 48 and this is in the retail book was 48 at Q3, it is 45 in Q4. We've still got about £20 billion or so of fixed coming up from maturities. So there are still opportunities in terms of pricing optimisation that we think we can do there. We still think there are things we can do in terms of the mix that I was talking about in answer to Chris's question. We are still going to focus on building our current accounts and the structural hedge in terms of the deployment of those balances. So there is nothing in that list that is new, it is about a continuation of the practices and the policies that we have successfully executed over the last few years.

So in our assumptions around that 290 as previously discussed, yes we thought about or still do think about a rate rise a year, but actually in that we also assumed that the mortgage market wasn't going to rise to you know come and save us, that actually the market would stay tough. So our working assumption is that we would continue to have to work hard as a business in terms of being able to perpetuate that margin. But some of the things, you know there is still an element, there are the last vestiges of crisis funding to roll off. But some of the better years in terms of that contribution and NIM have gone, but we will still seek to be as efficient as we can in the markets with regards to that. But there are still more potential in terms of retail pricing, there is still more potential in terms of current accounts, there is still more potential in terms of optimising our mix as a business and we will still do a great job in difficult circumstances of preserving that mortgage market and taking what we think is the right strategy.

António Horta-Osório
And Rohith just on top of everything that George said, I think it is worth paying a little bit of attention to the evolution of the current account balances because those are convenience balances, not price driven balances. They show the trust in our brands. We have been going three percentage points above the market and this is continuing and we expect to continue to grow above the market in 2019. And just to give you an idea, we have more than £5 billion of those balances which we will reinvest into the structural hedge at the right moment, post the end of last year which we are not investing because now the difference between the 5 year swap and LIBOR is very small and we don't think it pays anything to actually hedge. But just to give you an idea, so those balances have grown from the number you have of £180 billion, they have already grown more than £5 billion since that number which we will be reinvesting at the right time and they will provide continuous additional value just to add to the points that George just mentioned.

Question 4 – Raul Sinha, JP Morgan
Hi good morning, it's Raul Sinha from JP Morgan. Can I have two please. Can I come back to the cost performance because it is quite different from what we have gotten used to from banks across the sector. So firstly, where is the cost delta coming in from? You know what are you finding that you have to spend less money on in an environment where other banks are telling us that they have to spend more money on Brexit preparation and regulatory costs and all the other things?

António Horta-Osório
It is a one million dollar question!

Further question
And then I guess related that there is a broader theme that as you digitalise the bank more are you finding that it is easier to take costs out? And what does that mean for the sort of broader implications of your cost plan going forward? I guess that's the first part.

António Horta-Osório
I think that is a very good question and I would like to connect it with a loop that I showed about the virtuous circle and additional competitive advantages it creates for us because I mean the way we look at the world is the following. This digital world is a reality and a massive additional investments are not one-offs, they will continue. Customers want more and more change, quicker and they want it at better prices. So you will have to invest more and more in digital. Zak gave several examples. And in my view this will continue. So only the banks that are able to ramp up this investment producing benefits for customers, only the ones that are able to decrease BAU costs accordingly will be able to keep decent returns for shareholders. Otherwise one of the two has to give in. So we have been able to be doing the two.

And just to give you some examples of what went well and new things we are doing this year, just to give you a few examples. For example, sourcing. We are continuing to concentrate our suppliers and giving more amount of volumes to less suppliers in exchange for better prices and the transfer of the productivity gains they get into us, so in a partnership sense for example.

Second example, e-auctions. We now do more than 50 per cent of all our contracts in the final stage after the termination of all the contract key points. You go to an e-auction where you have additional savings because either you get it or not in a transparent way, just to give you an example. Organigrams of the banks, we told you repeatedly about less layers, bigger spends of control. So we are taking that further, not only at bank level but area by area level. Each area is different, but the more we can within the specificities of each area, compress the business area with more spans of control and less layers not only we save costs because we save middle management roles, but we get the more responsible, more responsive, simple and agile organisation. So just to give you three examples.

And to your point, digitisation as Zak showed through robotisation and straight through processing and the other techniques, digital where customers do it themselves of course provides additional savings. But I would like to wrap all of these examples in a cultural matter. I have told you this repeatedly and I strongly believe in it. Costs is a cultural matter, if you don't address them they grow. And if you instil a culture of attention to costs of not spending money that should not be spent in the first place and spending better the one that has to be spent, over time you have a significant difference versus others. And costs should be totally within our control and that is why we are so committed to always delivering things within our control like the guidance we are giving you on costs. So we are quicker, we have then things better than we thought and it is always better to be ahead basically, it gives us more options.

Further question
Thank you that is really helpful. I guess the second question is just on the income outlook for 2019 and you know the broader I guess question that people are asking, can you grow income you know in 2019 if hard Brexit were to be avoided? And we have had a discussion on NIM already, but perhaps if you can touch upon other income as well? You know what is offsetting the sort of year on year step down in the gilt gains perhaps into 2019? And is there anything else in terms of moving costs?

