LLOYDS BANKING GROUP PLC – 2019 FULL YEAR RESULTS – TRANSCRIPT
(amended in places to improve readability only)

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LBG PRESENTERS:
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António Horta-Osório
Good morning and thank you for joining our 2019 full year results presentation. I will briefly talk about the Group's financial performance and then review our strategic progress, as we are now in the final year of GSR3.

Vim will then give an update on our Retail Bank, before William runs through the financials.

We remain focused on delivering our purpose of Helping Britain Prosper, whilst building additional strategic advantages for the benefit of our customers, and generating strong and sustainable returns for our shareholders.

Against these objectives, we have again delivered significant strategic progress, while continuing to invest in the business. We have made around £2 billion of strategic investment since the start of GSR3 and are on track to meet our commitment of more than £3 billion by the end of 2020.

We have also generated solid financial returns in 2019 despite the challenging external environment and the large PPI charges we took in the first 9 months of the year in response to the unprecedented volume of information requests ahead of the time-bar in August.

Underlying profit for the year amounted to £7.5 billion with a market leading underlying Return on Tangible Equity of 14.8 per cent.

Statutory profit after tax was £3 billion and statutory Return on Tangible Equity was 7.8 per cent, both significantly below last year, mainly driven by PPI.

Excluding PPI, RoTE would have been 14.4 per cent, ahead of prior year, illustrating the profit generation capacity of the Group as PPI comes to an end.

Our unique business model delivered this solid statutory performance, which; together with our robust capital position; has enabled the Board to recommend an increased final dividend of 2.25 pence per share, taking the total ordinary dividend to 3.37 pence, an increase of 5 per cent on last year, in line with our progressive and sustainable ordinary dividend policy. And we are moving to quarterly dividends from Q1 2020.

Our approach of progressing our strategic transformation at pace and continuing to deliver strong and sustainable returns to shareholders, while being watchful and responsive to external risks remains the right one, and this confidence is reflected in our 2020 guidance.

In terms of the financials, as I said, we delivered a solid performance despite the previously mentioned headwinds.

Net income of £17.1 billion was slightly lower than prior year, with the Net Interest Margin remaining resilient at 2.88 per cent, in line with our guidance.

At the same time, we maintained our relentless focus on costs, and reduced total costs by 5 per cent, including BAU costs by 6 per cent, and delivered positive operating jaws. This enabled our market leading cost income ratio to reduce further to 48.5 per cent, even while we continued to invest strongly in the business.

We are maintaining our prudent approach to risk, with credit quality remaining strong and the net asset quality ratio of 29 basis points within our guidance, despite the 2 large single name cases we talked about earlier in the year.

And the Group built 86 basis points of free capital. Pre-PPI the capital build reached 207 basis points, demonstrating the capital generative nature of our business model.

The Group continues to target an ongoing CET1 capital ratio of around 12.5 per cent plus a management buffer of around 1 per cent. For now, given the announced increase in the countercyclical buffer, likely only partially mitigated by the proposed Pillar 2A offset, both at the end of 2020, we are holding a level slightly above this, finishing 2019 at 13.8 per cent.

From 2021, our current view all else being equal, is for the Pillar 2A to fall further as pension contributions increase, enabling us to bring capital back towards our target level of circa 13.5 per cent.

The business model remains strongly capital generative. In line with our ongoing guidance, we expect free capital build of 170 to 200 basis points in 2020. And the Board will continue to consider potential excess capital repatriation at each year end.
We have grown our portfolio prudently in key segments. Open mortgage book, Consumer Finance, SME and Mid Markets have grown by over £6 billion since the start of GSR3, whilst Large Corporates are deliberately lower as we continue to optimise the Commercial portfolio towards higher risk adjusted returns.

The Open mortgage book was up £3.5 billion in 2019, as a result of the Tesco book acquisition announced in September.

Our SME portfolio has continued to outperform and has grown by 3.3 per cent since the start of GSR3, ahead of the rest of the market.

We are also focused on delivering the growth opportunities in our Insurance & Wealth business. Since the start of GSR3, our open book assets under administration have increased by around £37 billion, supported by £18 billion transferred from the Zurich acquisition.

On the liability side, I have talked to you before about our strategy to grow high quality current accounts and reduce tactical balances. Since the start of GSR3 we have grown personal current accounts by 11 per cent, well ahead of the rest of the market. This shows the strength of our customer focused, multi-channel, multi-brand strategy.

I will now turn briefly to the UK economy. The UK economy remained resilient despite the challenges in 2019 from the slowing global economy and elevated uncertainty from both domestic politics and the future relationship with the EU. With the new majority government now in place and the UK having left the EU, there is now a clearer sense of direction and some signs of gradually improving economic indicators.

Households’ spending power is rising at close to 2 per cent a year, the strongest for three years, reflecting a combination of stronger pay growth and low inflation.

Employment continues to reach all-time highs, the unemployment rate remains close to its recent 45 year low and we are seeing some signs of improving consumer confidence.

On the corporate side, business confidence also shows evidence of a gradual recovery as Brexit related uncertainty has reduced.

And similarly, housing market data displays early signs of upturn in both activity and prices, driven by the reduced uncertainty.

However, despite the early signs of improvements in economic indicators and the expected significant Government stimulus through infrastructure projects to be potentially announced next month as part of the Budget, the interest rate curves are yet to react. There remains uncertainty given the ongoing trade deal negotiations which continues to weigh on absolute growth. And, of course, there remains uncertainty about how the coronavirus outbreak will impact the world economy.

I will now give you a brief update on the Group’s significant strategic progress in 2019. Two years ago we launched the third phase of our strategic journey, with the aim of transforming the Group for success in a digital world, while continuing to support our core purpose of Helping Britain Prosper. Our strategy is underpinned by increasing levels of strategic investment, which is only possible due to our unique business model and market leading efficiency.

This investment drives improvements to the customer experience and delivers further productivity enhancements, which ultimately both creates greater investment capacity and underpins strong and sustainable returns. As I have said on many occasions, we see this as a key competitive advantage of our business model. Our plan is built upon a number of ambitious targeted outcomes across four pillars covering the breadth of the Group. With one year remaining, we are performing well against these and running ahead of plan in many areas.

I will look at some of the outcomes in more detail. Through the combination of our unique business model and strong digital capabilities, we are the only provider to serve all of our customers' financial needs in one place.

Our unique Single Customer View is now available to more than 5 million banking and insurance customers, covering multiple products including pensions, home insurance and protection, and we remain on course to extend this to around 9 million customers by the end of 2020.

Engagement levels with Single Customer View significantly surpass those of standalone insurers, as well as initial Open Banking user activity.

Our continued efforts to enhance customer experience has resulted in consistent improvements in our Net Promoter Scores, up by 3 per cent during the first two years of GSR3, or by nearly 50 per cent since 2011. In line with our commitment to Helping Britain Prosper, we have continued to demonstrate support for UK businesses. We are a leading lender to SMEs. We have increased our stock of lending by around £8 billion since 2010 versus a market that has decreased by around £21 billion. This has resulted in a market share increase of around 6 percentage points to 19 per cent at the end of 2019.

We are also seeing a strong start for our joint-venture, Schroders Personal Wealth. In 2019, Retail wealth referrals increased by 33 per cent with associated gross new assets under administration growing by 21 per cent. Both have shown a strong pick up since the launch of the joint venture.

We are confident that Schroders Personal Wealth can build on this positive start and meet the ambition of becoming a top three financial planning business by the end of 2023.

We also continue to operate a disciplined approach to cost management, supported by investment in transforming ways of working and new technological capabilities. And we have today announced a new target of less than £7.7 billion of operating costs in 2020.

Our cost advantage relative to peers now stands at more than 13 percentage points, having improved by a further 3 percentage points in the last two years, and we remain committed to driving further efficiencies.

As well as investing in our own capabilities, we also recognise a need to embrace external innovation and work collaboratively with FinTech providers that can offer products and services that will deliver additional value to our customers. This has resulted in a number of exciting partnerships and we continue to monitor opportunities in this space.

Successful execution is reinforcing our competitive advantage and creating new ones. We are future proofing the business, delivering increasing levels of investment in key areas. In absolute terms, our technology spend increased by 14 per cent year on year in 2019 and remains among the top quartile of global peers, while as I highlighted earlier, our cost:income ratio continues to improve.

As a result, the Group continues to deliver strong and sustainable returns for shareholders, with statutory Return on Tangible Equity above peers over the period.

Despite this, we are not complacent and remain focused on ensuring that our key strategic and financial priorities are delivered in 2020, while also thinking ahead to the next phase of our strategy.

Alongside this significant strategic progress, we are also continuing to deliver on our ESG targets, and today we have published a separate investor presentation outlining our approach.

This makes clear that we see ESG as a core element of building a sustainable business, not just an ancillary activity. We have a proven track record on ESG with our Helping Britain Prosper Plan and I would like to highlight some of the areas we have led the market such as being the number one UK bank in supporting green bonds for UK corporates, and being the first FTSE100 company to set public diversity targets for gender and ethnicity.

We have also become the highest corporate payer of UK taxes in each of the last four years.

And in January we announced a series of new and ambitious targets that recognise the need to tackle climate change and promote green finance for the future business prosperity of the UK. This includes targeting more than 50 per cent reduction in the carbon emissions we finance by 2030.

