

## LLOYDS BANKING GROUP PLC –2019 HALF YEAR RESULTS – TRANSCRIPT

(amended in places to improve readability only)

**Wednesday 31 July 2019 – 9.30am**

### **LBG PRESENTERS:**

António Horta-Osório, Group Chief Executive

George Culmer, Chief Financial Officer

Antonio Lorenzo, Group Director, Insurance & Wealth

### **António Horta-Osório**

Good morning everyone and thank you for joining our 2019 half year results presentation. I will talk briefly about our performance in the first half of 2019 before Antonio Lorenzo gives you some colour on Insurance & Wealth. We will then hear from George on the financials and we will have time at the end for questions.

We have delivered strong strategic progress and a good financial performance in the first half, with market leading efficiency and returns. Together, this has enabled the Board to announce an interim dividend of 1.12 pence per share, an increase of 5 per cent on last year.

Over the last few years we have delivered prudent growth in targeted segments, while reducing costs and increasing investment in the business. As we said at Q1, economic uncertainty persists and this is now leading to some additional softness in business confidence, while we also observe some weakening in international market indicators.

In this environment, our balanced approach, progressing our strategic transformation while being watchful and responsive to short term risks remains the right one, and this resilience is reflected in our 2019 guidance. At the same time, our longer-term guidance remains unchanged, although continued economic uncertainty has the potential to further impact the outlook.

We remain well placed to continue supporting customers, help Britain prosper and deliver sustainable and superior returns for our shareholders.

In terms of financial performance, we have delivered a good result with statutory profit after tax of £2.2 billion, a strong return on tangible equity of 11.5 per cent, and underlying profit of £4.2 billion.

While being selective on growth opportunities has some impact on volumes, the net interest margin remains resilient and is in line with our expectations at 290 basis points. At the same time, costs are down 5 per cent and our market leading cost:income ratio improved by a further 1.8 percentage points to 45.9 per cent, in parallel with increased investment in the business.

We are also maintaining our prudent approach to risk, with credit quality remaining strong and the net asset quality ratio of 26 basis points remaining inside our full year expectation of less than 30 basis points.

Across the business, we have seen a strong performance from Insurance & Wealth, who are running ahead of the strategic plan, Retail continues to deliver in a tough market, and we have seen challenging market conditions in Commercial Banking.

We were disappointed to incur a further PPI charge of £550 million in the second quarter, led by a surge in information requests ahead of the August deadline. However, we have still generated market leading returns and built 70 basis points of free capital in the first six months, despite the 33 basis point impact of PPI and 11 basis points for IFRS 16. This has resulted in a CET1 ratio of 14.0 per cent post-dividend and further demonstrates the capital generative nature of our business model.

I will now turn briefly to the UK economy. As I have already mentioned, the economy has remained resilient although we are seeing continued uncertainty which is leading to some additional softening in business confidence and in international economic indicators.

Consumers remain well positioned as employment has continued to rise, with over 1.2 million more people working than at the start of 2016, and real wages are also rising at more than 1 per cent per year. All of this supports consumption and therefore GDP growth.

The impact of the economic environment is however felt most keenly by UK corporates. Companies' employment and investment intentions have both deteriorated in the second quarter and PMI surveys suggest lower activity levels across sectors.

We have also seen global growth softening and interest rate curves flatten in the second quarter, which is a less supportive environment for retail and commercial banks. Against an uncertain backdrop, we continue to undertake a significant transformation of the Group which positions us well for the future. Over the last few years, we have deliberately re-shaped and re-positioned the Group, improving balance sheet strength and delivering sustainable profitability.

The Group has a broadly similar sized core loan book in 2019 as it did in 2010, of around £440 billion, given our prudent approach, but there has been growth in our targeted segments. Consumer finance, SME and Mid Markets have grown by £22 billion in this period, while large corporates and the mortgage book are deliberately lower, offsetting this.

Risk weighted assets are down £208 billion, halving over the period, and run-off assets, which totalled nearly £200 billion in 2010, are de minimis today. This high quality repositioning has enabled the Group to improve returns, while reducing risk and releasing capital to shareholders.