George Culmer
Yes as I said in the Presentation, whilst we were still on a sizeable mark to market gild gains will be under, will be inside and we are still a seller of that particular asset, will be inside of that.

In terms of overall shape, when you look at the businesses or when you look at the performance in '18 versus '17 as I said in the Presentation, as a sort of stand up performance insurance and wealth who are probably about a year ahead. I think when we were here talking about strategy and we talked about the fundamental offset between new business going up and the back book running down. The thought that it would take a couple of years for new business to overhaul. I am delighted to be able to say we have achieved that in 2018 with that growth in new business that I talked about. That dynamic continues but I would expect as a consequence of that to see insurance from an OI perspective be ahead '19 versus '18. In commercial I would also like to be ahead, it's a tougher market and there are market vagaries out there. So I think that is a tougher ask. And then within the retail, it is still pretty tough, you've got things like corporate feats sort of contracting so that will play through into the side of LEX. Just in terms of things like ATM usage, mortgage fees etc, I would have thought retail might be slightly under in terms of

’19 versus ’18. So I put those together with the lower gains in the centre. If I’m £6 billion I would be shooting for trying to get £6 billion again or something of that order in terms of 2019 versus 2018.

Paul Sinha
Thank you.

Question 5 – Fahed Kunwar, Redburn
Hi it’s Fahed Kunar from Redburn. Can I just follow up on that revenue growth question. I mean if I back out from your low 40s depending on what kind of low 40s you are looking an £18 billion revenue number for 2020 on your cost base. You are at £17.7 billion now. Your organic revenues were down year on year, consensus has them down again next year as well. So is that right in thinking that the inflexion in revenues will be more of a 2020 story or do you think there are things that can actually get revenues moving in 2019? You kind of said OOI isn’t going to be moving in 2019. So should we think that NII actually starts to show some kind of growth in 2019 or do we expect organic NII to fall again in ’19 growing into 2020? That was question one.

And question two was, your core Tier 1 ratio of 39 facilitated obviously a very good buyback this year. If you look at your fully loaded core Tier 1 ratio so BaselIV and IFRS9, some of your peers in Europe have given that number. Do we know what that number is for you? And do you expect that number to have to go up from where we are today or do we think that actually that can be bought into the current number? So every bit of generation from here, free capital generation can be returned to shareholders or the Regulator will start to keep some of that going forward?

Third question was on the current account market. How much of the current account growth is your time deposit customers dropping into current accounts because of low rates? And how much is new customers coming to you opening current accounts with you? Thank you.

António Horta-Osório
Okay just on the third one which is the easiest one to respond to! As rates started to creep up since a year and a half ago, what we see is that inertia of deposits, savings going into current accounts has not continued. If anything you have slightly the other way around which we would expect to continue if rates for example rise, should the soft Brexit happen which is an opportunity. What we have is a superior proposition I think from our multi-brand proposition and especially through Club Lloyds which is a very strong proposition for certain of our segments has been rising very significantly. That has been the main driver of the increase. And as you know these are the most valuable deposits because they have a much higher margin than other deposits. So that is really great segmentation, great commercial work led by Club Lloyds, but also happening in the Halifax brands to give you an example. George to take the other two.

George Culmer
And the other two. I mean in terms of, we referred to your second question sort of Basel IV, IFRS9 so not entirely sure what that refers to. So needless to say I don’t have it with me. But what I can say, do I expect that capital requirements change? I don’t expect that capital requirement to change. I see no reason why it should. And we have been there for the last couple of years or so and I think that is a healthy and appropriate position in terms of capital strength for this bank. So I don’t foresee that changing.

Further question
Even incorporating Basel IV risk weights in the mortgage book?

George Culmer
But the Basel IV risk weights are sort of a factor that will sort of play through into that and in terms of the cost of getting there and that sort of goes back to some of the earlier questions about paying for those through the statutory profit generation. You know the IFRS9 volatility as we move through the transitionals into the outer years and I think the Regulator quite rightly has been very clear how they like to see IFRS9 and how they would respond you know should one be in a stress type event in terms of use of regulatory buffers etc. So I think the RWA plays into the calculation and that is something I think we will be able to cope with. And I think the IFRS9 I think we know where the regulators are which I think are like minded with ourselves in terms of that goes into capital ratios.