I will now hand over to Vim, who will talk about how we are delivering the leading customer experience in the Retail Bank.

Vim Maru
Thank you António and good morning everybody, I am delighted to be here today to share the strategic progress we are making within the Retail Bank.

I'll start with an overview of our business. We have an outstanding customer franchise with significant reach through our multi-brand and multi-channel model.

The combination of these allow us to interact with a broad spectrum of customers, generate data and insight, and deliver excellent service through whichever channel they wish to engage.

We are a truly customer focused business and continually strive to make things simpler and more transparent for our customers, and our success here is reflected in an improvement in customer satisfaction scores by almost 50 per cent since 2011 as you have heard from António, and a reduction in customer complaints by more than 75 per cent during the same period.

On the back of these strong foundations, we are delivering on our targeted strategic priorities. We remain on course to maintain our number 1 branch market share by the end of the plan. We have the largest digital bank in the UK, with 16.4 million digitally active customers and 10.7 million mobile app customers, both of which are up 3 million since 2017.

And finally, we are delivering more tailored propositions to our customers. I will provide more detail on each of these later in the presentation.

During the first two years of GSR3 we have delivered a resilient financial performance against a challenging backdrop which has been characterised by low interest rates, heightened levels of competition and a number of regulatory developments. On the latter, we have often proactively made changes ahead of those implemented across the industry.

Despite this, we have delivered stable income in the period with resilient margin trends due to the result of clear management actions in light of the competitive environment, a shift in business mix as we deliver a combination of organic growth in targeted segments and the identification of inorganic opportunities that are value accretive to our business.

These actions have largely offset a more challenging environment for other income, a trend that we have seen across the industry.

As a means to offset these pressures, in line with the Group, we have demonstrated strong cost control despite investing heavily in our business, with BAU costs down 7 per cent in the period and investment up 14 per cent. In addition, underlying credit quality metrics have remained robust.

As a result, the business, which accounts for around 50 per cent of the Group, has continued to deliver strong returns, above the Group's target level.

Turning now to two pillars of our multi-channel strategy.

The behaviour of our customers continues to change. Whilst digital adoption has increased significantly in recent years, especially in our mobile channel, interactions within our branch network have continued to decline, albeit at a more moderated pace in the last few years. Whilst these trends mean the way in which we serve our customers through the branch network will change accordingly, it is worth reiterating that we do not see branches as a cost lever. Branches represent a small proportion of Group costs and this is outweighed by their significant value to our multi-channel model. Indeed, over 70 per cent of our customers interacted with us through more than one channel in 2019. Given the strategic importance of our branch network, our priority has been on re-focusing and re-formatting this to meet varying customer needs.

The pivot towards serving more complex customer needs has delivered a number of tangible successes to date, such as increasing market shares in relationship mortgages and Business Banking current accounts, as well as a 19 per cent increase in mortgages protected through the branch network.

The continued shift to digital channels, and in particular mobile during the course of GSR3, is creating new customer expectations with a focus on simplicity and real-time insight, with these expectations also influenced by their experiences outside financial services.

In response, we are delivering functionality enhancements that resonate with our customers. These enhancements include areas where we were first to market, such as the integration of Google maps in our app which has the dual benefit of increasing customer satisfaction, whilst also improving self-service capabilities and consequently freeing up colleague capacity. Our actions have supported an improvement in our mobile app NPS by 3 per cent to 68.4 between 2017 and 2019.

These developments, combined with our targeted propositions to customers have enabled us to further strengthen our customer relationships, with current account customers growing by around 9 per cent since 2014, whilst average balances per customer have increased by more than 50 per cent, showing that we remain the primary bank of choice for our customers.

In a period where new entrants to the market have been increasing in share, we believe this demonstrates the success of our business in not only attracting new customer relationships, but increasing our relevance for existing customers. The growth in PCAs also contributes to our balance sheet structural hedge that William will talk about later.

As the largest retail bank in the UK, we have an unrivalled understanding of our customers with a vast array of data points providing unique insights on behaviours, preferences and expectations. This knowledge, combined with our significant investment in data and digital capabilities is allowing us to better identify the varying needs of our customer base and consequently deliver more tailored propositions that deliver real value. For example, half of our customer base hold larger balances and have more complex needs. Through our multi-brand propositions, we have tailored our solutions for these customers.

As an example, our Club Lloyds proposition, which offers credit interest, lifestyle benefits and access to preferential conditions for additional needs, aligns well with this population, with these customers holding balances nearly 3 times higher than the average customer.

It is this level of customer understanding that enables us to deliver products and services that offer true differentiation, supported by the investment in our data capabilities. In the future, it also provides the opportunity to diversify our revenue streams. This will remain an area of major focus for us in the coming years as expectations for personalisation continue to rise and given our unique proposition serving all financial needs in one place, we believe we are well positioned to build on this.

Finally, we have a leading franchise across a number of our business lines and have made good progress over the course of the latest strategic plan.

In areas such as mortgages, we have operated with a clear strategy. Within the highly competitive intermediary channel, we have prioritised margin and risk over volume, as well as delivering excellent service for our intermediary partners, whilst we have grown more significantly in the relationship channel, supported by increased investment during GSR3. Elsewhere, we have continued to take share in targeted segments such as PCAs, car finance and consumer loans.

Looking ahead, we will continue to adopt a channel specific strategy in mortgages. In the intermediary market, which accounts for 75 per cent of new business, the extent of our participation will likely be dictated by market pricing trends as you saw in 2019, where our growth increased in the second half as the market improved.

In consumer lending, we have successfully integrated MBNA, delivering a return on investment of 18 per cent, above the original target. Going forward, we see growth opportunities from the expansion of MBNA into personal loans. We also see opportunities in Motor Finance, where we have recently renewed a number of key relationships including, I am pleased to announce, Jaguar Land Rover.

We will continue to improve links between the Retail Bank and our joint-venture, Schroders Personal Wealth. We also expect the sophistication of our Single Customer View to provide customers with more functionality and further increase engagement, whilst we will better integrate our Home and Protection offerings within our digital and physical channels.

In addition, working with Scottish Widows, at the beginning of this year we launched our new lifetime mortgage proposition through the intermediary channel and we will roll this out further during the course of this year.

Finally, in Business Banking, our branches will be used to facilitate more meaningful conversations. And as António mentioned earlier, our collaboration with FinTech partners as a Group will enable us to combine innovative services with our significant scale.

These initiatives will leave us well positioned for the future and ensure that we continue to deliver a leading customer experience.

Thank you and I will hand over to William who will run through the financials.

William Chalmers
Thank you Vim. As António said, I will now give you an overview of the Group's financial performance in 2019 and we can then open up for Q&A.

Turning to the first slide with a summary of the financials. As you have already heard, in 2019 the Group delivered solid financial returns and a resilient underlying performance, in what was a challenging external environment. NII of £12.4 billion was down 3 per cent, with a resilient NIM of 288 basis points, in line with our guidance. Other income at £5.7 billion continued to be somewhat pressured in Q4 and was down 5 per cent on the year.

Moving down the P&L, the 5 per cent reduction in total costs was driven by both operating costs and remediation being lower year on year. Within that, operating costs were down 4 per cent year on year, meeting our guidance of less than £7.9 billion. Remediation was down 26 per cent, albeit a bit above our expectation for 2019 as a whole.

This operating performance resulted in a solid pre-provision trading surplus of £8.8 billion, which is relatively stable on the prior year.

Moving further down the P&L, credit quality remains strong with a net AQR of 29 basis points, again, within our guidance. Together, all this translated into a resilient underlying profit of £7.5 billion.

Statutory profit before tax, however, of £4.4 billion, was down 26 per cent compared to the previous year, this was given the impact of PPI. PPI is also reflected in the earnings per share of 3.5 pence, which is 36 per cent lower than 2018.

I will now discuss the individual items in some more detail. We begin with net interest income and margin on the next slide. NII of £12.4 billion was down 3 per cent on 2018, based on a resilient Net Interest Margin and broadly stable average interest earning assets.

The NIM of 288 basis points fell by 5 basis points year on year and 3 basis points in the fourth quarter. This margin pressure in 2019 as a whole was mainly driven by continued competitive pressure on the asset side. And to a degree, this is likely to continue over the coming quarters, as we discussed at Q3 results.

On the other side of the balance sheet, lower deposit costs and higher Retail current account balances provided partial offsets during 2019.

Also in the fourth quarter, the stated margin saw a further benefit of about 4 basis points from aligning MBNA product terms with the rest of the cards business. This represents the completion of the EIR adjustments, as I highlighted at Q3.

Average Interest Earning Assets were essentially stable at £435 billion in 2019. The Tesco book acquisition and other targeted loan growth, in SME and Motor Finance, were offset by closed mortgage book run-off and the tail effect of the Irish portfolio sale in 2018. We expect Average Interest Earning Assets to stay broadly unchanged in 2020.

In protecting the margin, we are maintaining our active approach to managing the balance sheet, including tactical acquisitions such as the Tesco portfolio. These help partly mitigate the impact of rates and the competitive environment in which we are situated.

Going forward in 2020, we expect the NIM to be between 275 and 280 basis points. This importantly assumes an average 5 year swap yield of 75 basis points throughout the course of 2020.

I will now move on to next slide and to asset margins across our key segments. The margin has remained resilient in 2019. Turning first to mortgages.