At the same time, we have implemented a culture of relentless focus on efficiency and costs. This has driven down operating costs from £9.6 billion in 2010, excluding TSB, to a target of less than £8 billion in 2019. This has been achieved by taking underlying costs out of the business. Our business as usual cost base was down 30 per cent at the end of 2018, including the impact of the acquisitions of both MBNA and Zurich's workplace pensions business.

We have also continued to increase our investment in the business for the benefit of our customers and have committed to more than £3 billion of strategic investment over the course of GSR 3. I would now like to spend a few moments showcasing our strong progress to date.

We are now half way through this ambitious strategic plan, responding to the changing environment and transforming the Group for success in a digital world. We are already delivering a number of tangible customer and business outcomes against each of our strategic priorities, supported by £1.5 billion of strategic investment to date. These successes reinforce our existing competitive advantages and create new ones, equipping us to compete more effectively both today and in the future.

As I have mentioned previously, this investment is enabled by our unique business model and market leading efficiency. These allow us to continuously increase investment in the business, delivering improved processes and further productivity enhancements, as well as tangible improvements to our customer experience, while generating sustainable and superior returns for our shareholders. We see this as an additional key competitive advantage.

I will now look briefly at some successes across our strategic pillars, starting with Digitising the Group, where we continue to spend more than ever before on technology. In the first half of 2019, our technology cash spend equated to 19 per cent of our operating cost base, an increase of more than 20 per cent on the prior period. And over 70 per cent of the first half technology spend has been weighted towards creating new capabilities and enhancing existing ones.

As Zak mentioned in February, we have adopted a modular approach to transformation and we continue to successfully execute against this. It provides benefits to both customers and colleagues as we deliver change quicker, more cost effectively and on a more meaningful scale than ever before. For example, virtual assistants are now managing up to 5,000 conversations daily with customer satisfaction increasing by 10 points and 25 per cent of queries handled without being passed to a colleague, a trend we expect to increase over time.

We are also significantly ahead of our plan in terms of migrating apps to our private cloud.

Half way through GSR3, we have transformed around 40 per cent of our cost base, up from 12 per cent in 2017. We are on course to meet our target of greater than 70 per cent by the end of 2020.

Let me now show you how this investment in Digitising the Group is helping deliver a Leading Customer Experience. We have repositioned the business to be a truly customer focused organisation, with this reflected in strong and improving customer satisfaction levels.

Our net promoter score continues to increase, up 5 per cent in 2019 to 65, and by more than 50 per cent since 2011. Our score for the digital channel surpasses this and has also increased by 5 per cent to 67.

As you will see shortly, these improvements are not just limited to our retail channels. In corporate pensions, we have transformed the customer experience, improving our Employer NPS from a negative 41 to a positive 52 over the last four years.

These scores reflect the unique competitive advantage of our multi-brand, multi-channel model. We are the largest digital bank in the UK with around 16 million digitally active users and 10 million mobile app users, with 75 per cent of products now originated online.

This is complemented by the largest branch network in the UK, which we are refocusing to meet more complex and value-added needs, such as mortgages, Financial Planning and Retirement and Business Banking.

The combination of these has also enabled us to deepen customer relationships. We are the largest current account provider in the UK with more than 17 million active current account customers. Most importantly, our overall balances have grown by around 60 per cent since 2014, significantly ahead of the market, as a result of our targeted propositions across our brands.

And finally, looking at Maximising Group Capabilities. As we highlighted in February, we are the only provider to serve all of our customers' financial needs in one place, building on Open Banking with our unique Single Customer View proposition.

Single Customer View is now available to over 4 million banking and insurance customers and demonstrates unrivalled engagement, significantly surpassing early Open Banking levels and those of standalone insurers. We will extend this to more than 9 million customers by the end of 2020 and provide greater functionality, something that Antonio will cover shortly.

We also expect Open Banking usage to increase as new products are added and we have seen the initial signs of this, having been the first bank to add credit cards and savings last month. This will be complementary to our Single Customer View, creating an opportunity to further deepen relationships with our customers.

