LLOYDS BANKING GROUP PLC –2018 HALF YEAR RESULTS PRESENTATION

WEDNESDAY 1 AUGUST 2018 – 9.30am

António Horta-Osório, Group Chief Executive

Good morning everyone, and thanks for joining us. I will cover the key highlights for the first half of the year before Juan covers our progress against our GSR3 priorities. George will then go through the financial results, after which I will conclude and we will take your questions.

Starting with the highlights for the first half. We have made significant business progress and have had a strong start to the Group's latest strategic plan. We have successfully delivered against a number of key initiatives including the integration of both of our recent acquisitions, MBNA and Zurich as well as launching our non ring-fenced bank, Lloyds Bank Corporate Markets. We were also the first major UK bank to comply with the Open Banking industry deadline.

In February we announced an ambitious strategy for the next 3 years, which we have significantly increased the level of investment in the business which is underpinned by continued reductions in the Group's underlying cost base.

While we implement this ambitious transformation, we also remain focused on delivering more immediate results for our customers and shareholders.

We have continued to deliver growth in our targeted segments with increased net lending to our SME clients and within our consumer finance portfolio. Our Insurance and Wealth management business has also benefitted from significant new business growth in workplace pensions, planning and retirement.

Financial performance in the first six months has again been strong, with continued improvement in statutory returns. Statutory profit after tax increased 38 per cent to £2.3 billion. Return on tangible equity increased to 12.1 per cent, on track to meet our target of 14 – 15 per cent from next year.

As a result, we have delivered capital build of over 120 basis points, taking our CET1 ratio to 15.1 per cent, pre dividend, on a pro-forma basis.

And in line with our low risk positioning, the PRA has informed us in July that our Pillar 2A CET1 requirement has reduced by 0.3 per cent.
Given this strong performance in the first half, the Board has approved an increased interim dividend of 1.07 pence per share, reflecting our policy of delivering a sustainable, progressive dividend stream.

We have also improved a number of our targets for the current year. We have improved our guidance for the net interest margin and for impairments, and we now expect capital build, including the benefit of the sale of the Irish mortgages, to be around 200 basis points, which is at the top end of our ongoing range.

Turning now to financial performance. Statutory profit was higher at £2.3 billion. Underlying profit was 7 per cent higher, reflecting increased income largely driven by an improvement in the margin to 2.93 per cent.

We continue to enhance our competitive advantage in costs. BAU costs were 4 per cent lower driving flat operating costs compared to 2017, despite increased investment and the inclusion of MBNA. Our market leading cost:income ratio further improved to 47.7 per cent, or 44.9 per cent excluding remediation.

Asset quality remains strong, with an asset quality ratio of 20 basis points, having increased solely due to lower releases and write-backs. We continue to see no deterioration in the portfolio while we continue to judge the UK economy to remain resilient.

UK growth has recovered from the impact of the adverse weather in the first quarter, with higher expected growth in the rest of the year.

Income continues to be supported by record levels of employment whilst pressure on consumers' real incomes is now abating.

The economy is also more resilient given a significant reduction in household leverage over the last few years, with consumer credit balances as a proportion of disposable incomes being one quarter lower than pre-crisis levels, and given lower levels of debt in the corporate sector as well. Also, growth in the world economy has been increasing, which is positive for UK exports.

Uncertainty remains however, on the path to leaving the EU, and we will monitor this closely over the next few months.

I would now like to return to how our market leading cost efficiency is enabling a significant increase in investment and returns. When we presented the latest phase of our strategic plan in February, we highlighted the biggest ever investment in our business, with more than £3 billion of strategic investment over the next 3 years, a more than 40 per cent increase over our previous strategic plan.

In a period where the challenge of increasing investment and managing consequent cost inflation is being experienced across the sector, we believe the ability to make an investment of this size while committing to further net cost reductions at the same time is a key differentiator which is only made possible by our culture of ongoing relentless focus on efficiency.

Our market leading efficiency positioned us further evidenced in the first half with another significant cost:income ratio reduction, also excluding remediation costs. We continue to target a cost:income ratio including remediation in the low 40s, as we exit 2020, with reductions every year.

This ongoing process of identifying areas for efficiency improvements, combined with continued investment in the business, results in improved processes and further productivity improvements.

This in turn will support further reductions in net costs. In the first half of the year, as I said, while maintaining a flat cost base despite increasing investment and MBNA costs, we were able to reduce BAU costs by 4 per cent.

We continue to expect net cost reductions over the plan period, reducing operating costs to less than £8 billion in 2020 from £8.2 billion in 2017, thereby driving further improvements in our cost:income ratio and creating even greater capacity for future investment.

However, this focus on efficiency also delivers a significant number of benefits beyond improving our cost position. Our greater investment capacity funds improvements to our customer proposition, digital channels and service levels, which in turn supports improvements in customer satisfaction, with our net promoter scores up by over 50 per cent since 2011 to 61.

Finally, the combination of all of these factors ultimately leads to improved financial performance and superior and sustainable returns for our shareholders. We continue to target a statutory Return on Tangible Equity between 14 and 15 per cent from next year, reinforcing our strong position relatively to peers.

The ambitious plan we announced in February was built on our existing strong capabilities, and consisted of four new strategic priorities: leading customer experience; digitising the Group; maximising Group capabilities; and transforming ways of working.

Juan will now talk you through the progress against these priorities and some of the tangible benefits our increased investment is already producing for both customers and colleagues.

Juan Colombás, Chief Operating Officer

Thank you António and good morning everyone. As António has already highlighted, we have made a strong start to our new strategic plan. It is early days – with only 4 months into the plan – but I would like to take the opportunity to show you a few examples of the progress we have already made.

Turning to Digitising the Group. For our business, it is critical that we are able to deliver innovative services to customers, while also improving our efficiency and our flexibility. We are therefore significantly increasing our technology spend.

This spend equates to around 15 per cent of our operating cost base and for the full year is expected to be around 20 per cent higher than in 2017. This puts us in line with a number of top quartile global peers, who are leading large transformation programmes.

Importantly, over two thirds of this spend will go towards enhancing our existing capabilities and creating new ones, consistent with our chosen approach of simplifying and modernising our IT and data architecture progressively intended to avoid the costs and execution risks posed by a large scale system overhaul.

In the first half of the year, we have successfully leveraged robotics across multiple areas including mortgages, Financial Planning and Retirement, payments and Risk. Through this, we have been able to free up 115,000 colleague hours, thereby creating additional capacity.

In addition, and in line with our strategy to adopt a hybrid approach, we have made targeted investments in both public and private cloud solutions. These investments are the foundations to providing a secure, cost efficient and scalable infrastructure, allowing us to retain flexibility to respond to change.

These achievements in the first half are reflective of the scale of our ambition and have been supported by around 15,000 of our colleagues working across Transformation, more than 20 per cent of the Group, one of the largest transformation programmes in financial services.

With the largest digital bank in the UK we continue to see growth across the almost 14 million digitally active customers and around 10 million on mobile.