Our approach to focussing on margin and risk rather than volume, and the new business flexibility provided by the Tesco book, helped to protect our margin in what was a competitive environment. Furthermore, the rollover of new maturing fixed business is now also happening on much more favourable terms versus the last couple of years.
The gross margin on our total mortgage book stood at 1.7 per cent in the second half of 2019, down 10 basis points compared to the same period last year. Back book attrition meanwhile remained in line with our expectation of 15 per cent, with a significant proportion of customers now on relatively small balances.

In Consumer Finance we have continued to grow our portfolio, mainly in Motor Finance, which was up £1 billion in the year. This targeted growth supports the Group margin.

More broadly, the Consumer Finance market evidences some competitive pressure. The increase in the gross margin to 7 per cent in Consumer Finance was driven in part by the MBNA product terms alignment that I mentioned earlier. Excluding this benefit, the margin would have been 6.6 per cent.

Finally, the margin on the Commercial Banking portfolio shows stability at 2 per cent. The asset base here was down by around £5 billion over the year, primarily in the second half. And this in turn was mainly driven by our ongoing re-positioning of the Commercial portfolio.

Focused on the Global Corporate and larger Mid Markets segments, we are actively re-positioning the Commercial business towards higher risk-adjusted returns. We are addressing low returning client relationships and maintaining a very clear focus on RWA optimisation. This approach is going to continue into 2020.

Now let's look at the other side of the balance sheet and our liabilities including the structural hedge.

The current low interest rate environment is challenging for all retail and commercial banks. Over the last two years, since the start of GSR 3, in-year 5 year swap rates have reduced significantly and the curve, as you know, has flattened. Despite this, we have delivered a resilient margin. This demonstrates the strength of our approach to actively managing the balance sheet and indeed protecting value.

In support of this we continue to grow current accounts and reduce tactical balances. Current accounts were up by over £3 billion in the year, and now make up nearly 30 per cent of our deposits, versus 16 per cent only 5 years ago. This improving profile continues to support the liability margin which was in turn stable over the past year.

We do continue to see further opportunities to grow current accounts, leveraging our multi-brand strategy and allowing us to maintain pricing segmentation in the low rate environment.

Tactical balances, on the other hand are expected to reduce further as we continue to enhance the mix of our deposit portfolio.

Turning to the hedge. Generally, given rates, we held back from reinvesting the structural hedge during 2019. We do, however, invest when we can protect value, following our disciplined hedging approach.

In Q4, for example, we reinvested some maturities as term rates improved. The hedge balance therefore stood at £179 billion at the end of 2019, which is up around £7 billion since end September. The weighted average life of that is remaining at about 3 years.

The approved hedge capacity stands now at around £185 billion, meaning that in turn we have approximately £6 billion un-invested which in turn provides us some additional flexibility should the rates change.

So next I turn to other income on slide 26. Other income came in at £5.7 billion, down 5 per cent year on year. 2019 as a whole continued to see an unhelpful backdrop for our Commercial Banking markets business. To a lesser extent, we also saw lower other income in Retail than 2018. The latter was particularly impacted by lower fleet volumes in Lex Autolease.

Q4 was a little softer than Q3 at £1.27 billion, driven by continued softness in Commercial Banking and a number of smaller items, including some pressure on Retail current account fees.

Insurance & Wealth, on the other hand, is continuing to perform well, albeit it is also impacted by rates. The year saw healthy growth in workplace pensions, supported by auto enrolment and higher general insurance income, net of claims. In the first half, as you know, it also benefitted from the change in the investment management provider and longevity benefits.

Central items are down a little, partly due to lower gilt sales, and an exceptional 2018 for LDC, as we had flagged previously. Gains on the sale of gilts and other liquid assets amounted to £185 million compared to £270 million a year earlier.

Looking forward, in 2020 we plan to continue investing to build the resilience of the other income line.

For example, in Insurance & Wealth we are investing in Financial Planning & Retirement, Protection and Home Insurance product capabilities. These will allow us to continue to benefit from the structural and market share growth opportunities that we see in this market.

In Commercial, we have invested in a corporate payments platform to increase flow revenues.

And in Retail, we are developing value-added rewards and loyalty propositions to our current accounts to support a continued high quality customer proposition.

Together this all means we expect other income to build gradually during 2020. To be clear, it will still be market dependent and improvements are likely to be somewhat back-end loaded. But we do not think Q4 should be annualised in 2020.

I will now look at costs on slide 27. In today's revenue environment we are doing what we can to preserve operating leverage and investment capacity is clearly critical. Total costs were £8.3 billion and down 5 per cent, driven by reductions in both operating costs and in remediation.

We reduced operating costs to less than £7.9 billion, which was down 4 per cent, in line with our guidance which we enhanced twice over the last year. Remediation of £445 million relates to a number of small items across existing programmes and was 26 per cent lower than the previous year. Although Q4 was a bit above our expectation, we expect remediation costs to reduce to around £200 to £300 million per year from 2020. Alongside this we drove a 6 per cent reduction in BAU costs. This increased efficiency was combined with continued investment.

Above the line cash investment totalled £2.4 billion in the year, including £1 billion of strategic investment that in turn was up 6 per cent in the year. Around 63 per cent of the £2.4 billion investment spend was capitalised, which is in line with previous periods.

Notably the reduction in operating costs came at the same time as improved customer experience with NPS going up, as António and Vim highlighted in their presentations.

So, turning to costs and we look in particular at one or two items here. As you know, the Group has a focussed cost culture and a strong track record of delivery.

Going forward, there remain further opportunities. Examples of this are listed on the slide here, including automation, reduction in our property footprint, our cloud strategy, and just doing things better. For example, there are meaningful further opportunities in private and public cloud for a more flexible and indeed a lower cost base.

Reflecting on all of this, and as António said earlier, we expect operating costs to be less than £7.7 billion in 2020 and for the cost:income ratio, including remediation, to be lower than in 2019. As I said, focus on cost control is particularly important in the current environment. It is something we will continue to concentrate on and it will remain a source of competitive advantage for the Group.

Turning to the next slide, we will take a look at credit. Credit quality remains strong. The net AQR for 2019 was 29 basis points, this in line with our guidance for the year. It is impacted by two material single name cases as highlighted already at Q2 and then again at Q3. Excluding these, the net AQR remained low and stable.

Looking at the balance sheet, we remain in a prudent and a relatively benign position. Stage 2 and 3 balances are stable versus 2018. Coverage has reduced slightly, mainly driven by write offs of fully provided Commercial assets, movement into Stage 3 of heavily collateralised assets and methodology refinements in the Commercial Banking portfolios.

Looking forward, the underlying credit portfolio remains strong. IFRS 9 may introduce additional volatility, and recent years' benefits from Retail debt sales and Commercial write backs will slow, but we nevertheless continue to expect the net AQR to be less than 30 basis points in 2020.

Turning to the next slide to take a look at the portfolios. Our mortgage portfolio credit quality remains strong. New to arrears are low at around 0.4 per cent and the book has a low average LTV of 44.9 per cent. New business LTV is correspondently also low at 64.3 per cent.

Our legacy mortgages, originated in 2006 to 2008, continue to reduce every year. These fell by 12 per cent in 2019. Although the portfolio is seasoned and performing well, it generates disproportionally large stress losses. With continued reduction in its size, albeit at a gradually slowing pace, the impact on our stress test results will consequently reduce.

Moving to cards, new to arrears in Credit Cards remain modest at around 0.7 per cent and charge-off rates correspondingly are low and stable.

In Motor, we continue to price and reserve prudently. Used car prices softened during the year, but they stabilised during Q4.

And finally, our Commercial book remains high quality and it benefits from diversification, low interest rates and effective risk management. This includes a prudent approach to what we define as vulnerable sectors, with each representing less than 1 per cent of the Group's loans and advances.

Likewise, collateral is an important safeguard. SME lending, which is one of our targeted growth areas, and represents more than 30 per cent of the Commercial portfolio, is largely secured.

The two single name cases we have talked about during the year are not representative of the wider Commercial portfolio. Again, overall credit quality remains strong.

I'll now move to address the below the line items. As I mentioned earlier, statutory profit after tax of £3 billion was down 33 per cent, and as you know impacted by PPI.

Focussing on restructuring for a moment, the charge of £471 million was down 46 per cent on last year, primarily reflecting the completion of the MBNA integration and ring-fencing work. These reductions were partially offset by initial costs relating to the establishment of Schroders Personal Wealth.

Looking forward in 2020, we expect restructuring to be somewhat higher as we continue to transform the business. This will include severance costs, estate rationalisation and regulatory driven costs, for example, the IBOR transition.

You'll note that no further provision for PPI was taken in Q4. We continue to work through the information requests received by the August time bar, we have now reviewed over 60 per cent of the 5 million PIRs. The conversion rate remains low. Indeed, we are comfortable with our 10 per cent assumption and continue to work within our existing provision. We are also pleased to say that the final agreement has now been reached with the Official Receiver and that is included in our provision.

Moving to taxes, the higher effective tax rate of 32 per cent reflects the non-deductible PPI provisions, it is in turn partially offset by the release of a deferred tax liability. We continue to expect a medium-term effective tax rate of around 25 per cent. However in 2020, given the corporate tax rate is likely to remain unchanged, it should be slightly lower, as we see a DTA revaluation of about £300 million coming through.