In addition, we have delivered £10 billion of gross lending to UK businesses in H1 2019, ahead of schedule to meet our £18 billion target for 2019, while we also continue to target £6 billion net lending growth across start-ups, SME and Mid Markets businesses by 2020.

We are pleased with our strategic execution to date, but we are not complacent and know there is still a lot to be done to achieve our GSR3 goals and therefore success in a digital world. Delivery will be supported by our unique business model and market-leading efficiency, which continuously creates the capacity for increased investment. As I mentioned, this investment drives improvements to both internal processes and customer experience, while also delivering superior returns to our shareholders. We have a proven track record of delivery in this regard and I continue to see scope for further improvement.

In summary, the first half of 2019 has seen strong strategic progress along with good financial performance. We have the right strategy for the current environment and continue to invest strongly in the business. The resilience of our business model is seen in the guidance we have given for 2019, which you can see on the slide.

Longer-term targets remain unchanged, although as I said earlier, economic uncertainties continue and could impact the outlook.

Despite this, we remain well placed to continue to support our customers, help Britain prosper and deliver sustainable and superior returns for our shareholders.

I will now hand over to Antonio Lorenzo who will talk to you about the significant strategic progress being made in our Insurance and Wealth businesses.

### **Antonio Lorenzo**

Thank you Antonio and good morning everybody, I am delighted to be here today to tell you about the great progress we are making in Insurance & Wealth.

Our financial performance has been strong in recent years, with new business premiums up 72 per cent versus the first half of 2017. This is a result of growth across multiple business lines including corporate pensions and the step-up in auto enrolment contributions, as well as growth in individual protection.

As I will show you today, we have also grown share in other areas that we have heavily invested in and prioritised, such as home insurance where our offering has been transformed following re-platforming. Given this, net income is up 23 per cent over the same period, more than offsetting run-off from longstanding products.

This growth, combined with strong cost control in the period from increased digitisation, has supported a 58 per cent increase in underlying profit over the last two years. The business is now an increasing contributor to the Group, representing 38 per cent of other income in the first half of 2019, up 7 percentage points year-on-year. The business has also up-streamed around £7 billion of cumulative dividends since 2011.

Insurance & Wealth is a uniquely positioned, integrated business with a comprehensive proposition across multiple product lines, leveraging the Group's multi-brand and multi-channel model.

Since 2015, we have reshaped the business to be leaner and more customer centric, while significantly increasing investment. As a result, we are in a better place to harness the considerable operational and financial synergies arising from being part of the wider banking group.

Looking ahead, we are well positioned to capture further growth across a number of fast growing and attractive markets, as well as deepening engagement with our customers.

I will now discuss some of these areas in more detail. We see our Single Customer View as a unique and unrivalled opportunity to meet all of our customers' financial needs in one place.

We have already made this available to over 4 million customers and will extend this to more than 9 million by the end of 2020. As you have already seen, customer engagement to date has been strong, with over 9 million monthly pension views alongside banking products and active engagement around funds and contributions.

Looking forward, our intention is to increase functionality for our customers, allowing them to have greater control of their financial needs than ever before, including pension consolidation and fund switching. With approximately 60 per cent of our Group pension customers having a multi touch relationship, we see this as a significant, differentiated opportunity. Beyond this, we are targeting growth across the board, strengthening our positions in multiple businesses.

We believe in today's environment, for a business division of a major financial services group, it is quite unique to have achieved above market growth since 2015, in business lines where we already hold top-5 market share positions. And most importantly with clear line of sight for further growth over the coming years.

To bring this to life, as I mentioned in February of last year, we intend to increase our share across the attractive Financial Planning and Retirement market. We are targeting 15 per cent market shares in both corporate pensions and individual annuities by 2020 and £50 billion of open book Assets under Administration growth. Here we have already delivered £28 billion of growth as of July, supported by the Zurich acquisition.