But it is not just about scale – we also have strong customer satisfaction with best-in-class app store ratings and a digital new business market share that is greater than our average market share across core products. Moreover, 55 per cent of our mobile customers only use their smartphones to bank with us.

While industry uptake to date in Open Banking has been relatively low, we expect engagement to increase as new propositions are launched. These strengths give us confidence that we are well placed to remain the bank of choice for our customers in an Open Banking world.

We note that 41 per cent of surveyed customers suggested that they would find account aggregation services to be useful, with over three quarters of customers expressing greater comfort in their main bank providing this.

Finally, by re-platforming our mobile app, with all key banking brands on the same platform, we can increase scalability and are able to react faster to opportunities doubling the frequency of new releases to the market.

With a market share of 21 per cent, we have the largest branch network in the UK and we expect to maintain this reach, whilst re-shaping and re-purposing our branches to deepen customer engagement and increase our focus on complex needs. These changes, which reflect changing customer demand, will also help to optimise our cost to serve.

In the first half, we have increased our fleet of mobile branches, serving multiple locations where it is not economically viable to maintain a physical presence. We have also more than doubled the number of branch locations from which customers can access qualified mortgage advisors remotely.

Our experience to date with flagship branches has been encouraging, benefiting from higher productivity and customer satisfaction scores. As a result of these initiatives, customer facing time spent on complex needs has increased by 10 per cent year on year to 46 per cent. Looking ahead, we expect this to increase to around 60 per cent by the end of the plan period.

And finally, looking at progress against our insurance initiatives. In the first half we have made a strong start in capturing the sizeable opportunity available to us from being the UK's only integrated financial services provider by increasing our penetration into the growing Financial Planning & Retirement market.

We have delivered over nine billion of open book growth in the first half of the year. This has been supported by both strong net inflows and positive market movements, while also benefiting from the accelerated transfer of Zurich's UK workplace pensions assets.

Going forward, we continue to target £50 billion of open book growth by 2020, with the majority of this expected to be delivered during the final two years of our strategic plan.

In the first half of the year, we began the roll out of a single customer view capability across the three main banking brands, allowing customers to see their banking and insurance products in one place. We expect to have around 3 million customers using this service by the year end.

Pilot feedback was positive, with around 10 per cent daily click through rates. This further demonstrates our unrivalled levels of digital engagement. Our digital banking customers make on average 16 visits per month, significantly ahead of standalone insurers, which in some instances are fewer than once per month.

In turn, this provides us with clear advantages and confidence that our single customer view will be a market leading proposition and will drive increased customer satisfaction.

In summary, the selected examples I have outlined this morning provide a snapshot of the strong strategic progress we have made in the first half of this year.

I would now like to hand over to George who will talk you through our financial performance. Thank you.

George Culmer, Chief Financial Officer

Thank you Juan and good morning everyone. As you have already heard, the first half has seen significant business progress and the Group has delivered another strong set of financial results.

Underlying profit at £4.2 billion is up 7 per cent with income up 2 per cent, flat operating costs, reduced remediation charges and the expected increase in credit due to lower write-backs and releases.

This has driven an underlying return on tangible equity of 16.3 per cent, a 23 per cent increase in statutory profit before tax to £3.1 billion and a statutory return on tangible equity of 12.1 per cent.

Looking at the individual lines.Net interest income of £6.3 billion is up 7 per cent, driven by an improved margin of 2.93 and a 1 per cent increase in average interest earning assets.

In the first half we have again seen lower funding and deposit costs offsetting mortgage pricing pressure, as well as the benefit from MBNA. For the full year, I now expect the margin to be in line with H1. And over the longer term, in line with our previous guidance, I continue to expect the NIM to be resilient through the plan period.

This resilience comes from both our approach to managing the margin which, as you have heard many times, is across the Group and across assets and liabilities, and from our view of the drivers of margin.

These drivers include: The management of our mortgage portfolio. The targeting of growth in higher margin areas such as consumer finance and our SME and Mid-markets business. Our strategy to optimise the customer liability mix, reprice deposits and target growth. The Group’s strong deposit franchise which will deliver an increased contribution from the structural hedge. And the ongoing benefit of our improved ratings, including the very recent S&P upgrade.

Finally, it is worth emphasising that we remain favourably positioned towards rising rates, with back book attrition more than offset by margin widening elsewhere across the book and the positive benefit from our £170 billion structural hedge.

Looking at mortgages in more detail. As you know, pricing remains competitive although we have seen some recent easing. This competition has been a feature of the market for some time and, over this period we’ve managed our book to maintain margin and value, and avoid high risk growth.

The result of this is seen in the resilience of the back book, our high level of retention, and our new business mix and margins. And the overall book margin is down just 40 basis points since 2014 despite a 34 per cent reduction in the back book, which now stands at around £110 billion, with an average customer rate of around 3.4 per cent and only 14 per cent paying a rate above 4 per cent.

In addition, up to £18 billion of the book is on balances of less than £50,000 with low monthly repayments and a low incentive to move. And attrition for the total book has remained stable over the period at around 13 per cent.

In terms of new business, as mentioned, we’ve deliberately targeted retention as well as mix and margin over volume.

Retention is running at around 80 per cent while our focus on longer duration and higher margin new business has resulted in 5 year business now accounting for around 40 per cent of flow.

Looking at other asset classes, the Group's overall margin has benefited from targeted growth I just mentioned in higher margin consumer finance, SME and Mid-markets.

In consumer finance, balances are now over £40 billion with a margin above 7 per cent, driven by growth in both Cards and Motor Finance, with gross margins of around 9 and 4 per cent, respectively. And in Commercial, balances are just under £100 billion with an improved asset margin of around 2 per cent, driven by growth in SME and Mid-markets with a margin of around 3 and 2 per cent, while we have seen lower lending volumes in lower margin segments including Global Corporates and Financial Institutions.

On customer funds, as you know, we've used our multi brand strategy and single balance sheet approach to optimise balances across the Group and increase the gross margin to around 0.4 per cent. This optimisation has included emphasising lower cost Commercial Banking over Retail deposits, reducing the more expensive Retail tactical balances, growing current accounts and targeted repricing across the book.

For current accounts, these remain our most valuable accounts in terms of customer relationships and the structural hedge, and these have grown strongly over the last 5 years with Retail and Commercial balances growing above the market at 13 per cent compound growth and now total £107 billion, including a further £3 billion of growth in H1.

In terms of repricing, we will continue to use our multi brand strategy to optimise price, and future opportunities include £25 billion of fixed term savings, which we expect to largely reprice by the end of 2019.

Turning to the structural hedge. This growth in current accounts has been a key part in building our structural hedge balances, which contributed around £1.3 billion of earnings in the first half and now total £171 billion with a weighted average life of 4.1 years.

We continue to apply prudent criteria for including balances in the hedge and at half year it comprised around £30 billion of equity, £81 billion of Retail and Commercial current accounts, out of eligible balances of £107 billion, and £60 billion of rate insensitive savings, which is less than 20 per cent of total savings accounts. And the total hedge of £171 billion is around 37 per cent of total balances and in line with peers.