Looking briefly at returns, as I mentioned earlier, the underlying Return on Tangible Equity in 2019 was strong at 14.8 per cent. The statutory return of 7.8 per cent has clearly been impacted by PPI. Indeed, if you exclude PPI, the statutory RoTE would have been 14.4 per cent, as António said, up just under 1 percentage point from the previous year. I realise that is just a hypothetical number, but it does illustrate the profit generation capacity of the Group as PPI comes to an end.

As we have communicated earlier, we expect the underlying and statutory profits to converge. This convergence will be driven by resilient underlying performance and lower below the line items. In 2020 therefore we expect increased statutory profits and a statutory RoTE of 12 to 13 per cent.

So let's turn to the balance sheet. Group loans and advances stood at £440 billion at the end of the year. We enjoyed some growth in key segments, offset by continued run-off of the closed mortgage book and lower balances in Mid Markets and Global Corporates, as I described earlier. The open mortgage book of £270 billion was ahead of last year, in turn enhanced by the £3.5 billion Tesco book acquisition.

Motor Finance meanwhile increased by £1 billion whilst SME continued to grow ahead of the market.

We maintain our focus on pricing with discipline, particularly in the intermediary mortgage market. Our open mortgage book strategy remains unchanged.

We are very focused on efficient management of the balance sheet. RWAs reduced by £3 billion in the year as we continued to optimise the Commercial Banking portfolio, as I mentioned earlier. This more than offset the impact of IFRS 16 and the Tesco book acquisition together.

Looking forward in 2020, we expect RWAs to be broadly in line with 2019, despite regulatory headwinds. Indeed our estimate of regulatory pressure on RWAs is currently below our initial estimate of £6 to £10 billion in 2020.

And now moving to TNAV. Tangible Net Asset Value per share reduced by 2.2 pence to 50.8 pence in the year. The in-year generation of 1.1 pence, after netting PPI, was more than offset by dividends of 3.3p. As you can see from the quarter on quarter TNAV walk on the lower part of the slide, market movements in the fourth quarter did have a meaningful impact.

And finally, before I conclude with 2020 guidance, we will take a brief look at capital. Organic capital build remains strong with the Group generating 207 basis points of free capital in 2019 before PPI and 86 basis points even after the PPI charge.

The Group's organic capital build in the year was supplemented by 34 basis points from the cancellation of the remaining buyback in the third quarter. Meanwhile, we deployed 9 basis points of capital for the Tesco book acquisition.

The pro forma CET1 ratio therefore ended at 13.8 per cent after the announced final dividend of 2.25 pence per share. The ordinary dividend is equivalent to 123 basis points of capital.

Looking forward, the Group continues to target an ongoing CET1 capital ratio of around 12.5 per cent plus a management buffer of around 1 per cent. For now, given the announced increase in the countercyclical buffer, very likely only partially mitigated by the proposed Pillar 2A offset, both at the end of 2020, we are holding a level slightly above this, finishing 2019 at 13.8 per cent.

From 2021, our current view all else being equal, is for the Pillar 2A to fall further as pension contributions increase. That will enable us to bring capital back towards our target level of circa 13.5 per cent.

The business model, as you know, remains strongly capital generative. In line with our ongoing guidance, we continue to expect free capital build of between 170 to 200 basis points in 2020.

And as António said at the start, the Board will continue to consider potential excess capital repatriation at each year end.

So, turning to 2020 guidance. To recap, in 2019 the Group delivered significant progress against our strategic priorities and generated solid financial returns. As a result, the Board increased our total ordinary dividend to 3.37 pence per share, which is up 5 per cent on 2018.

As António noted in his presentation, we will be moving to quarterly dividends from Q1 onwards, with the first payment being in June.

And looking forward, our 2020 guidance is outlined on the slide to my left. It reflects the health of our business and indeed the confidence that we have in it.

In setting our guidance, we remain focused on delivering our purpose of Helping Britain Prosper whilst building strategic advantage and generating strong and sustainable returns.

This concludes the presentation for today and we are now ready to take your questions. Thank you for listening.

Question and Answer Session

Question 1 – Joe Dickerson, Jefferies
Thank you. It's Joe Dickerson from Jefferies. Just on the outlook for the non interest income. Can you talk about what you are seeing in the Insurance business? Others are talking about a potential hardening of rates in 2020. Are you seeing anything like this or expect anything like this to help drive that business?

And then in terms of the full year on the capital guide, can we expect that you would expect that you would distribute down to that 13.8 per cent level in respect of the full year in terms of excess capital repatriation? Thanks.

António Horta-Osório
Thanks Joe. William shall you take this one?

William Chalmers
Sure. Well maybe just to address the insurance point first. Just to give some background on what is going on in the insurance business because it is important context really. We see 2019 performance as being a year of investment in the business. It was partly influenced in the first half by the change in investment manager and by the longevity benefits that we got. But it was also characterised by building the business across all lines really, auto-enrolment being one, annuities being the second. As we go into the second half, those benefits from change in investment management provider and the longevity benefit drop out and the underlying business starts to perform.

So looking forward into 2020 there is a number of factors going on. One is the change in investment management provider and the longevity benefit are unlikely to repeat. But having said that, the engines of the business including in annuities for example, including in protection for example, start to take over. There are, within that also, some cost benefits which should be coming through probably in the second half of the year and that also will help build the insurance contribution through the other income line.

In terms of the specifics of your rate hardening, to a degree, I am not sure if that is particularly general insurance related question, I imagine it is, to a degree, but I don't think we are relying upon them for the performance in the insurance business during the course of 2020.

The capital question. We have taken a deliberately prudent stance in relation to capital. We have obviously observed the countercyclical buffer change, we have observed what we think is very likely the partial mitigation through Pillar 2A. We have a view on what will happen to capital requirements in the years thereafter as António and I articulated in our message. It is the case that we have the benefit of being at 13.8 per cent now and therefore have anticipated the change in the countercyclical buffer mitigated partly by Pillar 2A and therefore in theory the build that we enjoy through the course of 2020, the 170 to 200 basis points that I mentioned in the speech, in theory is distributable capital. But that will be a matter for the Board at the end of 2020 to decide what the capital repatriation policy should be.

Question 2 – Rohith Chandra-Rajan, BAML

Thank you. Good morning, Rohith Chandra-Rajan from Bank of America. I have a couple of questions on net interest income please. The NIM guidance for this year. So your exit run-rate is 281 basis points. So the guidance for 275 to 280 basis points is pretty resilient on that exit position. I was just wondering if you could talk through some specific areas. So you talked a little bit about the hedge, so what is the impact of the reinvestment that you have done in Q4 and also an expectation that the 5 year swap is slightly above current levels. So you were previously guiding for £250 million headwind from the hedge this year, how has that changed? And also any guidance on the impact in 2021?

The second thing is the SVR book fell by £12 billion in the year. What impact does that have and what pace of attrition do you see going forward?

And then finally on the NIM, the repositioning of the commercial book, what impact does that have in the year? And I guess well it is those three potential headwinds, where do you see the offsets?

And the second was just a clarification on the Balance Sheet. You talked about flat interest earning assets, is that flat on the Q4 number of £437 billion or the full year number of £435 billion and how do you see the balance sheet mix of the loan book mix evolving over the course of the year? Thank you.

William Chalmers

Thank you first of all for the questions Rohith. Maybe I will start with the Net Interest Margins and give you some sense of the dynamics going on there. When we look at the Net Interest Margin there are a number of features, a number of factors going on. One is as you say, the structural hedge and the replacement of the structural hedge balances that roll off during the course of 2020. Two is what is happening in our major product markets, mortgages obviously being a big one, but also what we are doing in unsecured and what we are doing in Motor. Furthermore there is also the dynamic introduced by the corporate optimisation, Commercial Banking optimisation that I described earlier on. Savings on the other side, the liability side of the balance sheet and then your question was as to our sensitivities to market rates.

So those are the dynamics. To give you some context and colour around them, in terms of our guidance, we see about £200 million less structural hedge income in 2020 versus 2019. That has been factored into our guidance of 275 to 280 basis points. In terms of the mortgage picture, there are two features going on and Vim will want to comment I am sure on the SVR point which I will get to in a second. There are two features going on principally. One is we are seeing a much more benign front end pricing environment now to what we were seeing this time twelve months ago. Which means that as we roll off our fixed mortgage book, it is rolling on to more attractive rates. That differential is favourable, it is positive today versus negative as it was 12 months ago.

When we then look at what else is going on in the balance sheet, there is a bit of a mix effect. It is modest to be honest, but there is a bit of a mix effect in terms of unsecured and Motor. There is a little bit of growth there as I have pointed out historically and looking forward. And then our Commercial optimisation, it is very much about addressing the low yielding relationships and that comes through in part in Net Interest Margin. And again feeds through into the guidance we have given.

And then finally your question on sensitivity. There is not a huge differential between 75 basis points versus where the five year swap curve is today, it is about 10 basis points I think off the back of last night's pricing. If we were to take a more market aligned scenario into account, we would think that shaves off a couple of basis points in terms of our view on the NIM which puts us in turn at the lower end of our guidance. So still within guidance, but at the lower end of our guidance and that is the cumulative effect of the introduced part of the structural hedge coming in at slightly lower levels than we anticipated in our 75 basis points. Plus the absence of a base rate rise. That cumulative effect shaves off a couple of basis points and shifts us towards the lower end of our guidance.