Now onto your first question. I mean look in terms of income, look we’ve talked about resilient OOI. It is still a tough market, but it is resilient and there will be less gains if you like and so if you like. There will be a greater degree of other and fee generating income in terms of 2019 which is probably a good blend as one moves forward and as insurance gets hold who knows where OOI will go 2019-2020 etc. I have probably no better idea than you. But you know you’ve got a better blend and you’ve got a stronger result coming through. So in a tough market you know you can see light at the end of the tunnel in terms of OOI and in terms of what we've done within commercial as we right size in retail. And as we invest in insurance. Within you know the NIIs, we have talked about the margin, we've talked about margin resilience. Our stance to volumes going back to earlier questions is part dependent on us, but part market dependent. And we are very clear that our primary concern is to generate value for our shareholders through returns and capital generation and that will drive our approach to volumes in the market and how we play the balance sheet and how we play the business. And I am not going to sit here and tell you what the numbers might be in 2021 etc. But I would just reaffirm the point that in terms of managing this we have a number of levers at our deployment and for us you know how we use those to drive that return, to drive that capital generation are the most important and we will see where the market goes and we will respond accordingly to that. But we have the benefit of a variety of products. We have the benefit of a variety of channels, we have the benefit of a variety of brands. And I think we are in so much a better position than the vast majority of our peers in being able to deal with the tough market of what it is and still generate those returns.

Fahed Kunwar
Thank you.

Question 6 – Joe Dickerson, Jefferies
Hi, it's Joe Dickerson from Jefferies. Just a couple of questions if I may. I guess what drives the conviction on the sub-30 basis points AQR given that we have seen two of your competitors take what I think are unexplained top ups for Brexit, but obviously they have some visibility that I may not? Is this your mix, is it the improved underwriting acumen over the past 7-8 years? What really drives the conviction around that asset quality charge?

And then secondly, George was there any reserve strengthening in the insurance business on home owners that the volatility number there was about a hundred, I think you did £236 million of volatility. That seemed a little higher than I thought by about £150 million. So I was just wondering if there was a reserve strengthening?

And then Zak, I will be the one to ask you a question. How do you think about as you implement everything that you are implementing down the road. How do you think about taking what has traditionally been a cost for banks in terms of technology and digital implementation and turn it into revenue generating opportunities in the outer years?

George Culmer
Shall I go first. So in terms of the insurance volatility, absolutely no this is. Look if there had been any reserve strengthening that would have been above the line item, that wasn't. Most of our book is short-tail household business which is you know still requires expertise and competency to reserve, but it is not like a long-tail asbestos book or anything like that. No the below the line stuff for volatility in Q4 where there was in excess of £200 million negative was entirely market dependent. And what happens within the insurance accounting is within the underlying profit we put our long-term assumptions and then you deal with any deviations from that in that below the line. And so the sort of stat profit number has the actual investment return for the period.

And if you recall in Q4 we had equity markets of 10 per cent. I had a widening of credit spreads by 16-17 basis points of that order. Now we look to hedge the business, but things are never quite as simple as that particularly in insurance. I can make the choice between hedging capital or hedging earnings because unfortunately they move in different ways and we hedge out the capital position which leaves me some residual volatility in terms of the earnings. So in terms of that £236 million or whatever the number is, about £90 million of that was a negative from credit spreads so the widening of credit spreads with the delta coming through from equity markets where again we hedge out the position but we hedge out the capital position. But there is absolutely no surreptitious reserve strength or anything like that below the line. It is purely market driven deltas in terms of the insurance business. And as I say, we hedge capital. We have to choose.

Then look the conviction of the 30. We didn't pluck it, we did a piece of work. And the answer to your question was sort of yes and yes because you talked about book mix you know and the preponderance of retail secured. And you know we are always subject to fallen angel type risk. But we talked about the reduced sector exposures, reduced key name exposure. They don't go away, they persist with us. But predominantly when we are low risk it is about the portfolio choices that we make. In terms of that preponderance of retail, that preponderance of secured and that factors through in terms of the numbers. Yes you know IFRS9 we have all got to learn to live with IFRS9 and I am not disappointed it is a journey I am not going to have to make. But there will be moments of volatility, but if I look beyond that, if I look through the cycle we think around 30 is the right number to call. I can't guarantee it won't spike up above that if there is a moment of economic schism or fundamental change. But the 30 comes from pieces of work and looking at the composition of our book.

And then in terms of the sort of Brexit stuff, the point we were trying to make in the slides. We think in the spectrum of economic scenarios that we came into the year with in terms of 1st Jan, you know we picked up this severe downside. That wasn't something we moved to through the year, that was something we started the year with. And in terms of picking that up and factoring that in and we think that is appropriate for where we are so we don't see the need to strengthen at this moment in time based upon again what we are seeing in our book and what we are seeing in the businesses and what we are seeing in the consumers you know who bank with us. So we came into 2018 with that spectrum that picked up that tail. We didn't see the need to introduce that as we moved through the year.