Going forward, as mentioned, we expect the contribution from the hedge to increase through the plan period.

Looking now at other income. Other income was £3.1 billion for the six months, and in line with previous half years. A good second quarter of £1.7 billion was driven by strong new business income in Insurance, which in line with our strategy, was up 75 per cent on the first half of last year, mainly from higher workplace pensions volumes in financial planning and retirement.

Retail performance in Q2 was stable on the first quarter and marginally down on prior year for the first six months, as growth in Lex Autolease was offset by our recent changes to overdraft charging.

And in Commercial, OOI was up quarter on quarter, having seen increased markets activity, but down on prior year for the six months with lower levels of revaluations and disposals than in the first half of last year.

We also continue to be a seller of gilts and other liquid assets. And Other Income includes £191million of gains on asset sales of £11 billion, compared with a gain of £146 million last year.

Finally, a good Q2 means that we now target other income for the full year at around 2017's level, after excluding the impact of Vocalink.

On costs, as you know, the Group continues to benefit from its competitive low cost advantage and operating costs are flat year on year, even after MBNA and our increased investment spend.

BAU costs are down 4 per cent year on year, and down 7per cent excluding MBNA, as a result of a range of cost actions including digitalisation, process improvement and procurement. This reduction has enabled increased investment, with expensed investment spend and depreciation up 14 per cent to £1.1 billion, which is broadly in line with the total above the line cash spend for the six months of £1.2 billion. And this spend includes our increased strategic investment as well as the completion of a number of large regulatory projects, such as GDPR and Open Banking.

Capitalisation of investment spend is broadly in line with previous periods at 59 per cent of above the line spend, or 50 per cent if you include the below the line spend, which is all expensed.

And going forward, as you've heard, costs will continue to be a competitive advantage, enabling increased investment, improved efficiency and improved customer experiences, and thereby driving superior returns.

On credit, quality remains strong and there has been no deterioration across the portfolio. The Group continues to benefit from its prudent approach to risk and its conservative assumptions and the gross AQR of 27 basis points is in line with the last couple of years, even after including MBNA.

This prudent approach is seen in the strong mortgage affordability with LTVs again falling. Our prime credit card and motor finance book. An optimised Commercial portfolio with a diversified, high quality book and limited exposure to any single sector. And a Run-off segment that is now less than £4 billion, and which we have subsumed back into the operating divisions.

Stage 3 assets total £8.7 billion and have reduced as a proportion of total loans and advances to 1.8 per cent while at the same time provisions have been prudently increased to 25.2 per cent of drawn balances.

And this prudence, along with the strength of the Group's underwriting and first half experience gives us confidence in improving our 2018 guidance to a net AQR of less than 25 basis points.

Looking briefly at the individual portfolios. Within mortgages, as mentioned, LTVs continue to fall and now stand at 43.5 per cent with almost 90 per cent of the book with an LTV of less than 80 per cent.

And our prudent, targeted underwriting has also resulted in reduced buy-to-let balances and an underweight exposure to London and the South East.

We are also seeing no deterioration across the portfolio and mortgage new to arrears continues to fall. In credit cards, we are similarly seeing no deterioration, with MBNA continuing to perform in line with expectation and new to arrears also remaining low.

In Motor Finance, we have a portfolio of around £19 billion, of which £7 billion is hire purchase lending which is secured on the underlying vehicle. And here, in terms of experience, it is a similar story with no deterioration, with used car prices for both petrol and diesel remaining resilient while we also remain prudently reserved.

Turning then to statutory profit. Statutory profit after tax of £2.3 billion is up 38 per cent with lower below the line charges and a lower effective tax rate of 27 per cent. EPS is up 45 per cent.

Market volatility and other items include positive banking and insurance volatility, partly offset by the loss on sale of the Irish mortgage portfolio.

Restructuring costs of £377 million include £155 million for severance, as well as the ongoing costs of the integration of Zurich and MBNA, property rationalisation and the implementation of the non-ring fenced bank.

The PPI charge of £550 million includes £460 million in the second quarter and the increase in Q2 takes our expected weekly run rate up from 11 to 13,000 complaints.

This increase reflects both current experience with claims running at just over 12,000 per week and the expectation of increased volumes as we approach the time bar, and any potential additional remediation arising from the continuous improvement of the Group's operational practices.

Looking briefly at the balance sheet. Loans and advances at £442 billion are down £2 billion from year end, with high quality growth offset by the £4 billion reduction from the sale of the Irish portfolio.

The open mortgage book is flat on the start of the year at £267 billion, and we remain confident of closing the year slightly ahead of the opening position.

In Commercial, we have seen targeted loan growth of around £1 billion in SME and Mid-markets, while in consumer finance we continue to see the benefit of growth in Motor Finance.

This targeted lending is also reflected in average interest earning assets which increased by £1 billion, with asset growth of £2 billion partly offset by a £1 billion reduction from the Irish sale.

Finally, risk weighted assets of £211 billion are down £7 billion year on year and flat on year end, with further portfolio optimisation, particularly in Commercial. Pro forma RWAs are £207 billion, reflecting the completion of the Irish sale.

Turning finally then to capital. The Group's pro forma capital build in H1 was 121 basis points, which includes strong underlying capital build, as well as 25 basis points from the Irish sale, a 28 basis point charge from PPI and an Insurance dividend of 8 basis points. This strong capital performance means that the Group now expects capital build of around 200 basis points for 2018, at the top end of our guidance range.

We're also pleased to have been recently informed by the PRA that our Pillar 2A buffer has been reduced by 30 basis points to 2.7 per cent, and the Board will continue to target a CET 1 requirement of around 13 per cent, and a management buffer of around 1 per cent.

Finally, TNAV has increased by 0.4 pence per share to 52.1, reflecting 3.3 pence from statutory profits and reserve movements, offset by dividend payments and share buybacks of 2.9 pence.

That concludes my remarks and with that I will hand back to António.

António Horta-Osório, Group Chief Executive

Thank you, George. To conclude, we have made significant business progress in the first half of the year with a strong start to the Group's latest strategic plan and we have again delivered strong financial performance and capital build.

Looking forward, and as a result of these strong results, we have upgraded our financial guidance for capital, margin and AQR. We remain on track to deliver against all other guidance, which remain unchanged, including delivering a return on tangible equity of 14-15 per cent from next year.

Our differentiated, customer focused business model continues to deliver. Our multi-brand, multi-channel approach, our cost leadership, low risk positioning, increased investment capacity and execution capabilities will produce further competitive advantage, enabling the Group to continue to help Britain prosper, whilst delivering strong and sustainable results for shareholders.

Thank you, we will now take your questions.

Question and Answer Session

Question 1: Raul Sinha, JP MORGAN

Good morning everybody it is Raul here from JP Morgan. Firstly thanks very much for the incremental disclosure on the slides, both on the mortgage book and the savings. Obviously we would love to see that repeated going forward but can't help myself asking a question on it as you invited it. Obviously on the retail relationship balances you disclose £25 billion of low margin fixed rate balances I was wondering George if you could give us some sense of the cost of that as it stands today.