António Horta-Osório
Before Vim goes to SVR, do you want to comment which was the basis for the AIEAs?

William Chambers
Yes, I think he mentioned, it's £435 billion.

Vim Maru
Just to add to William's point. I guess just on the mortgage side growth, I mean three key elements that matter. One is where the reversionary book goes so that's your question in terms of attrition, that has been stable in the second half of the year and that is obviously on a smaller base as that keeps coming down, so that is stable. Then retention of customers, that is also stable during the course of the year which is good news. And then as William called out, the new business margins that we are seeing right now in the market are looking better than maturing margins at the moment and therefore we get a carry there which we have started to see that happen in the final quarter of the year and that is obviously a positive in terms of what we see coming into this year.

António Horta-Osório
Thank you.

Question 3 – Guy Stebbings, Exane BNP
Morning, Guy Stebbings from Exane BNP Paribas. Can I come back to the other income line and insurance first of all. You referenced the strong benefit from auto-enrolment rates picking up coming through on the Workplace Planning & Retirement income. My understanding is given the embedded value accounting approach without another step up in auto-enrolment rates, that line goes backwards in 2020. So if you could confirm whether that is true or not?

And also you referenced strong general insurance. Presumably the run-offs in the St Andrew's book becomes a headwind there? So you put that together with some headwinds on regulatory changes for other income line with some of your peers giving guidance around the overdraft fee changes for instance and High Cost of Credit. I am just trying to gauge whether £5.7 billion is a sensible run-rate or the H2 £5.1 billion to £5.2 billion is more like where we are going to end up for the full year?

And then I just have a quick second question on current account growth which has obviously been very strong in helping the growth in the structural hedge. If we look at the current account switching data it tends to be quite negative over the last few quarters for Lloyds. So I am just trying to understand the very strong data that you are reporting for current account growth and how we reconcile that with the current account switching data? Thanks.

António Horta-Osório
Okay. So William will take the first and Vim will speak to you about the second.

William Chalmers
Well thanks for the question Guy. On the insurance topic, you are right, auto-enrolment is effectively embedded value accounted. The step-up that we saw in 2019 was in part a function of the contributions step-up. We do ultimately expect that to be insufficient and there will in turn be a further step-up but I very much doubt it will be 2020. So as a result what you see in auto-enrolment is an ongoing business which is again one we very strongly believe in and will continue to invest in. But you will see it slightly dip or

slightly lower in 2020 that piece of the business versus 2019 simply by virtue of that accounting. But again I want to underline it is a business that we strongly believe in and will continue to invest in and we see that as a going forward point.

The GI point there are a number of factors going on within GI both as to premiums and growth of the business, the opportunities that we see around the business. I wouldn't identify St Andrews as a, I mean to a degree it is relevant, but I would not identify it as a particularly strong issue in the overall profile of the GI business that we are in the process of building right now. There will be other factors that will be far more important.

The regulatory changes, you mentioned High Cost of Credit, in particular the overdraft pricing issue. We are not going to put a number on the overdraft issue. Most of the overdraft issue is in the Net Interest Margin line, not in the other income line. Much of the overdraft issue has been to a degree contemplated and anticipated by some of the product changes that Vim can talk about that we have introduced in the years prior to today. So some of the pressure from that overdraft change has been pre-empted by some of the moves in the product line that as I say precede 2020. So that particular issue is unlikely to change the other income line. I think your point more broadly on regulatory pressures and are they exerting pressure on the business, for sure, they are there. The business that we have I think is a very successful business model that will succeed no matter what, but the regulatory pressures for sure they exerted to put pressure on the income.

António Horta-Osório
Vim would you like just to add something?

Vim Maru
So I will add two things. I will finish the overdraft point and then I will talk about switchers. So as William says, we eliminated unarranged overdrafts and returned item fees two years ago. So in effect the change that we have got to make now is different to what most of the industry is having to go through. And therefore we are not specifically calling that out this time around and it is all embedded into William's margin guidance. So I think that is probably just worth re-iterating and also I think from an OOI perspective it is not in there because we made the change already a couple of years ago. And as we said in the market as well, 90 per cent of customers will be better off so that will be a headwind, but as I say that is in the guidance.

And then on switchers I think I tried to allude to this in the presentation as well it is really important for us to focus on existing customers as well as new customers. And you have seen the data in terms of existing customers, what we are seeing in terms of growth of balances from those existing customers. We are also seeing as you have seen, 9 per cent growth over a period of current account customers too. It doesn't have to come through the switching service for us to book new current accounts. And then when you look at the switching out data and what we can see, what we see in the switching out data, the quality of where the growth is coming in, the switching out data is pretty low and that is why you are not seeing that impact our business in the way you might think it does.

António Horta-Osório
So we are growing with segmenting our personal business and we have key segments where we want to grow. And we came to the conclusion just to build on what Vim says that for example, the Halifax switch offer that we were giving to customers was quite indiscriminative and it did not attract the right customers that we wanted to attract. So it is an example of what you now see. So we are very pleased about how our attraction of the right current accounts is going. And I think that is highly demonstrated by the fact that our PCA balances, continue to increase above the markets and significantly 11 per cent versus 7 per cent since the beginning of GSR3 and we could go to a much longer time zone that really demonstrates the high quality of those current account balances. Those are stable balances not driven by price, but by trust and convenience and they have the additional advantage that given they are stable they have the higher yield because they are invested on average on four years maturity which we now have shortened because of the yield curve being flattened. So you have to look at the evolution of current account sales in the market with that perspective. And also with the fact that current accounts are free so you can have as many as you want. The question is which one is your primary bank account. That can only be measured by the current account balances.

William Chalmers
Just before we leave your question there, I think there was one aspect that we didn't adequately address which is on whether you should annualise the Q4 point. So perhaps just to give some response to that. I think I mentioned some points in my speech which ended with you should not annualise the Q4 other income print. To just give it some context and reasoning behind that. When we go through the business lines we look at Commercial Banking for example and there will be a couple of variances in Commercial

Banking. One is for sure the market dependency and if you see a market that comes back to life you will see a lot more activity in the commercial banking market. Equally if you don't the second prong, our second strand to the Commercial Banking business is around the cash management part. That has been an area of substantial investment for the Group over the last couple of years. We now have a platform which has successfully been rolled out and delivered to a number of clients. So that is a strand which is much less market dependent. It is therefore a more reliable indicator of commercial bank activity as it will build into the second half of 2020.

If you look at Insurance, there are a number of areas in Insurance. Again it is not going to repeat the more one-off natures as I mentioned in the first half. But you see some underlying build in annuities for example. You see some underlying build in the protection products for example. There is as I mentioned in the second half of 2020, some cost benefits that we are expecting which will come in through the other income lines simply because of the way in which insurance is accounted in our business.

You look in turn at the retail banking business. There is a transition in customer behaviour going on in the payments area. And so as they move away from cash and towards cards we expect better payments revenues off the back of that. These factors allow us to build into 2020 in the other income line. So what it means I think is that we see other income which is going to be gradual number one. Number two, it is going to be back ended. Number three, to a degree at least some aspects of it will be market depended too. But it will be very disappointing to see Q4 annualised. We do not believe that Q4 should be annualised.

Question 4 – Aman Rakkar, Barclays Capital

Morning William, morning António, morning Vim. It is Aman Rakkar from Barclays. I have two questions. One on the Net Interest Margin. Can I just clarify your comment earlier, you were saying if you updated your Net Interest Margin for a 75 basis point five year swap you would come in at the lower end of the guidance you had given at 275 basis points to 280 basis points. And you mentioned that that basically captures the fact that you are also not getting a base rate hike. What happens if we actually get a base rate cut as when I look at forward curves, it looks like there is an increasing chance of a cut. Is that an incremental risk of you basically coming in below 275 basis points next year? And I guess part of the answer to that will be dependent on deposit beaters. Do you think you can basically absorb the majority of a base rate cut in terms of your customer margin? That is question one.

And the second was regarding CET1. So the messaging around capital seems quite positive. I was wondering are you able to provide any guidance on Basel IV, either in terms of the impact on your business when it would come in and a view as to whether it will be implemented on 1 January 2022?

William Chalmers

If I take each of those three Aman. The first point I should clarify if it was not clear enough. Our guidance is based upon 75 basis points in year, five years swap rate on average through 2020. So that is the basis for our guidance. The market rate for the five year swap rate is circa 65 to 66 basis points right now, a difference of about 10. If we get that market rate, aligned with the absence of a base rate rise in the back end of 2020, the impact of that is a couple of basis points. We see that as being within our 275 to 280 basis points margin guidance. It just puts us towards the lower end. So that is the first point.

The second point, you said what if there is a cut? I think there is a couple of points to make around that. Clearly a cut is not what we envision. We think as António mentioned, we anticipate a significant physical stimulus which in turn changes the monetary outlook and that is the reason why our scenario is as it is. But should we get a cut, there is a couple of points to make there. One is that a base rate change of that type allows a degree of friction within the overall product base which means that you can recoup some of the issue there. The second is in the context of a base rate cut you may very well see a widening gap between the swap rate and the rate at which the mortgages are being sold. And so you may see some widening in the margins off the back of that which effectively is similar to what you are seeing now frankly. In that context we would expect to see some recompense or some benefit from a more benign margin pricing environment which in turn would help us build margin and indeed to a degree the volumes of the business. So that is the second point.