António Horta-Osório
And just to add a little bit to complement what George says. If you are a retail and commercial bank like we are, the preparation for an event like the possibility of a hard Brexit cannot be then 3,6,9 month in advance because we are an accrual bank. So the stock you have versus the new business is incredibly higher. So I have been repeatedly asked over the years, why don't you grow more at Lloyds? And that is the best preparation for an unforeseen event such as a cliff event. Because if you look at our core loan book of £444 billion, it is exactly the same by coincidence with what it was 8 years ago. Just a composition change. We have less large corporates for the reasons we have been repeating to you year after year. We have less large mortgages in London for the reasons we told you and we have less mortgages in general. And we have on the other side more credit cards where we bought a seasoned book in MBNA, we have more car finance where we were under-represented. And we have more SMEs. But the total £444 billion over 8 years where there was positive GDP growth in nominal terms in the UK significantly is the same. So that for me is the best defence in terms of quality of a loan book if you think an unexpected event could happen. And on top of that we try to show you apart from the IFRS9 as George says which has volatility, we try to show economic behaviour, so you look at delinquencies. There is no change on that.

And thirdly, we try to provision prudently. So write-offs in the year have provisions of almost four times that in the balance sheet. We are prudent on residual values in car finance. So we try to do it prudently. So the book has not grown apart from the toxic assets which were all sold. The core loan book is the same with slightly different composition for the reasons we discussed. We show you that economically nothing is happening which I am not surprised at all because unemployment is again at a historical high, 4 per cent unemployment rate. You have the world economy growing a little bit less than last year. But still 3.5 per cent according to the IMF, Britain is a large open economy so that helps Britain exports. You have business investment going down because our businesses are telling us there is uncertainty, they delay decisions as you know. So business investment is going down. But the overall if there is a continuation of the scenario, it is for GDP to continue growing at reasonably the same levels 1- 1.5 per cent. And we will continue to give you going forward economic data on impairments and quality of the asset books so that you can start having a feel for the difference between accounting which will be IFRS driven as George says and the economy and what is happening with delinquencies and the quality of the different loan books.

Zak Mian
And in terms of technology costs and the potential benefits, I think from, although we invest heavily in technology there is a huge upside to this because we can see through things like Cloud, Big Data, it offers also opportunities to reduce our costs because we can move applications that run on propriety platforms onto commodity platforms and reduce our cost of ownership. But I think there is also a huge opportunity given, we are lucky enough to have a very big customer franchise and we hold a huge amount of information about customers on their behalf. And really things like Machine Learning I think give us huge opportunities to generate great customer insight back to our customers through our channels which as I talked about earlier, customers are using more and more. So we have got 22 times a month for a customer to talk to a customer about something to deliver some nugget of information and insight about their current financial position and how they are spending their money. And all of that I think in my mind if you couple in the Single Customer View, give us huge opportunities to also drive income.

Question 7 – Andrew Coombs, Citi
It's Andrew Coombs from Citi. If I could just return to other operating income and drill down a bit further please. From what you've said there seems to be one key headwind in the gilt gains in two tail winds of opportunities that you have particularly drawn out here in Insurance and Wealth. And so if I just address each of those.

Firstly on the gilt gains. You said you've still got significant unrealised mark to market gains, yet you would expect the gilt gains this year to be inside the £270 million. Is there any way you can just frame that for us?

George Culmer
There is about £400-500 million of gains. Does that help?

Further question
That does. Second one. If we turn to wealth, if I think about the Schroder's joint venture launching in June, can you just give us a feel for how the economics is shared, the fee structure or the aggregate margin I should say. But also you say about becoming top three within five years, what would that mean in terms of AUA today versus then?

George Culmer
Okay, I mean I will answer the latter as opposed to the elements of the former which is still subject to working through. But I mean it is a 51-49 split. We currently have about 13, the expectation to be in that you would have to be sort of mid 20s of that type of size. And the expectation going in that is that there is an organic story that works, but our sort of presumption is if the right things come along that we will supplement that within inorganic. But I would say that we built this on the premise that we thought that actually if there isn't, organic would still work. But it is of the sort of mid-20s type size.

António Horta-Osório
In today's numbers, in 5 years could be higher.

Further question
And then finally on the insurance. I think in corporate pensions you previously were talking about moving from a 10-15 per cent market share. Looking at the slides in the back you had a 12 per cent share of flow. It sounds you have got a lot of initiatives coming on line this year particularly with the single view. So how quickly can you move towards that 15 per cent and what is the revenue opportunity there?

George Culmer
It will take a while for the revenue opportunities to come through I would say, but I am looking at Antonio Lorenzo here and what he is going to commit to. But if I said yes, it is a couple of years.

Antonio Lorenzo
The market share is a couple of years, so income will grow as well.

António Horta-Osório
And Andrew just to complement something George said on the gilts which we have discussed before. We continue to sell gilts because first we sold all of our long-term gilts and the spreads have now been going higher. But the shorter term gilts the spreads have been going down and so they are now building sub-LIBOR returns. And they continue to go down. The more they continue to go down, the less sense it makes for us to hold them, that is why we keep selling them. Unfortunately we sold the longer ones where spreads with this uncertainty have gone higher just for you to have this in mind.