And then a couple of broader questions please, one on capital and one on the hedge. Obviously firstly maybe on the hedge, the £171 billion you refer to that as a fully hedged position. When you look at that as a percentage of the balance sheet compared to other UK banks you are actually in line maybe slightly lower than some of the other UK banks. Does that mean that we should not expect the hedge to grow any further from here? I obviously see that you expect the hedge income to increase over the next three years so I was just wondering if you could talk to us about how you see your relative position and can there be some scope for growth there?

Sorry one more question on capital if you don't mind. Just the Pillar 2A move. Your thoughts on what is driving that would be really helpful, thanks.

Answer: George Culmer

The Pillar 2A, look we are pleased to see that, the Group has derisked extensively over the last few years and it was very pleasing to be given that reduction. I think it was pleasing in an absolute sense in terms of getting the reduction in the capital requirement. I think it serves as confirmation around our capital requirements what we have said about that for both the short term and medium terms in terms of our around 13 per cent so that was pleasing to see. So I think it was a good indication and a good reflection of what we are doing. As you know we can't say much about the components of that but I think it was heartening and underscores I think what we say about where we think our capital requirements will be.

In terms of the structural hedge, without giving you precise indications in terms of growth, I mean our strategy of targeting current accounts is not going to change. A lot of growth has come from the pick-up in balances. As you know we went in short, I think we opened this year, something around about £160 billion with a weighted average life just over three. We are now growing into a more natural position of north of £170 billion and slightly north of four. So you will see a pick up this year actually because I will go through the year and into next year at a more fully engaged position as opposed to growing into that position. So you will see that benefit coming through. Our strategy won't change though in terms of targeting those high value customer accounts as well.

And in terms of costs and deposits and all those sorts of things, so things like the fixed book for example, I mean that is around 1.18. I think the cost of that, that was about 1.2 at the end of Q1. So that still sits. So let's say that is the sort of £25 billion we were talking about in my Presentation. And when you look across the piece in terms of savings, the aggregate cost is round about the sort of 47 basis points, that was about 48-50 in terms of Q1. So again you can see it coming down marginally as you go from period to period.

Question 2: Chris Manners, BARCLAYS CAPITAL

Good morning everyone it's Chris Manners from Barclays here, just two questions if I may. The first one following up on the net interest margin. I saw you had been factoring in about one base rate hike per year for the next three years. Could you just share with us how much of a benefit that is to your net interest margin and maybe your thoughts around deposit betas you will be thinking about?

And the second question was on capital generation. Obviously you are guiding to 200 basis points of capital generation this year which is pretty decent. If we look at your RWAs, that gets us to around £4.1-4.2 billion of capital generation. Your dividend seems to be indicating around £2.3 billion payout, seeing a one-third, two-third split. So is there anything stopping you paying out that I suppose £1.9 billion as a buyback later on?

Answer: George Culmer

So in terms of sensitivity, I mean these move around, dependent on assumptions around pass through. When the first rate rise came through we did not disclose the specifics but a portion of that got passed through. I am not going to say now what our policy will be should rates be hiked in the very near term.

In terms of sensitivity, I think the report and accounts talks about £80 million or something like that for a 25 basis point hike. As I look today just with the amount of liquidity that we have got on board, we are probably more at about £110 million over a 12 month period for a 25 basis point increase so that is the type of sensitivity. And also on the big picture bit which I know we talked to you before, the real sensitivity is around those £170 billion of funds and how that flows through into earnings over the life of the hedge. So the short term bits are interesting, but I think the bigger bit around gearing is how things like the reinvestment rate works for the structural hedge.

In terms of capital generation and flow through, I think as you know the Board will make its determination at the end of the year and it would be wrong for me to say anything about that ahead of that, but I think our policy is quite clear in terms of how we deal with surplus above our capital requirement and you saw that last year. And I am sure that will be a feature of the Board's discussions.

Two things that I think you have seen today. One is as you say the strong capital generation that we have delivered and the strengthening of that guidance for the full year. And I think what you have also seen, going back to Raul's question were in terms of the Pillar 2A and that coming down, I just see that as further confirmation of our capital guidance, that capital requirement of being around thirteen plus an additional one, as being further confirmed and further strengthened as well. So strong capital generation, strong requirement and our policy remains the same in terms of distribution above that capital requirement. As I say, the determination will be made at the year end, but that is our position.

<u>Question 3: Fahed Kunwar, REDBURN</u>

Hi thanks for taking my questions. Three if you don't mind. The first one on NIM and current account penetration. Looking at your interest free balances as a proportion of all your deposits, it is sitting at about under 20 per cent whereas other peers are sitting at more like 50 per cent so I think there is obviously room to grow there and structure the deposit rates. But why is it so much lower than peers in the first place is my first question?

And then the second one, on your flat NIMs going forward in the second half 2018. How much of that is predicated on the swap rates or will the spreads in mortgages continue to stay where they are because there has obviously been signs of improvement in the last month. And how do you think about that?

And then my last question is on other operating income. We talked at the Strategy Day about the insurance business. I think George you said that the back book is still going to outweigh the front book for the next year or couple of years and then in 2020 onwards we should see growth. Has today's performance in insurance and the last Quarter's performance in insurance, changed that picture? And should we think about the insurance revenue growing from here? Thank you.

Answer: George Culmer

I will kick off with those. I will deal with the last one first. Yes it has been a very good performance for insurance. And in line with the strategy as you said that we talked about in this room back in February in terms of growing that book and as you mentioned it is the dynamic between front book growth offsetting back book. And I think we are ahead of where we expected to be. And the growth in particularly things like auto-enrolment, the success of the financial planning and retirement is that it is good to see we are up so much. We will be up next year. I am looking to target 2019 in terms of insurance positive OOI growth. So there is a sort of pull forward there that is reflective of the strength of what actually is being delivered in Q2 and the success and the strategy within that business. So that is very heartening and very pleasing to see.

In terms of the second, in terms of our outlook and the resilience, look, we are not assuming any dramatic change in terms of market competitiveness for mortgages or whether it is loans or assets or whatever, even on the liability side of the thing. So actually my 293 stands, it is not dependent upon a significant easing in mortgage spreads or anything like that. Our ongoing presumption is the mortgage market is tough and will remain tough. Yes we see some easing, but we are not booking that and flowing that forward. Our going presumption is it stays tough. So we would stand by that 293.

And then NIM and in terms of proportion of current accounts, I don't know 50 per cent that is not a sort of number that is known to me.

Answer: António Horta-Osório

It is a good point. I mean we are increasing current accounts by around 9 per cent when the market is going good, around 6, so we're gaining market share. So we are increasing the weight of current accounts as George said previously, we think that will continue to happen.