António Horta-Osório

In any case just for you to have clarity on this. In terms of our base rate rise expectation, it is back-ended. So it does not really impact until the NIM of the year, just for you to have that clear on our plan.

William Chalmers

I think to move onto your core tier 1 question, the Basel point. Basel IV is obviously something that we are keeping a close eye on. We are at the moment in a situation with some uncertainty about what the authorities choose to enact in terms of Basel IV. We are also in a state of uncertainty about how the PRA might choose to incorporate that or adopt that. And indeed what mitigation might be possible around the Basel IV set of rules, whatever they might be. And so we have stepped back from giving guidance on Basel IV partly because right now we are simply giving guidance on 2020. But also because frankly the uncertainties around Basel IV are still very considerable and so we are reluctant to start giving guidance which in turn may well be wrong.

Aman Rakkar

Sorry just one follow-on if I am allowed. So potentially this time next year you could end the year with 13.8 per cent CET1 ratio, pretty decent visibility about Pillar 2A coming down such that 13.5 is the right number for you. So you know is Basel IV enough of a risk on the horizon such that you wouldn't pay down to 13.5 during the course of 2021?

António Horta-Osório

Our positioning, that is very simple it is unchanged. So we have an ongoing capital guidance of around 13.5 per cent and if at the end of the year when the Board decides, if the Board would decide not to pay down to 13.5, there would have to be a significant reason which we will have to explain to you. So exactly as in previous years, that is the policy. We come to the end of the year and the Board decides with information available then, our guidance is 13.5. Should we not go to 13.5, we would have to explain to you why as we told you this year. At the end of the year we prudently hold already the 30 basis points that we see this year which will then come down next year. So the Board has always the same policy, at the end of the year with the information available then would decide on dividends and on repatriation on excess capital. And the usual practice is the same, we would distribute down to the target. If we don't we would have to explain why.

Question 5 – Andrew Coombs, Citi

Good morning, it's Andrew Coombs from Citi. If I could just stay on capital and the capital stack. You have been very transparent on your thoughts on countercyclical the 2A offset. I think the remaining question that hasn't been asked is around the impact from the Bank of England stress test and the implications of your PRA buffer. On the basis that you haven't changed your 1 per cent headroom above the 12.5 per cent, should we assume that when you look at the stress tests in co-ordination with your internal stress tests, the 2B has not changed?

And the second question, could you just elaborate now with the benefit of hindsight on the stress test and with time passed, why was there such a leg-up in your losses for the consumer book under stress in the Bank of England stress test?

António Horta-Osório

Thank you Andrew, William will take your questions.

William Chalmers

First of all you would not expect me to and I am not going to comment on Pillar 2B, it is a matter for the PRA.

The second point in terms of the stress test results, the stress test results are first of all characterised by us passing. We in fact passed by a higher hurdle to the relevant CET1 requirement than we did the year before. So I think it is important to characterise it in that way before we begin. Why was it a relatively significant draw down? A couple of reasons. I think one is given we are a retail business, as you know IFRS 9 hits us probably harder than a commercial business or corporate business and that is simply because of the perfect foresight that is going on in the stress test bringing losses forward. Two, it is a very UK focused stress. Three, conduct has been a feature unfortunately of our results for some time and it also featured in the stress test. As we roll forward we very much hope that conduct will come down and hence our illustrations today of numbers if you exclude PPI charges. But that we hope will be a lesser issue in stress tests moving forward than it has been historically.

And then to your particular point within the Retail book what is causing a bit of stress, it is the mortgage portfolio in particular that I mentioned on the slide up there earlier on which to say the 2006 to 2008 mortgage portfolio is a mortgage portfolio that incurs higher stress losses. Now as we see it, it is a well performing book that is well seasoned and we feel very comfortable with it. But when you run it though the stress, particularly the PRA generated stress, it is generating significant stress losses.

Andrew Coombs

Okay, if I could perhaps come back to the first question and phrase it slightly differently. Your 1 per cent management buffer that you incorporate, what are the inputs into that 1 per cent? What makes you feel comfortable that 1 per cent is the right number?

António Horta-Osório

Andrew as William said, we can't really comment on the PRA buffer, like any other bank we cannot comment on PRA buffer. But given that you saw that we kept exactly the same capital guidance of capital requirements around 12.5 per cent and the management buffer of around 1 per cent. If you do the maths I think that is quite helpful.

Andrew Coombs

Understood.

Question 6 – Raul Sinha, JP Morgan

Good morning, it's Raul Sinha from JP Morgan. The first one is on the comment around the outlook slightly starting to improve for the UK. You have probably got the best insight of all the banks, given your current account share into what is going on on the ground. So just to understand a little bit more, what are you seeing?

And then secondly, trying to marry that with your flat balance sheet guidance on average assets because I think you also said pricing has improved. So if I take that along with the fact that you have seen some signs of recovery, why are you not being more positive on the asset growth aspiration for this?

And I have got a second one, I don't know if you want me to wait?

António Horta-Osório

Why don't you say the second one?

Raul Sinha

So the second one is on the head office which is quite big in the context of the Group. Well the £26 billion of RWAs and it makes £800 million of profits. LDC is within that and HSBC yesterday said that they are going to close their principle finance business because of the peak to trough losses in the stress test and I was wondering if you have got any thoughts about whether or not this is also one of the areas which is causing your volatility in the stress test performance? The Head Office, how should we think about the outlook for the profitability for that and the RWAs? Thank you.

António Horta-Osório

Thank you. Look you are absolutely right. I mean we are the largest retail and commercial bank in the UK and throughout the country. And so I think we have quite important information available as leading indicators. And what we see is actually quite a clear picture which is coming into December, and we have discussed this in previous presentations, you have seen a resilient household sector built on rising real wages and continued rising employment and households are supporting consumption which is more than two-thirds of the economy. But you are seeing a decline on business confidence that sooner or later if continued would not only damage the investment but employment and would affect the rest of the economy.

So what happens with the election as I said in my remarks, where you have a clear Government with a clear majority, you now have in our opinion a much clearer sense of direction. And in line with that, what we are seeing is the following. Real wages, we just had the final numbers. The highest in the last few years to the average of the three months. So real wages continue to grow at around 2 per cent. This is compounded by another record employment number.

You see house prices with early signs of recovery for two months in a row and much broader number of transactions, much bigger number of transactions and this is throughout the country. This is not only London and south-east. Consumer confidence levels that several surveys have published have also improved.

And on the business side where the problem was, you have seen a significant pick-up in confidence. We see that throughout the country as well in our contacts with our customers which should lead over time to more investment which is positive.

Finally, on the positive side, we clearly expect a significant fiscal stimulus on infrastructure projects from the Government in the Budget which should change as William said, the relative stances of monetary versus fiscal policies.

So what do you have on the negative side? You still have significant uncertainty as I also said on the trade deal with the EU in particular, but also with the other main geographic regions so that also still has some uncertainty. And obviously we should not underplay whatever the impact of the coronavirus might be in terms of supply chains on one hand and trade. And on the other hand on consumption of China which is the largest part of the world GDP growth every year. So those are the negatives. My view as I see the economy at this moment in the UK, is this all taken together is positive.

So your question then is why are you not increasing assets as a consequence and also given what we are seeing on mortgage prices? Well depends on the segments. We are absolutely minded to continue to grow on our key target segments as I mentioned in my presentation. So in terms of car finance, we have a 15 per cent market share but that is lower than our overall 18 per cent market share. We intend to continue to grow there. In SMEs we have constantly grown above the market, in mortgages the margins have continued to improve as Vim says, and this has been back-ended in Q4 and into Q1, our January performance is better than what we expected. So you should expect us to act accordingly. But as William also said, and I mentioned as well, we are continuing on the large corporate space, we are continuing to optimise the portfolio in the sense of some products and relationships where we have sub - cost of equity returns. And as you saw, the commercial bank has been as a consequence a big contributor to the cash flow to the free capital that we release every year. And that should continue.

So our guidance for the moment although stable has these two differences between large corporates and our target segments which link to the guidance and that squares the two parts of your question.

Vim Maru
And maybe if I just add one thing, just on the mortgage market, the beauty of our intermediary channel strategy is that it is not fixed, it is a triangle that we are looking at and if things look better we will do more as we did in the second half.

William Chalmers
Raul I will get to your Group centre question in a second, I will simply add one point to the comments there of António and Vim which is because of this optimisation exercise in the commercial business it is not a static balance sheet. We are getting out of some exposures simply because the relationships are not yielding what we would like to see. But we are going into others. And so don't think of it as just a static set of relationships, it is actually one that is turning and changing all through the year.

On the Head Office point, the central piece is made up of a number of different blocks. The LDC component is one of them. Treasury and gilt sales for example is another. I think I mentioned in my comments that we expect to see that down during the course, the gilt sales piece I mean, during the course of 2020. We hope that we will see some improvement actually in LDC, so there will be some offsetting factors there. And then the third element in central is composed in part of transfer pricing relationships and how we price and set the business up. And that is a picture which is not really dependent upon external market conditions so much as dependent upon the internal choices that we make as to how we establish and run the business.