Andrew Coombs
Thank you.

Question 8 – Andrew Hollingworth, Holland Advisers
Andrew Hollingworth from Holland Advisers. Just two quick ones. Coming back to the point earlier on about capital generation sort of in theory and in practice and you made the good analogy between free cash flow and the industrial business. I appreciate there are timing and regulatory issues that George has talked to. But in a simple year where that wasn't taking place where we didn't have loan growth, would there be any reason why the capital generation in theory and in practice wouldn't be almost the same?

And then the second question is on dividend payout ratios. Would it be fair to think the ordinary dividend payout ratio in the future could be similar to the one we have seen today?

George Culmer
Okay to your first point, when do things end? I am dealing with RWA headwinds which I'll get through the sort of BBA, PRA and then of course you are then into the Basel IV 4 ratchet which kicks through the year which opens up a whole load of interesting thoughts in terms of how you structure your book and encourages you, not saying we would do this, but encourages you to go down the higher risk and all those sorts of things. The whole framework as you go into the basic floors is out there, but requires an awful lot of thinking about. But the other big drive I have a pension with deficit funding to pay off which I will renegotiate with them every 3 years. The last valuation was taken at the sort of worst of times, the next valuation I think is the back end of this year or next year whatever.

But again, ultimately there is a steady state where the things should converge. The bit that I can't tell you is at what point in time that becomes.

Further question
No but the point being they converge at the theory line, not the practical line?

António Horta-Osório
You are right, I mean if the capital generation has no additional uses of capital, it converges with increases in RoTE, but it is a matter of uses of capital that George just described

George Culmer
And then the Group, to your other question, the second question, the Group's distribution policy is the Group's distribution policy which is, we have a progressive, sustainable dividend policy. So I think what you are seeing again, the Board will decide each year but you know you are seeing you know modest single digit growth in line with the underlying growth of the business. I think that seems perfectly appropriate. And then approach to surplus. You know the policy won't change in terms of if we have generated above our surplus requirement, making a decision each year, the Board will make the decision as to the use of that surplus and informing that decision we will look at internal plans, look at external environment, alternative usages of that money. If there are no uses of that money then distribution becomes the obvious thing to do. But I don't foresee any change in that policy.

Further question
But the question was about the regular dividend, the ordinary dividend as opposed to the. So I get the fact that you are going to distribute excess which will be either a buyback or special which you have done in the past. But obviously as you get towards a cleaner point in your return on tangible it does become interesting I think. Domestic Investors in the UK are rather yield and income focus as opposed to the US, your ordinary dividend has a relevance to that factor.

António Horta-Osório
I mean that's a valid point. We think as George has said, the dividend policy approved by the Board is the right one, it is a prudent one in these uncertain times. So we have more than, we have around twice ordinary dividend coverage and we think we increase it prudently like 5 per cent a year as we did this year and then we distribute excess with information we have at the end of the year. It is absolutely the right policy for an uncertain environment like the one we have today. In the future the Board might want to review it, but we absolutely all share in the Board that this is the right policy to have now and I think the decision that the Board took yesterday shows you as I said in my speech, the confidence in the future because we are distributing again everything above our capital requirements. So we have all the excess capital on top of capital requirements and the management buffer as we did last year, we are giving back to shareholders.

Andrew Hollingworth
Thank you.

Question 9 – Fahad Changazi, Mediobanca
Good morning, Fahad Changazi from Mediobanca. Could I ask some questions on Scottish Widows please? You had a capital actions in 2018. I think you had already moved to CMI 2017 by H1. But could you just highlight the capital actions you took in 2018 and what potential you have for further capital actions at Scottish Widows going forward from here.

Second thing was you paid back some sub-debt in Scottish Widows and I think you have got calls coming up in 2020 some sizeable ones. So could you just sort of highlight what your intentions are with that debt and how you feel about the leverage of Scottish Widows?

So just to square all this together, you paid a lower dividend from Scottish Widows up to Group, £350 million versus £500 million last year. Do we have now a new norm of a £500 million dividend coming out for the full year from Scottish Widows? And if you just tie that in with the solvency II ratio perhaps you are targeting in the entity?

George Culmer
Okay I don't think I am going to give you granular details on our intentions on the sub-debt, but look first up Scottish Widows is a very successful capital generative business. And within that each year we make choices in terms of capital deployment or capital repatriation. And the obvious example in that is do I see attractive bulk business which I deploy that capital if that doesn't come through? Okay I may be down on OOI, but I will return that capital by the end of the year. So in terms of sort of

normalised dividends to one of your questions, I am not going to fix myself to a specific number because it depends upon the business opportunities that we see within the business and we want Scottish Widows to be successful which is sort of profitable growth and if the right thing to do is retain and deploy the capital we will do so. If opportunities aren't there we will repatriate. So I am not going to give you a fixed number to say it is always going to be this because it will sort of depend.