<u>Question 4: Guy Stebbings, EXANE BNP</u>

Thank you. Guy Stebbings from Exane BNP Paribas. Just taking you back to Capital and the 13 per cent go to plus the 1 per cent management offer. I appreciate the Pillar 2A has come down, but if I put in your SRB for the ring-fenced bank as the Bank of England suggested for the stress test this year, we get to pretty much 13 per cent bang on for your capital stack before any PRA buffer or management buffer. So I just wanted to check what your assumptions are going forward? I know you can't say what your buffer is but is your working assumption that it is going to be pretty negligible in the future or perhaps that the Pillar 2A could fall further perhaps from pension contributions in the future?

Answer: George Culmer

Well as you say in your question, it is limited what we can say about the PRA buffer etc. My expectation all other things being equal is that as I put money into my pension scheme as you say, the pension element of the Pillar 2A should come down as the cash goes in, surplus builds, that is the starting point for the calculation and that should, all other things being equal, flow through into your Pillar 2A.

In terms of the other parts of the question, you can do the maths yourself, I am not going to comment on what the PRA buffer might or might not be, but you can do the maths yourself and see where it lands out. All I would say again is that this is a matter we have discussed very closely with the relevant authorities and we are very comfortable in our short term and our medium term guidance and if your maths leads you to conclusions about what is in and what is out and what the size of things will be, I am sure your math isn't wrong.

<u>Question 5: Jennifer Cook, MEDIOBANCA</u>

Jenny Cook from Mediobanca. Just two questions. One on the contribution of gilt sales to other income. That was £190 million in H1. I think at Q1 results you guided that contribution would be similar to 2017 which implies about £70 million in H2. Am I thinking about that correctly?

Secondly just on the hedge. I think the notional increase was about 2 per cent Q on Q yet the average duration increased about 11 per cent. I was just wondering if you could kind of square us up on that in terms of what it is implying in terms of what you are putting on? Thank you.

Answer: George Culmer

Yeah again, in terms of gilts, yes you are right. So we were 191 I think plays 146 last year. And my expectation as you set out is that we will, there will be a slower level. It is just where we are in terms of realising the positions that we have got. I mean this comes from a balance sheet perspective in terms of these assets when you take in the capital charge, the carry costs that you have to incur that it is not worth holding these positions. So we have been coming out of these positions and again as a consequence of us reshaping the balance sheet and look at the carry costs. And you are right, we are 191. I would expect you talked about £70 million; it will be of that order in the second half of the year. It won't be another £191 million, it will be of the order you talked about.

And then in terms of the hedge, yes I am sure you are right. As I said we were deliberately going short. Remember the position has been when rates are very low and there was no reward in terms of locking up shareholder money. There was nothing to protect from a sort of downward movement because you are already down. And then the expectation of rates picking up, we were deliberately shortening our hedge and so we were deliberately running a sort of three position, the natural position at that time would still have been about the 4-4.1 years. So the natural position hasn't changed. It would have been constant around about a four year weighted average. We were deliberately going short. So it was 3.2, 3.3 at the start of the year and we have deliberately gone in and lengthened that hedge in terms of getting us back to what would be our natural position of around 4-4.1 of that order.

Answer: António Horta-Osório

I think Jennifer what you are referring to of our duration increasing more than the nominal is because if you remember we first went to the natural position in nominal size but we kept a shorter duration than the target which is as George says 4.1. So we are now in the natural position both in nominal amounts and on the weighted average duration which is the 4.1 and in Quarter 1 we were still short in terms of the average life.

<u>Question 6: Chris Cant, AUTONOMOUS</u>

Hi it's Chris Cant from Autonomous, thanks for taking my question. There was a PRA Consultation Paper out on Friday looking at the definition of default in mortgage risk models. I note that TSB, Sabadell reported a Group Capital Impact of 25 basis points in relation to making exactly the kind of change the PRA is proposing that you and all of your peers will need to make in the UK. If I back that out for TSB it implied about a 5.8 percentage point increase in mortgage risk density and obviously the heritage of TSB's models is the same as Lloyds. So can we read that across? It would imply quite a large capital impact of that 110 basis points, if I have got my maths right. Is your model substantially different and therefore you are un-impacted by this? I think you are currently using 180 day definition of default? Thanks.

Answer: George Culmer

Hi Chris, yeah you are right, there is obviously a swathe of new models, new capital pronouncements that come through. The first thing I would say is in terms of what we have previously said, stands absolutely good is when you look at our numbers over the planned period we would expect to see strong statutory profit growth as you have seen today in the first half results, see that continue. But you will know that over that period we are basically holding our capital guidance around the 170-200 and it is precisely because of things like paying for RWA density, paying for increased pension deficits etc. So in our expectation of free capital generation over the plan period, that already prices in expected new capital requirements.

Look, without getting on the specifics, the definition of default is coming where we expected it. I would say your maths seems rich in terms of your expectation of impact. We also see some other things that are coming in in terms of things like PS13-17 where we have got changes to PD and stuff like that and the through the cycle benefits which we would expect to see some offsets in that.

So as I look forward, that seems a big number. Yes there will be an impact but I think it will be offset by things like as I say, PS13-17 which will help us. And what definitely holds true is that over the plan period that increase in the statutory profit pays for funds for not just pension contributions but also things like RWA growth, but also RWA density pick up.

Further question
If I could ask the question a slightly different way then and I appreciate your comment about the maths being rich and maybe there is something else going on in terms of what Sabadell is flowing through rather than just this default definition change, but it implies a sort of target risk density for TSB's mortgage book of around 17 per cent. So wrapping in all of the various bits and bobs you are talking about, where do you think your mortgage risk density is likely to land by say 2020. I think you are about 11 per cent at the end of 2017?

Answer: George Culmer
Yeah we are about 11-12 per cent but I am not going to give you, it would be wrong for me to give you a number now as to what I think that is.

Further question
Why?

Answer: George Culmer
Because I am not going to answer. I don't have that number in front of me. I could go back to the office and find out what that number is. I think what I said matters Chris in terms of, we look forward. And the definition of the default has come in where we expected it to be, yes it will add a bit of inflation in terms of RWA density, but there are going to be offsets going the other way like the through the cycle stuff we talked about. So it would be wrong for me to pluck a number now.

Question 7: James Invine, SOC GEN
Hi good morning, it's James Invine here from SocGen. I just wanted to ask about your approach to PPI provisioning as we get closer to the time bar please? Because I noticed that this Quarter you have taken the provision up to 13,000 a week, that is ahead of the 12,000 that you averaged in Q2 and I would have thought that Q2 would have been quite high for claims as we had the second wave of the advertising campaign starting in April. So with that in mind is this basically you trying to put a little bit away ahead of a surge of complaints coming in just before the time bar as people rush for the line? And should we expect that over the coming quarter as you take a little bit more just to try and build that provision further? Thanks.