Question 7 – James Invine, Soc Gen
Thanks, good morning. It's James Invine here from Soc Gen. William you talked about the Pillar 2A coming down with the pension contributions. I was just wondering if you could tell us please what the gearing is on that? So for every £100 million that goes in what happens to the Pillar 2A?

The second question I guess is just to confirm that within your ongoing 170-200 basis point guidance you have included the current existing plan that you have agreed with the trustees, so you are not assuming any renegotiation?

And then the third is I was just wondering if you could give us a view on where the deficit stands today versus the £6 billion schedule payments that you have got? Thanks.

William Chalmers
On the pensions relationship, the trustee contribution point that you made, we are about to undertake a next revaluation and pension contributions discussion with the trustees. That will be effectively with a date of the end of 2019 and then negotiation will proceed during the course of 2020 with the expectation that we will wrap it up at the back end of 2020 which then establishes our

contributions going forward. So the contributions for 2020 will be as planned. The contributions thereafter will be a function of that discussion that we have with the trustee which will be subject to the normal inputs into that conversation.

Now just give me your first and third question again?

James Invine
So the money that goes into the pension fund, what is the gearing? What do you get back on your Pillar 2A?

António Horta-Osório
So the Pillar 2A, what is the contributions, what is the impact of the pension contributions?

William Chalmers
Yeah, that is probably something which I won't talk about publically because it is really a matter between us and the PRA as to the extent to which they see Pillar 2A benefits from pension contributions. Safe to say that a component of the Pillar 2A is to accommodate a pension stress. And so logically the amount of capital that you need for that stress should go down as the pension fund gets better funded. So you can see the correlation there. I won't go into the particularities of the said maths as the offset.

James Invine
Okay and then do you have a view on how big the deficit is at the moment?

William Chalmers
It is in line with our expectations based on obviously the disclosure as to the accounting and the liability less the contributions as we had anticipated before.

James Invine
Thanks.

Question 8 – Chris Cant, Autonomous
Good morning, it's Chris Cant from Autonomous. Thank you for taking my question. If I could ask on your RoTE guidance please. You have cut the guidance for 2020 to 12 to 13 per cent and I understand you are still adding back the amortisation costs within that. In 2019 the amortisation add back was worth about 120 basis points on your reported return. But obviously your EPS figures include those costs as do most peers in their calculations. So if I take your guided range of 12-13 per cent, knock off 120 basis points, multiply through by the 50.8 pence of TNAV you have just reported, that implied statutory earnings for 2020 of 5.5 to 6 pence. Am I missing anything in the maths there?

And when I look at consensus of 6.5 pence of earnings for next year, given everything you have said it does feel like that other income number is going to come down quite a lot if that is the EPS number you are pointing us to given the rest of your guidance on provisions and NIM. Thank you.

William Chalmers
Thanks for the question Chris. I am going to answer that in parts because what I don't want to do is give you guidance on any particular EPS number you may be arriving at. The first of those two parts, the RoTE calculation, you are right, the amortisation point is in the RoTE, I see it more generally as about 100 basis points. But you are absolutely right, it is there. We have thought about that and I think to the extent that we have taken into account any adjustments that we do are more likely to be off the back of GSR4, rather than right now. So the point is, certainly cognisant of the point but it is going to be addressed in GSR4 and not today.

As to your calculations, it may be worth you just running with Douglas around the calculations that you have and he can give you some guidance. But again I would hesitate before being too precise about confirming any particular EPS outcome that you are coming out with.

On the other income point, I think I would come back to the discussion we had earlier on around what is going on in the other income lines. And the strands there really just to briefly recapitulate, we are seeing in each of our business lines clearly a degree of pressure but also a degree of opportunity as to each of them. Going through them very briefly, Commercial Banking I mentioned a few strands earlier to a degree about markets activity, but also to a degree about transaction banking or cash management I should say.

Within Insurance, we see the advancement in annuities; both bulk and individual, we see the advances in protection. We see some cost benefits that don't get locked in until the second half. And in Retail as said, as payment practices change so will payment revenues.

So there is then the central item which I mentioned earlier on I think, is going to see less of gilts income, hopefully a little bit of improved performance off the back of LDC. You add all of that together, I am not going to give you any other income guidance number because we don't but it is firmly encapsulated within the overall P&L guidance that we are giving you, including the RoTE of 12–13 per cent.

Chris Cant
If I could just follow-up briefly. In terms of bridging from your guided statutory RoTE target to an EPS number, I appreciate you don't want to give a figure. But if I ask it slightly differently. The TNAV number of 50.8 pence for the full year, your around the level you say you need in terms of CET1, you are going to be doing quarterly dividends during the course of 2020 which will avoid any meaningful build I guess in TNAV during the course of the year because you are distributing on a more regular basis. So that does appear to be kind of your base jumping off point for the 12 to 13. So is there a bigger range of uncertainty around your statutory RoTE guidance or can we use that in the maths? Because you have given us the 12 to 13.

William Chalmers
No I don't think so. I would hesitate before reading too much into your dividend point there Chris. I mean the dividend as you say may get distributed more often. On the other hand it does not change the total distribution number one, but also number two, the cash sits in the balance sheet and therefore contributes to TNAV for quite a long period. You only actually hit the targets or only make the distribution at the point of distribution. You may accrue for it earlier on but it is still in the TNAV.

António Horta-Osório
And I think Chris another point that obviously you have to consider is that if you look at the TNAV evolution, I think, the impact of PPI on TNAV was higher than the dividends distributed and PPI as we just said is about over so that is another point I think increases TNAV throughout the year.

Chris Cant
Okay, thank you.

Question 9 – Fahed Kunwar, Redburn
Hi it's Fahed Kunwar from Redburn. Just a couple of questions. The first one is on restructuring charges. So I think going forward you are looking at a restructuring charge in excess of the £471 million that you booked for this year in 2020. A lot of the UK banks, a lot of the banks have come out with restructuring charges that have been higher than expected. So I have got the kind of sense from the presentation that there is more to come on the cost base. Should we expect kind of permanently higher restructuring charges on the back of that as well if we are to assume that costs keep coming down? That is question one.

And question two is on capital distribution. So I think we can all do the maths that you have excess capital in 2020, you are trading at 1.1 times price to book, your revenue lines going backwards. Any growth you have had over the last couple of years has come from inorganic acquisitions on NII, MBNA and Tesco. Would you consider more inorganic purchases and how do you think of that in terms of buying loan books versus buying stuff to help your wealth business, your insurance business and that struggling OOI line? Thanks.

António Horta-Osório
Just to start with your final question and then William can elaborate and answer the first one as well. Our strategy is exactly the same. Within our positioning if there are loan books that fit our positioning with our type of customers we would consider them. We are not considering anything significant at the time as we speak, but we will continue with the policy that we have followed in the past. If there are loan books like Tesco or like others that fit within our positioning and have interesting customer segments at

attractive returns for our shareholders, you should expect us to look at all of those and potentially we could acquire some. I mean this is completely the repetition of the policy because as I said we don't have anything at the moment that we are looking at.

Fahed Kunwar

Can I ask one follow-up question to that? Is there a regulatory burden on how much you can increase that loan book by because of your size in the UK? And would that incentivise you to look outside of your loan book to other parts of your business?

António Horta-Osório

No I don't think so. We pay particular attention to our market share in terms of current accounts where we showed you our current account market, so balances around 22 per cent. But in terms of loan books we are below that so don't think there is any special constraint. It will be a matter of targets, segments to the right customers and attractive economics for shareholders as I think the past transactions show.

William Chalmers

You had a question on restructuring charges as well Fahed which perhaps I will answer. The restructuring charges I mentioned for 2020, we expect to be somewhat higher than it was in 2019. 2019 saw the run-off of a couple of programmes, ring-fencing and MBNA among them. 2020 is going to see one or two factors going the other way. I mentioned increased severance. I mentioned property, portfolio rationalisation. I mentioned response to regulatory change, in particular IBOR. Those are features, there are other bits and pieces in that overall restructuring picture but those are three significant ones that are important to point out.

Your question, is that going to be an ongoing feature of the business. It is an interesting question because the restructuring line is a response to what is going on in the world around us. And so in a sense the question has to depend upon a point of view as to regulatory change, how often are we going to see IBOR type shifts for example. It is a question that relates to how is technology going to change? How often are we going to see movements to Cloud off the back of legacy systems? It is a function of those types of issues, and if you have a view the regulatory change is hopefully going to be slightly less prevalent looking forward than it has been in the past, then in turn we should see our restructuring charge benefit off of that as we go forward. Having said that, as you know, we are in an environment of rapid technology change right now and restructuring charges in part are a response to that. I don't expect that to slow down any time soon.

Question 10 – Fahad Changazi, Mediobanca

Good morning, it's Fahad Changazi from Mediobanca. A couple of quick questions. Firstly just on Solvency 2, you got 170 per cent pre dividend on Solvency 2, can you just confirm that you are happy with this level and you are happy with the leverage after repayment of the loan last year and consequently £500 million of dividend?

Second question, you accelerated the bulks in H2, there is some seasonality in that, but I remember in Q3 you mentioned the sourcing of assets and the yield on those assets and Vim mentioned that now you are going to Lifetime Mortgages. So I was wondering, could we expect at least £2 billion of bulks each year the way that is going?