We have also as part of the managing that business in terms of the efficient and right things to do, making sure that we are as efficient in terms of capital usage as possible. In the current period as I said it is sort of lost in the slide because we very cunningly offset it against the pension contribution, but we had, there was about £600 million of capital benefit that came from the transfer of the pension scheme that we talked about, but also looking at the charging structures between Scottish Widows and the ring-fenced bank and the value streams that came out of that. As we go forward we will continue to look at capital opportunities within the business in terms of hedging structures and in terms of things like unit matching, there are a number of things that we are looking at in terms of risk profile, capital deployment which could mean that there could be some additional sums coming out. Let's see where those get to, but it is a constant theme in terms of looking at the business.

In terms of overall solvency, we run it to a sort of 140 per cent plus. I think we closed the year in excess of that, we are about 150-160 per cent. Within that, as you say, that is the sort of, my solvency perspective, as the business throws off capital I have risk appetites in terms of the structure of that business if I am running down the capital base, I have stranded sub-debt that I will deal with. We have dealt with some internal. I won't tell you now what we are going to do on that sub-debt in the future, but it continues to be capital generative and we will do the right thing at that time. But in terms of any payment out as you say, we just highlight here the equity element but in terms of there is also a debt element where we are either looking to pay back internal or potentially retire external as well.

I think we have been very successful in the last couple of years in Scottish Widows in terms of re-energising the brand, driving forward growth, getting some momentum. You know as part of that I think we have also done a good job in terms of the capital management of that business and at all times making sure that the business is adequately capitalised, that we are meeting our internal risk appetites, that we are meeting our regulatory requirements and that there is sufficient capital liquidity within that business and that will carry on. But I would expect us to continue to look at capital opportunities as well.

António Horta-Osório
And also Scottish Widows has an important financial benefit being part of Lloyds Banking Group because as you know there is capital diversity benefits. Also we don't have to have such a big buffer in the company itself given it is part of a larger Group. We have it at a holding company level. So those are two additional levels of financial benefit versus a standalone insurance company.

Question 10 – Guy Stebbings, Exane BNP
Good morning, thank you, it's Guy Stebbings at Exane BNP Paribas. The first question was on card balances which dropped quite a bit in the fourth quarter, but you talked about continued appetite for growth there. So I just wanted to understand was there anything strange that happened in the fourth quarter that we should return back to normal?

And also on that point, any differences you are seeing between the MBNA portfolio and the Lloyds book now that you have had some experience with MBNA for a while now?

George Culmer
No there is nothing, I would expect balances to be growing in a sort of 3 per cent type that would be my expectations. [**António Horta-Osório** – it should grow in line with the market] And as Antonio said in his presentation, the integration is all but complete. We have a few important steps in front of us. But in terms of the balances, no there has been a lot of mutual learning and Elyn Corfield who has come out of MBNA now runs you know the wider unsecured book which is I think a reflection of the quality that we have seen in terms of the business and the personnel within that. But it has been, and I know you might expect us to say that, it has been a very successful acquisition financially, it has been a very successful acquisition in terms of from the business perspective of what both sides have learnt from each other.

António Horta-Osório
And if you remember at the time of the acquisition which said 17 per cent return on investment and we said completed by the second quarter of 2019. So we expect as we said following that, that we will complete one quarter ahead of target, so by the end of this quarter. We have had additional costs synergies and income synergies that we had not included in the previous plan that we got as we got best practices from each side of the business if you want into the common system that now will serve the four brands. And therefore the final return on investment will be 18 per cent instead of 17 per cent. Very pleased about it.

Further question
Thanks. And the second question was if you can help us on the interaction of the improved cost guidance of £8 billion a year earlier and the cost:income exit ratio of low 40s in 2020. I mean have you given yourself more wiggle room to perhaps get a slightly better cost:income ratio than you were previously thinking or is it more about freeing up scope for investment or if it is a tougher income environment you can still meet that low 40s cost:income?

António Horta-Osório
Well as George said before we are ahead of what we thought and being ahead of what we thought enables us to have additional options, therefore we will see how things develop and how we should use those options. But we are ahead of what we thought without any additional costs to achieve and we are very pleased about it and will continue to have additional benefits to come there. How we use them we will see depending on the situation how it unfolds.

Guy Stebbings
Okay, thank you.

Question 11 – James Invine, Soc Gen
Good morning, it's James Invine here from Soc Gen. I just wanted to ask about the non banking net interest income please. That has been a pretty small drag, so low single digits I think for quite a few quarters. And then in the fourth quarter it jumped up to around £40-50 million drag. So I was just wondering if there was anything specific in there and what it might do going forwards? Thanks.

George Culmer
I'd struggle to think of anything specific in Q4. You are right, it used to be a significant number in the £300-400 millions, it was down to about £100 million last year. It is £50 million for this year. My expectation for next year is it will tick up slightly and that would be based upon the business composition within CB. You have got things like IFRS16 which bizarrely has a sort of impact upon that. But nowhere near back to its previous levels. So I wouldn't take whatever it is from Q4 as a kind of run-rate, but it could get back up towards about £100 million of that order or slightly under that.