Answer: George Culmer
Hi James yeah. As I said in the Presentation, yeah we came in at 11,000 we saw about 12,000 from reactive. Across the first six months it is about twelve two to twelve three in terms of average. You are right, there were in that period there was FCA campaigns. There is still as we look forward two FCA campaigns to come. There is also actually things like the CMC fee cap which came in on 10 July and which we should start to see come through in August. It will be interesting to see how that plays through as well. We have also got the natural behavioural consequence as you get closer to the end and you would expect a ramp up in activity. And also we are actually getting better at things like being able to detect and interrogate databases to find our positives in terms of people that have PPI.

So it is a reflection of reality as opposed to running ahead and much as I would love to stand here and say it is phenomenally prudent etc. It is probably a reflection of reality of where I think it will actually go in terms of an assessment. So I think that is right. But it is a combination of what we are seeing, the behaviour consequence, what we are now able to do. And that is utilising some of the automation stuff that you have got to be able to interrogate, tranches of business. The unknowns out there are things like how the CMC fee cap actually plays through into this as well. But again it is a realistic assessment of what we think the costs will be.

There is also, as we play this out the cost of being wrong diminishes as well. So simply as I get closer to the deadline we started out as you know for every thousand it was wrong it was like £200 million. As of now for every thousand that I am out it is of the order of about a £140-150 million so that sort of cost diminishes as well.

So it is obviously paying for that, PPI again, what matters is that we are dealing with, as you know, remediating customers as quickly as possible. The key thing is that that time bar is in place and stays in place.

Further Question
Are you willing to tell us what your run rate has been through July?

Answer: George Culmer

Through July, the most recent week was I want to say about ten, eleven, something of that order. But you know don't place any great stay on that. It moves around. Two campaigns to come, but in the last couple of weeks it has been I think it has been south of twelve I think as we have moved through most of July.

Question 8: Alastair Ryan, BAML

Thank you, Alastair Ryan, Bank of America. Thank you for the disclosure on the hedge. So just to, a fairly minor question I guess. How much of that benefit of the terming out did we see already in the numbers and how much of that is third quarter as your average is, just to get the average out. So you start the year at X, then Y Q2. Did you do it all on 1 April or 30 June sort of thing? So any new guidance for the year? I am just trying to get a sense of in your second half margin, is there still a benefit from that terming out of the hedge as things stand or did you already have that in Q2?

Answer: George Culmer

I am not going to give you a number because I really don't know what that number is, but there will be a slight benefit in the back half but I forget what the number is, but I would expect a benefit in the second half.

Question 9: Joe Dickerson, JEFFERIES

Just a couple of questions, it is Joe Dickerson from Jefferies. António I thought it was interesting that you called out your share of branches in the UK because clearly you, unlike some of the larger peers have been focused on fulfilling the customer at multiple touch points and it also speaks to your share gains in the current accounts. If you look at say seeding market share of mortgages versus picking up share of current accounts, how can we think about the strategy going forward? How much is there a number that you would be willing to lose up to a certain threshold in terms of mortgage market share? Are you happy with what the current trends whereby you are growing the current accounts and growing in other areas on the asset side? So if you could comment on that first.

And then second going back to Chris' question on the PRA paper from last Friday. When we looked at the numbers it seems like TSB's PD assumptions are nearly half of what yours are. Is it fair to conclude therefore given the book shouldn't be that much different that they may be fairly company specific for them relative to you in terms of assumptions on ratings in their mortgage book?

Answer: António Horta-Osório

I will comment on the first one and George will comment on the second one. I mean I think you are absolutely right, I mean we have been trying to express this message for a long time. Contrary to Continental Europe where mortgages are the key product for customer loyalty, in the UK it is current accounts. It is clearly the key point, the key product for the customer relationship. It is how we measure primary current account holders. And it gives us as you say, a significant insight into what customer behaviour and needs are. And even more so in an open banking world where we believe we have a very significant advantage because customers in that multi-channel, multi-brand approach that you describe, customers interact with us 16 times a month and growing. And with the massive investments we are doing in technology, artificial intelligence, behavioural models, risk models, we are growingly knowing our customers much better and therefore we will be able to offer them the products and services they need when they need in transparent conditions at fair prices. And by the way this will include, which will be a first in the industry, the insurance as well, the insurance products with a single customer view across both banking and insurance which will be a first in the industry. And it is a massive opportunity as well because we have the largest digital bank in the UK and also because we have the lowest cost to income in the market. That makes it a very powerful opportunity for us as we now know our customers better and better.

Apart from that which is strategic, from a short-term point of view, current accounts are clearly our most profitable savings product as George has just described. And as you said, connected with our branch strategy, because I always said that branches were critical for current account acquisition. We are growing 9 per cent our balances which is the most important definition of current accounts, they are valuable current accounts. Balances are growing 9 per cent a year when the market is growing 6 per cent. So you also have this short-term advantage of the size of the current accounts and of the investment on the margin given current accounts are balances that people have by convenience and therefore they are invested behaviourally at a longer maturity and they have highest margins. So we are really pleased about it and the multi-brand, multi-channel strategy in my opinion is critical for the continual increase on current accounts.

On the branches, two additional points. First as you also said, we do not see branches as a cost lever at all, we see branches as part of our multi-channel offering to customers. And on the contrary, apart from being committed to keeping the largest branch network in the country and our 21 per cent market share which has increased as you saw in Juan's Presentation by 2 percentage points. We are increasing what is important for our customers that is provided by the branches.

Three examples. First time buyers. When people buy a house for the first time they really need advice on how to buy the house. We are absolutely focused on first time buyers and it builds on our Helping Britain Prosper Plan. We have 10 per cent more availability of mortgage advisers in the branches as we mentioned.

Second point, business banking which like to use the branches. We have increased the segmentation from £1 million to £3 million in terms of which business banking customers should be served by the branch network.

And thirdly, as George also mentioned, you have the strategic plan. We will be reintroducing progressively advice on financial planning and retirement also through the branches. So we are keeping and maximising what we think is a competitive advantage for as long as customer behaviour will determine it.

And then within the branches we are therefore changing the composition and the offering in the branches to these complex needs, the ones that customers mostly value and everything which is simple transactions, consultations, customers prefer and it is much cheaper for us if they do it online or at home on their computer. So that is our multi-channel, multi-brand strategy.

Answer: George Culmer
I will give a slightly shorter answer. Look it would be wrong for me to comment. Really, seriously I have not looked at, do not look at TSB's mortgage book and in terms of what assumptions that they use. So I cannot make any comparison in terms of how their PDs might compare to ours. I really don't look at what their book is or their assumptions.

António Horta-Osório
And they change their systems. And as you know there are now differences.

<u>Question 10: John Cronin, GOODBODY</u>
Thank you. It is John Cronin from Goodbody. Just following on briefly on that question around the multi-channel proposition. Is there some early validation of that strategy from an insurance perspective particularly?

Looking longer term, how concerned, if at all, are you around possible competitive action in that context. Just interested broadly on your thoughts on that?

And then my other question is, just probing on the PPI piece a little further. One question that has arisen is around the eligibility of the claims that are now coming in. So while I appreciate the run rate may pick up coming into the deadline, are you seeing any evidence of a greater proportion of ineligible claims in the mix in the most recent batch of claims?