Can I just confirm William that you did say we can expect zero longevity releases in 2020?

And just very finally, the longevity swap you did with the pension the £10 billion, will that have any tangible impact on the Pillar 2A?

William Chalmers

Thanks Fahad for those questions; they are all important ones. Solvency 2, yes we are happy with where we are on Solvency 2. There are as you know a number of kind of counterbalancing factors that go on into that. At the moment we are in a low interest rate environment. Low interest rate environments are not especially helpful from an insurance capital point of view. They increase the LCR, they increase the risk margin, but so far we are managing with that and we expect to manage with that during the course of 2020. So we feel good about the capital position and we feel good about the dividends during the course of 2020 coming off the back of the insurance company.

Second question, bulks. You are right, it has been an area of increased focus and attention from us. It is an area that it is not only us that are competing in that field and so there is a relatively competitive landscape in terms of sourcing assets. To a degree we should be able to source some assets from within the banking business that we run, that in turn affords us propriety opportunities. Now we need to be very mindful of a) the arm's length nature of those transactions and b) concentration risks, but subject to those caveats it is one of the benefits of being a combined Group. So I think the asset picture is as a whole, the competitive picture for sure. We should enjoy some competitive advantage there.

The yield point. You are right. I would say the bigger challenge to the pricing around bulks right now is more actually subject to the low interest rate pressures that we see rather than necessarily the competitive environment, the challenge being that in a low interest rate environment, the pricing that you can offer on a bulk is just inherently less attractive to a client. That I think is a more important factor for now. Hopefully we'll emerge out of that over the course of the year.

The annuities that I would go beyond bulks a little bit when we talk about our annuity strategy as I would also want to point out the individual annuities aspect to it and António mentioned it in his speech with respect to the opening up of the individual annuities platform that we have. That is an important engine of the business and it is an important engine in 2020 of the business.

You then asked about longevity releases, we had a big longevity release in the context of 2019 as you know. I wouldn't rule it out for 2020 but I wouldn't expect it to be of the order of magnitude that we saw in 2019. If we do get it I think the other point that is worth making, if we do get it, it is likely to be back end second half of 2020 and not front end as it was in the course of 2019.

And then finally, longevity swap, in a way I am glad that you brought that up because the longevity swap is quite a good example of the Pillar 2A analysis debate. We have a few risks in the pension fund. We have hedged and eliminated most of them. Longevity is one of those that was outstanding. By taking out the longevity swap we have effectively addressed part of that risk. We haven't done the whole pension population, I think about half the pension population is covered by that £10 billion swap that we did. Part of the reason that we did it, and ultimately this is going to be up to the PRA and not up to us, but part of reason why we did this was because it removes or reduces the stress of the pension fund and adverse in longevity environment. And that in turn should allow us to get some Pillar 2A benefits off the back of it. That is for discussion between us and the PRA about the quantum of those benefits but that is certainly part of the objective.

Question 11 – Claire Kane, Credit Suisse
Hi, it's Claire Kane from Credit Suisse. A couple of questions please. The RWA optimisation, how much of that strategy is driven by trying to improve stress test performance? I know you say you had an improved stress test performance last year in terms of the hurdle rate, but you are now going to the next one 100 basis points lower and effectively wiping out all of that hurdle. You mentioned you should have an improvement from the run-off of the legacy mortgage book, hopefully lower conduct, how aligned are you on decreasing risk in Mid and Global corporates to help with that?

And could you just comment on the differential on margin between back business and new mortgage business because I guess that is where the new growth is coming from?

And then my second question is on the capital generation guidance, 170 to 200 basis points. Could you tell us how much you have pencilled in there for the £800 million of pension contributions because clearly that is gross 40 basis points, but you have visibility on which schemes are in surplus so perhaps it is not quite as large as 40 basis points?

And then on the insurance dividend, you said you feel good about the outlook there. So are you assuming you have an increased insurance dividend for capital generation purposes next year? Thanks.

António Horta-Osório
Thank you Claire. William will take your questions.

William Chalmers
Thanks Claire. RWA optimisation first of all. It is not inspired by the stress test. The RWA optimisation is about improving the returns of our commercial business. If you look at the returns within our business and the capital allocation against them, it has been the case that Retail has been a relatively positive return and that Commercial has been positive, but has been less positive versus the Retail business. And we would like to correct that balance over time.

The testimony to that in a sense is the fact that much of the Commercial optimisation exercise is actually going on at the better end of the credit spectrum. So it is not involving the relationships that would typically contribute to stress losses if you were to have an adverse macro-economic environment. That is where we see some of the weaker returns and that is where we see the optimisation opportunity being better for the Group.

The third of your questions around Insurance dividend. The Insurance dividend typically contributes around 13-ish basis points of capital to the Group. We have two ways of looking at it. We have a run-rate dividend that comes off of the Insurance business based upon the performance of the Insurance business and obviously subject to that Insurance Board's okay on that. And then we have capital management activities undertaken within the Insurance business for any given issue. For example we put an equity hedge on it during the course of 2019. Then that in turn reduces the requirement for capital in the Insurance business which then generates an additional opportunity for capital repatriation for want of a better word from the insurance company to the Group. And so we see the dividend in two pieces in that respect, the ongoing business and the capital actions piece. 2020 we have in our pro-forma numbers actually, end of 2019 we have included the business as usual dividend. And then over the course of 2020 we will obviously see how the progress of the business matches up to see what the dividends will be at that time.

Claire Kane
Sorry I did ask about how much the pension contribution would take a hit because £800 million gross is not going to fully come off the CET1 given that some of the schemes are not all in surplus. So the pension contribution, what do you factor in, is it not 40 basis points, is it less than 40 basis points?

William Chalmers
Claire can we take that one separate with the IR Team, simply because it is perhaps a question that would be better answered by them. I would say most of the schemes, one or two of them are close to the edge for sure, but most of the schemes are in surplus. And those that are not in surplus are only just. So there is not too much of an issue that you are describing. But again maybe we will get the question answered in more detailed by the IR Team.

António Horta-Osório
Right, we will take one final question, we are a bit over time. We will take the last two then.

Question 12 – Martin Leitgeb, Goldman Sachs
Thank you, Martin Leitgeb from Goldman Sachs. Could I ask on competition in mortgages, I was just wondering if you could comment on how you have seen competition in mortgages evolving through the year? And a number of your peers have essentially indicated that they would like to grow above their current stock share going forward. I was just wondering how that might be evolving?

And the second question just on the TFS, so obviously there is the first meaningful maturities coming towards the end of the year. I was just wondering how you think this will impact deposits pricing here and whether you think there will be any spill over in terms of asset pricing given obviously a reduced amount of funding being available? Thank you.

António Horta-Osório
Okay, we broadly think that the mortgage environment well stay as you have seen it over the last few months. It is true what you say. On the other hand as Vim also said and given where the swaps are, the margins have improved for the market as a whole. The market is growing more as well. As I just told you we are seeing early important indicators of additional house sales, house prices and mortgage business as a consequence. The mortgage margins of new business are higher than the ones of maturing business. So we are anticipating these trends to continue on the back of a stronger market, given what we see on the economy, what we see on house prices, what we see on volumes of transactions and mortgages requests which you can imagine we already saw January numbers.

In terms of TFS I think you are right. There are still additional redemptions to be made. We are very comfortable with our liquidity position because as you know savings prices have in general in the market been going down and savings continue to be quite easy to attract. And you look at our current account balances which have the highest quality and they continue to grow significantly above the market. So I would not expect those TFS redemptions that you mentioned which will be a fact to modify the behaviour because they have been also happening last year.

Question 13 – Jennifer Cook, Exane BNP

Jenny from Exane, one very quick question. I am just trying to square your guidance on Average Interest Earning Assets because they are going from £437 billion at the end of Q4, Q4 average to £435 billion as an average for FY 2020. And simple averaging would suggest that you might be exiting FY20 with around £433 billion to get to that average. I just want to understand, one, if I am correct in that line of thinking. And two, if I look at expectations to FY20/21, there are £441 billion. So quite a big gap versus potential Q4 exit rate. Do you see yourself of achieving the volume growth necessary to close that gap?

William Chalmers

I will give a very brief answer and then perhaps we can just follow-up as appropriate. Which is simply to say over the course of the year there are periods of the year where the asset base is going down, particularly in relation to certain product areas. And then follows up off the back of that. So what you are seeing is an Average Interest Earning Asset picture which in turn reflects that in year change in the pattern of the overall assets. So you won't necessarily see the numbers work out in quite the way to be expected based upon end of period numbers. So that is a brief answer to the question and we can discuss it further.

António Horta-Osório

We can follow-up with you later.

Thank you very much everyone for joining us and for your questions. We really appreciate it. Thank you.

FORWARD LOOKING STATEMENTS

This document contains certain forward looking statements within the meaning of Section 21E of the US Securities Exchange Act of 1934, as amended, and section 27A of the US Securities Act of 1933, as amended, with respect to the business, strategy, plans and/or results of Lloyds Banking Group plc together with its subsidiaries (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. Words such as 'believes', 'anticipates', 'estimates', 'expects', 'intends', 'aims', 'potential', 'will', 'would', 'could', 'considered', 'likely', 'estimate' and variations of these words and similar future or conditional expressions are intended to identify forward looking statements but are not the exclusive means of identifying such statements. 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