Beyond this, for the first time I am also sharing with you our previously internal ambitions across a number of other areas, leveraging the strong growth in both digital and physical channels. For instance, we are increasing our customer reach through the branch network in line with the re-focusing on complex needs, with home insurance policies distributed through this channel up by more than 25 per cent year on year and in digital we are growing by more than 40 per cent in the same period.

On bulk annuities, we continue to be an active participant having decided to enter this market in 2014, although our focus is on pricing with discipline. As a result, we have grown below the market in recent years, opting to distribute surplus capital to the Group instead. Despite this, we see ourselves as well positioned for growth in the future given our lower cost of capital and stronger distribution capabilities.

Turning attention now to two main areas of our Financial Planning & Retirement strategy, where we see great growth opportunities, Corporate Pensions and our joint venture with Schroders.

Our financial performance has improved significantly in Corporate Pensions since 2015 and is reflective of our recent reshaping of the business. In 2015, we had negative NPS scores and a limited position across panels. Today, as a result of our focus on enhancing the customer experience we have significantly improved NPS and we now enjoy full panel coverage.

This has been further supported by maximising opportunities across the Group, including building relationships with corporates through our Commercial Banking business .

The Zurich acquisition is also a major enabler in this market, significantly increasing our reach to some of the largest corporate pension schemes.

Finally, we are creating a market leading wealth management proposition for our customers. Its aim is to provide a full service offering, meeting simple and more complex customer needs.

We will do this through three lines of business. Firstly, a Group branded mass market offering that we will launch at the end of 2020. Secondly, our Schroders Personal Wealth joint-venture, and thirdly, through providing access to a leading wealth management and investment business, Cazenove Capital, for our high and ultra-high net worth customers.

Through our partnership with Schroders we are now able to meet our customers more complex needs. The partnership brings together Lloyds' multi-channel distribution model and unique client base with Schroders' investment & wealth management expertise and technology capabilities.

Looking specifically at Schroders Personal Wealth, we believe that the business is well positioned to meet its ambition of becoming a top three financial planning business by the end of 2023.

Having established the company in the first of half of 2019, Schroders Personal Wealth will launch to the market later this year, operating a restricted model with a wide product set. We believe that a best-in-class product offering, combined with transparent and competitive fees, will be attractive to customers in the growing mass affluent market.

Growth will be further supported by referrals of our Lloyds customers, with these already up by more than 20 per cent year on year, as well as the consideration of inorganic expansion, should suitable opportunities exist.

And as we move forward, the success of the business will be measured across four key areas – Assets under Administration, adviser numbers, growth in net new business flows, and increased profitability.

Thank you, I will now hand over to George who will run through the financials.

### **George Culmer**

Thank you Antonio and good morning everybody. As you've heard, in the first half we have delivered a good financial performance with underlying profit in line with prior year of £4.2 billion. Net income of £8.8 billion is down 2 per cent but more than offset by a 5 per cent reduction in costs, while impairments remain in line with expectations.

Statutory profit after tax is £2.2 billion and down 4 per cent due to increased below the line charges, particularly PPI. And I will discuss these shortly.

Turning first though to net interest income. NII is £6.1 billion and down 3 per cent, due to a £3 billion reduction in average interest-earning assets and a margin in line with guidance at 290 basis points.

On average interest-earning assets, the movement reflects the continued run-off of the closed mortgage book of £2 billion and the sale last year of the Irish business of £3 billion, both of which are offset by continued growth in targeted segments including £1.4 billion in Motor Finance and £0.8 billion in SME.

On the margin, we have again seen a reduction in asset margins offset by improved liabilities. And I would expect this to continue in the second six months and for the full year margin to be in line with guidance at around 290. In terms of asset margins, we are not seeing any real change to the trends that we have set out previously.

In mortgages, as you know, the market remains very competitive. Most recently we have seen a slight improvement in new business pricing, but also a slight pick-up in SVR attrition to around 15 per cent. And the overall mortgage margin has remained resilient at 1.8 per cent and in line with the second half of 2018.