And then finally on the P2A piece again, to come back to that. Look a theoretical one, but had your P2A come down by say 70 basis points instead of 30 or 80 basis points instead of 30, would you have recalibrated your minimum 14 per cent guidance downward by 50 basis points for example?

Answer: António Horta-Osório
I'll take the first one and George will then take the second and third questions. Look, the way we look at open banking and competition in this space and basically in a digital world, is the following. It depends whether it will be good or bad in my opinion. And I think it depends on different banks strategy and competitive positioning. So as I see it there are three key components to be successful in this digital world. First you obviously need to have a good digital platform to start with as customers are exponentially using digital channels more and more. So this is not for three years' time, this is for today. And we have the largest digital bank in the UK. We have one of the best mobile apps as rated externally. And we have a 21 per cent market share of new business sold by digital channels which is the same market share as we have from non-digital channels. I think this is a major achievement to be frank. Because in growth segments normally the incumbents don't have the same market share in the new growth segments as they have on the old ones. And we have a 21 per cent market share of new business sold through digital channels. So in another way, we already sell more than 68 per cent of what our customers require. Our customer needs more than 68 per cent of those are already met digitally. So that is the first.

Second point, to my previous answer to Joe. How often do your customers interact with you? What is the quality of your customer base? Are they really loyal customers or do they have secondary accounts with you for specific products where you pay more? And that is not our strategy. So we have as I was saying, we have 16 customer contacts on average and going up within the multi-channel, multi-brand strategy. Customers are growingly interacting with us through all channels, but exponentially through the digital ones and we already have 16 customer contacts per month. To give an idea one of the leading insurance companies that just gave this number, it is like one contact every three months, across insurance it is a different business. But we being integrated between banking and insurance we have 16 contacts a month, our customers are high quality, they have their primary current accounts with us.

And so what does that mean? That we have all the raw material together with massive investment that we are doing, so more than 40 per cent up to understand better their behaviours, their needs so we have models, risk models, etc. So that is the second component.

And then, you can have a great digital platform. You can understand your customers very well, but if you are inefficient in the long-run you will not be able to provide them decent products at fair prices, keeping the required return for shareholders. And this is where our efficiency advantage plays in. So given that we are well positioned on these three fronts and we are increasing our investment to three billion pounds strategic investment alone when all of these type of things, 40 per cent up on the previous plan. And our cost base is flat year-on-year given we do significant reductions on the BAU costs, I think we are very well prepared to face whatever competition that will come.

Answer: George Culmer
And then your question, first PPI, I mean I suppose the simple answer is yes, we are seeing more ineligible complaints so as an example at the time of the first FCA campaign just prior to that we were getting eleven, twelve thousand a week and genuine complaints and there were about sixteen, seventeen thousand would come in which would produce eleven or twelve thousand. At the moment we are seeing about twenty-two thousand of those gross come that generates about the same level of valid legit complaints, eleven, twelve thousand. So you are seeing a deterioration in quality. You are also seeing what you gain in terms of the PPI process, the first thing you get is PIRs in terms of information requests and again you are seeing a surge in those. But again the hit rate is getting much lower, much lower, much lower in that you are getting more volume in and it is attracting proportionately less positives as you come through. So you are seeing more activity but to your point, a lot of it increasingly ineligible activity. And some of the base legit claims as I say stay around that eleven, twelve thousand and I am seeing all this more noise up here. And what you also get with the FCA at the end of the marketing campaigns you will see a surge and it is normally a massive surge in those ineligible and you see a much smaller movement in the legit claims and we saw that on the first and we saw that again in the second FCA campaign as well. So more activity, less of it is legit.

And then as you might expect, I am going to duck your hypothetical question in terms of the 30 per cent to your 80. Look it would be a matter for the Board to consider, I would say there is something for stability and consistency and certainty and I am not sure it does anyone a favour bouncing things around. But I can’t answer what we might have done, sorry.

<u>Question 11: Andrew Coombs, CITI</u>
Hi, it’s Andrew Coombs from CITI if I could actually ask one to each of you please. Firstly to George. Just looking at slide 18. Again thank you for the additional disclosure. Can you just provide the blended customer rate on the front book please? You obviously should be able to back it out given that you provide an overall gross margin and a back book customer rate, but I just wanted to check the maths?

I would like to invite António to say a few comments on the FCA paper about a possible Basing Savings Rate introduction?

And then finally to Juan, given your comment about open banking, I think you said 76 per cent would prefer to do the services via the primary bank, we know HSBC has already launched their aggregator, Barclays is about to do so. Could you just update us where Lloyds is on this plan? Thank you.

Answer: António Horta-Osório
Right, so I can start with your question. In terms of the consultation on the discussion paper from the FCA, I mean we have been in terms of our strategic plan over the last few years and focusing on Helping Britain Prosper, to try and simplify our product range, be more transparent. We think we went a long way along those lines. A clear example of what you already saw very visibly is what we did on overdraft, where we led the market in terms of transparency and benefits for our customers. And in terms of that basic rate we feel that we have significantly reduced our product range, simplified the offerings and therefore we think that type of approach in terms of the impact the FCA mentioned, would be in our case, given our market share, would be very, very small. We are constantly doing that, have significantly simplified the product range and the conditions for customers and I think you should take the overdraft as the best example of something that is not just discussion but it is already a reality.

Answer: George Culmer
And in terms, front book rates. Well you won’t go far wrong if you are in the two and a half type range.

Answer: Juan

Yeah and open banking. Aggregation is one of the services that you can get from open banking. But for us it is to look at what it is that the customers are more interesting in doing through internet. You will see in the coming months a long list of additional services that we can provide through our application, including aggregate services which is part of our plans as well.

Answer: António Horta-Osório

And the aggregation will be progressive because you want to start with current accounts, then you have all the savings, credit cards. The interesting thing here as I was previously saying to Joe is that our current account base is mostly our primary customers so they consider us their main provider. They are growingly interacting with us and they tell us as Juan showed you that they would like us to do that aggregation so given we can have not only the internal aggregation with both banking and insurance products, but we can then aggregate whatever they have in the system. Our behaviour on the risk models will be very effective in complementing what our customers in an aggregate way will really want and we see this as an interesting opportunity.

<u>Question 12: Claire Kane, CREDIT SUISSE</u>

Thank you, it's Claire Kane from Credit Suisse, two questions from me please. Firstly you have submitted your stress tests results to the PRA in June, is there any reason this year we should expect a smaller drawdown given there has been no change in the parameters for example, lower conduct charges?

And given we have had the paper on the calibration of the Pillar 2A do you have a sense of where that buffer will go to under stress from the 2.7 today?

And also when will you find out your actual hurdle rate from the PRA? Sorry, that was my first question.

And the second one is just on the insurance new business. Can you tell us how much contribution you got from the Zurich Workplace Pension Assets in the quarter? Did they transfer at the beginning of the quarter? And what is the timing on the rest of that transfer please?