James Invine
Okay, thank you.

Question 12 – Martin Leitgeb, Goldman Sachs
Good morning it's Martin Leitgeb from Goldman Sachs. Could I ask first on what your outlook is for the domestic deposit market in the UK and from what we can see there have been a couple of trends obviously excess deposit within ring-fence, with better deposits, better in particular for Lloyds over the last rate hike in the UK. At the same time recently we have seen one of your larger competitors rising rate in a fix term deposit space and I was just wondering how you think the domestic deposit market will evolve over the next maybe next one or two years?

And the second question related to Brexit. And I was just wondering have you noticed and change in terms of customer behaviour, particularly on the commercial side over the last couple of months or half year? And would you expecting an orderly withdrawal that will materialise over the next you know one year term? And would you expect a reversal of such upheld demand, could you see actually, you know would you expect a better performance of commercial if visibility improves from here?

António Horta-Osório
Yes, the answer to your second question is yes we have seen a growing uncertainty making some of our business customers withhold their investment decisions. The numbers that are out show as I said in my Presentation that business investment is down in our year which does not surprise us at all. So it absolutely corroborates what we see in practice. Should an orderly Brexit be done with an agreement I think that demand which is being withheld would increase and we would expect it to see it in commercial. On our case, in spite of that increased uncertainty and customer behaviour we actually have improved our performance in SME and Mid-Market lending. If you compare our numbers at H1 with H2 our target was for £2 billion net additional lending for the year. At H1 we were slightly below half of that, slightly below £1 billion and we actually closed the year with £3 billion. So there was a significant increase in our market share in both mid-markets and SMEs in the second half of the year which I would attribute to the fact that we have significantly reorganised our SME and Mid-Market business at the beginning of last year where we got two segments instead of three. We have made the large part of Mid-Markets orientated on a sector expertise base to better serve customers regionally. And the fact is that volumes started to ramp up from September and we finished the year with very good trends in Mid-Markets which had disappointed in the previous year. And the two combined £3 billion versus the target of £2 billion so we got additional market share gains.

On the deposit markets, I mean the way I see it is actually quite simple. I mean in the same way that you have low loan growth in the UK and therefore pressure on prices and asset margins as we showed you on our Presentation, that lack of demands that provokes pressure on prices on the asset side. On the other side of the balance sheet you have to fund the loans that you give. There is no pressure on the other side of the balance sheet because not only loan growth is very small in the UK, but deposit growth as you know is above loan growth. So loan growth is around 2-3 per cent and deposit growth is around 4-5 per cent. So even taking into account FLS repayments etc. my expectation is that in the same way that you have this heightened competition on the asset side, you have less competition on the deposit side for basically the same reason, so there is no demand for those deposits. And in our case there is an additional positive impact which is the fact that given our significantly above market growth in current accounts we can prune the high expensive deposits keeping the same loan to deposit ratio. So as you know we have a target loan to deposit ratio of between 100 and 110, if we grow more in current accounts we need more of the other deposits which are more expensive to keep the target loan to deposit ratio if we can prune the high cost deposits which as George said are also slightly above the market. So I think that situation is likely to continue if we have a continuation of the present economic and political circumstances, if those change the dynamics could change to the direction that you said. More loan demands then less pressure on the asset side and more pressure on the deposit that you would need to fund that loan demand. But for the moment my view is that a continuation of the present trend.

Question 13 – Chris Cant, Autonomous

Thank you, it's Chris Cant from Autonomous. Towo other points of detail really around your guidance. Your ROTE target, your definition excludes amortisation of intangibles and that was worth about 50-60bps in 2017 and it is worth about 80bps on your reported ratio in 2018. And given the high level of capex and your comments about significantly ramping up investments, should we expect that benefit to your reported ROTE to continue to increase and what would your 14-14 ROTE target be if you were not excluding intangibles towards the backend of the plan please?

And on interest earning assets, this is sort of related to the point about non banking NII picking up in the fourth quarter, there has been another oddity in my view during the course of 2018 that your quarterly average interesting earning assets have tended to be consistently below a simple average of your gross banking loans and advances each quarter. So you've reported an increase in interest earning assets in the fourth quarter for instance, but actually your gross banking loans only increased by £0.1 billion from end 3Q to end 4Q. So is there anything going on intra-quarter in terms of balances being just there at balance sheet date and dropping away? I am struggling to understand how you end up with an average which is below the point to point pretty consistently during 2018. It was less pronounced in 4Q but it was pretty pronounced for the first three quarters. Is there something going on there please?