Answer: George Culmer

I'll take the second one first. It will be a small amount. I forget the precise date it came across and we can get the number to you. But we are not going to be talking. A lot of these assets under administration so the basis point charge isn't large. So in terms of trying to work that out and what the impact will be, it would not have had a material impact on the first six months numbers. I can come back to you on the precise points of it, but it would not have had a big impact. So that 75 per cent hike in new business, there is nowhere like that, it is 25 per cent organics and 50 per cent Zurich. The Zurich will be just a few percent of that if that. It will be a very small contribution, very, very small.

And then on your first bit, when you say drawdown, you mean the delta between the stress delta and stuff like that. Well stress test will be interesting. We've not just got the PRA we have got the EBA one. I imagine, in terms of us being told what our hurdle rate is, I don't know if we get told that at the same time as we are told what the score is. We certainly haven't been told as of yet in terms of what our hurdle rate is. As you know within that they have got the dynamic Pillar 2A which I think goes half the way to dealing with some of those aspects. And there are some things that aren't covered that would have liked to have been included in that as well. But I am not aware of, I may be wrong, with what we were told of our hurdle rate beforehand in terms of passing that.

And then the stress test. Look these are going to be interesting because it is the first time in IFRS both of them, both EBA and PRA have this concept of perfect foresight which I must admit I do struggle with which is on minute one, on day one of the stress you can look out and see how bad it is going to be. And because you can look out and see how bad it is going to be, you reflect on minute one of day one the entirety of your IFRS9 impact of that. So that presumption which is going to produce quite an extreme result. So I think you are going to see some pretty interesting stuff that comes out from both EBA and PRA stress tests as we work through that. And it would be very interesting. We all have got to learn to live with IFRS9, I think we are all doing that, we are all learning as we go here. But I think the way that both EBA and PRA have chosen to do it, you could get some quite extreme outcomes just because of that perfect foresight approach.

Further question

Can I just have one quick follow-up? Do you think that they would look to the IFRS9 impact to recalibrate to your PRA buffer with effect this year? So effectively impact your potential to distribute at year end?

Answer: George Culmer
Okay I am obviously not the Regulator, but no. What do I think? It is but one input. I won't tell you anything you don't know Claire, and I think what was instructive was last year's stress test where if you recall there was the big consumer finance impact that came in and you saw some quite big deltas in terms of the stress and then the overlays that were applied. So that was the stress test result.

In terms of then the PRA buffer, without having being able to tell you what the number is going back to the earlier question in terms of what that buffer might be, the PRA could quite rightly say there is no automatic link. It is but one impact and I think we have quite good history to say that a reasonable approach is taken in terms of setting that buffer with regards the extremeness, likelihood or whatever of that stress. So you don't get an automatic cause and effect.

The whole regulatory stance on this actually which I have got with the transitional and all those sorts of things is how do I actually protect my capital standard and all my capital work that I have done from this ridiculous pro-cyclical accounting convention that accelerates and distorts and blows up P&Ls, how do I actually preserve some integrity of the capital position in that? So this bifurcation between what is going on in your numbers on IFRS9 versus, which is an acceleration, no recognition of income that you will be earning before those losses actually crystallise and were recognised, versus that capital bit, the regulatory is severely exercised and I know that they want to preserve the integrity of that capital position. And what they are searching for in the transition gives them time. As you know it was trying to find the elegant answer as to how do I keep my capital structures and my capital standards and can sign IFRS9 over to here and not let one corrupt tither. So that is where we are as you know it has been talked about for a while.

<u>Question 13: David Lock, DEUTSCHE</u>
Hi, it is David Lock from Deutsche, I have got three quick ones hopefully. Firstly Ireland, you sold the portfolio I think last year at a forty million loss. I just wondered if you could give us a sense of what income and costs might be related to that just so we can think about how that rolls through for next year?

And secondly on the restructuring costs I wondered if you could update us on where we are? I think you have got the MBNA restructuring, you have got various elements within there, just which components should we expect for the rest of the year?

And then thirdly, on Pillar 2A again. I think you have announced it a quarter early. I think normally you gave it in Q3, is that because you are just getting it early or is it a mid-review or is this your Pillar 2A for the stress test for the next twelve months or is this going to be reviewed again?

Answer: George Culmer
No, this is. Right this is just us getting it early. So this is the same number with the same duration as if I was telling you at Q3. The work has been done earlier by the Regulator and so I am telling you now as opposed to telling you at Q3 so there is nothing more mysterious than that.

In terms of restructuring I think I said at the Full Year Results that I expected for this year that ring-fencing would be about, this in billions, point two, point three, I talked about MBNA integration of about point one. And I talked about the property rationalisation at about point one. I didn't include that because it was dependent upon reviews and work to be done in terms of what the severance would be. You have seen from the severance today it is about £150 million let's say. Let's assume it is point two for the full year. So the numbers I previously gave would stand and then I would add a sort of point two for severance on top of them in terms of the restructuring.

And then Ireland, it was actually a hundred and ten million pound loss in terms of the loss on the disposal. The income and the costs are nothing of nothing. I want to say it is about fifteen, sixteen millions of income and a handful of costs. It is nothing of nothing.

Answer: António Horta-Osório
Which is actually why we sold it because if you remember this was not a portfolio where we had any credit issue, it was more of a financial equation and given prices got better and better it is clearly better for our shareholders just to get rid of this final part of the portfolio because it is clearly beneficial in terms of capital and on the equation as a whole.

<u>Question 14: Ed Firth, KBW</u>
Thanks very much, it is Ed Firth here from KBW. Sorry I have still got three questions I am afraid. The first one was just on the gilt gains. In the past I think you told us it was five hundred million of unrealised. Could you just update that number as to where we are today?

Secondly, if I look at your intangible deductions from core Tier I they are up about four hundred million in the half. Is that all capitalised investment spend and should we expect that trajectory to continue at that sort of level going forward because I imagine at some point your P&L amortisation and capitalisation should get somewhat closer?

And then just the final one was on Zurich. I think you got about six billion out of nineteen billion of assets across so far. Could you just tell us what the full year revenue is once the full nineteen is across?

Answer: George Culmer
Again, it is a bit like Claire's question. It is going to be a small number so I don't have the number to hand and we can get it to you but it is going to be a small number, I want to say something like a handful of millions, it is not going to be a big number in terms of the amount, but we can confirm to you what the number is later.

In terms of the intangibles, again when we give our capital guidance and all those sorts of things we include within that the expected deductions as we move forward of increased portion of intangible spend. I can't think it will be anything other than intangible pick up. I am not sure that I would just double it for a full run rate mind you. It seems quite a lot in the first half. But I don't think there is anything else that is in there.

And in terms of the unrealised gain on the gilts, I will have to get back to you in terms of where the five hundred million has gone to. I can get back to you in terms of what that number is.

Closing comments
António Horta-Osório
Any more questions? I think we have come to the end. Again thank you very much for joining us this morning.

End of Q&A