George Culmer

Okay, well I can answer half of that second question. There is absolutely nothing going on in terms of intra-balances or overnight stuff and bed and breakfasting and anything of that nature at all Chris. So we can sit down with you and actually hopefully someone can go through the averaging and show you how it works. So there will be the in quarter averages and now there will be the averages for the year, but there is absolutely nothing from a business balance sheet or anything like that that is occurring within those quarters that is causing the effect that you talk about. So the team are here and if we don't do it here we can do it after in terms of going through how that is calculated. But there is nothing that you've alighted upon that is causing that distortion.

And then you are right, in terms of the calculation, it is how the things are calculated at the moment and you are right you probably get benefit as you have more intangibles that benefit will flow through. And when you look at overall returns, I know looked at total share of our equity I think we are up a couple of percent on last year as well. So the trend in terms of returns is undoubted and it is driven by statutory profit. I don't have what that number would be if you excluded that but it is a return on tangible equity which you are right, as you invest more in the intangible element it becomes more of an adjusting factor in terms of the calculation, it is something worth stop pausing and thinking about. But we do also look at return on total equities as well, but it is a good spot. Because it is something we have been thinking about.

Further question

Thank you. If I could just ask the interest earning asset question in a slightly different way then. The gross banking loans didn't really grow much in the fourth quarter. I think consensus has got about 440 in for next year. In light of the comments you made about growth across the different bits of the book, do you think you can deliver that level of interest earning asset growth into 2019?

George Culmer
I'm not going to comment as to whether we can or can't. Getting right back to some of the earlier questions in terms of mortgage balances and how the mortgage market is and how we react to that, you know where we look to grow and you know where we look to defend. So I am not going to comment on the attainability of the point number.

Chris Cant
Okay, thank you.

António Horta-Osório
Shall we go to the last question.

Question 14 – Ed Firth, KBW
Thanks very much, it's Ed Firth from KBW. Three very quick ones. First could you just tell us how much expenditure you are expecting to capitalise in this year? I think it was about £500-600 million last year. Should we expect a similar run-rate for 2019? Shall I give you all the questions?

The second one is in terms of your return on tangible targets, what should we expect around the life experience variance as that number sort of bounces all over the place and it was down a lot this year. I don't know are we expecting a big bounce back or are we into some sort normalised run-rate?

George Culmer
Sorry within the Insurance and Wealth business?

Further question
Yes the experience variance line is like a £200-300 million swing. And then finally just picking up from what Fahad said, could you tell us when you are going to be able to tell us your Basel IV risk weighted assets? That seems to be a sort of secret number at the moment, but a lot of other, actually most other banks now give us pretty good guidance. So could you give us some idea, is it going to be sometime this year, back end of this year when we get that number? Thanks.

George Culmer
I could give a commitment that I might not give [laughing]. I am not going to say now. I mean we look at Basel IV in terms. I mean this is an invitation from 2020 to wherever, out there in the future. I am not going to give it today so we hear what you say and we will ponder and think about whether we come back to give you that percentage.

In terms of the insurance, actually the answer to the insurance is actually in prior year where there was a large benefit from a variety of assumption changes etc. So I actually think and when you look at those numbers you are right it is down a couple of hundred million. And I actually think last year was probably, sorry not last year, 2017 to be clear was actually flattered by a number of that. I would think this year is 2018 is more the normal sort of level.

And sorry what was the first question? Capitalising expenditure. Okay so wasn't it about £1.5 billion, I am trying to remember now, but it was about 60 per cent. I said in the Presentation that we capitalised about 60 per cent. I don't see any reason why that would change in terms of ratio.

António Horta-Osório
And anyway, just one point. As we gave you specific disclosure and detail on that number, we are increasing the level of investments, that most of that increase goes in intangibles which is immediately deducted from capital and given that our dividend policy is to distribute above a certain level of capital it is already included in terms of what we can distribute if you see what I mean. So it is already included. The part which is non intangible increases year on year £45 million which is nothing, okay.

Thank you everybody for joining us and we can take other questions you might have directly with us. Thank you.

FORWARD LOOKING STATEMENTS

This document contains certain forward looking statements with respect to the business, strategy, plans and/or results of the Group and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about the 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 forward looking statements made by the 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, inflation, exchange rates, stock markets and currencies; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the Group's credit ratings; the ability to derive cost savings and other benefits including, but without limitation as a result of any acquisitions, disposals and other strategic transactions; 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, instability as a result of the exit by the UK from the European Union (EU) and the potential for 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 the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; natural, pandemic and other disasters, adverse weather and similar contingencies outside the Group'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, practices and 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 Group'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 together with any resulting impact on the future structure of the Group; the ability to attract and retain senior management and other employees and meet its diversity objectives; actions or omissions by the Group's directors, management or employees including industrial action; changes to the Group's post-retirement defined benefit scheme obligations; 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 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 with the US Securities and Exchange Commission for a discussion of certain factors and risks 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 the Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward looking statements contained in this document to reflect any change in the Group's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. 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.