In consumer finance and Commercial Banking, margins are obviously at higher levels than mortgages, and similarly remain resilient at 6.7 and 2 per cent, respectively, driven particularly by growth in SME and Motor.

On liabilities, the margin has also remained stable at around 0.5 per cent and we continue to target growth in high quality current accounts, which are up £1 billion on the start of the year and £3 billion on prior year. We have also continued to run down tactical deposits, which at £17 billion are down more than 10 per cent in the last year.

The growth in current accounts has also increased our hedge capacity, though we have stepped off hedging in recent months given market rates. We are currently around 90 per cent notionally hedged, with a balance of £172 billion and a weighted average life of around 3 years, and this compares with £180 billion at around 4 years at the start of the year.

This means we now have about £13 billion of hedge capacity which we can invest when rates offer better value, and which provides additional flexibility.

Turning then to other income. Other income is £3.1 billion and in line with recent years, although Q2 is down on the equivalent period last year due to higher levels of financial markets activity in Commercial and higher central gains in 2018.

In terms of divisional performance, you have just heard from Antonio and the excellent progress made in Insurance and Wealth, which is up 21 per cent, led by new business in workplace, planning and retirement, which is up nearly 50 per cent, and a much-improved General Insurance result.

Elsewhere, other income in Retail was down 4 per cent at £1 billion with higher current account fee income offset by lower Lex Autolease fleet volumes, while Commercial fee income was disappointing in a challenging market and down 13 per cent as a result mainly of the depressed markets activity and the strong performance in Q2 last year.

In the Centre, gilt gains totalled £181 million in the first half, down slightly on the prior year's £191 million. And going forward, while we will continue to have gains on the portfolio, I would not expect to realise further material amounts this year.

And finally, operating lease depreciation is down 5 per cent on prior year although marginally up in Q2 due to the slight reduction in used car prices.

Turning to costs. As you have heard, our relentless focus on costs is a significant competitive advantage for the Group and particularly so in the current operating environment.

Total costs in the first half were £4 billion and down 5 per cent, with a 3 per cent reduction in operating costs and a 44 per cent reduction in remediation.

The lower operating costs are driven by a 5 per cent reduction in BAU with lower property, marketing and staff costs, offset by a 3 per cent increase in investment related spend as we continue to invest in the business.

And on investment, the above the line cash spend in the first half was £1.3 billion and included £0.6 billion of strategic spend as we remain on track for our more than £3 billion target by the end of 2020. And around 60 per cent of the £1.3 billion spend was capitalised, which is in line with previous periods.

Going forward, there remain further opportunities to reduce costs, and I continue to expect operating costs to be below £8 billion this year and for the cost:income ratio including remediation to be in the low 40s as we exit 2020.

Looking now at credit. Credit quality remains strong, reflecting the Group's ongoing prudent approach to risk and provisioning and a high quality, low risk loan portfolio that is well over 75 per cent secured. And for the full year we continue to expect the net AQR to be less than 30 basis points.

In the first six months, the gross and net AQRs are up 7 and 6 basis points respectively at 34 and 26, reflecting a number of items including the alignment of Lloyds and MBNA credit card approaches, slightly softer used car prices and a small change in methodology in Motor Finance, while there are also two individual names in Commercial Banking. In terms of actual experience, we are not observing any changes and new to arrears for mortgages and credit cards remain low.

On balances and coverage, Stage 3 balances are in line with the start of the year at 1.9 per cent of the portfolio, while coverage fell slightly to 23 per cent, largely due to some balances in Commercial entering Stage 3 where we do not expect to incur significant net losses.

Stage 3 balances and coverage within the mortgage portfolio are both in line with year end at 1.7 and 14.7 per cent respectively, while the other products in Retail have seen Stage 3 come down slightly to 1.8 per cent and with coverage maintained above 50 per cent. And across the Group, we have maintained a total balance sheet provision of £4.4 billion, which compares with an expected normalised cash write-off for the full year of around £1.2 billion, and again unchanged from the last couple of years.

Looking next at statutory profit. Restructuring costs were £182 million in the half and mostly comprise severance, the completion of the MBNA integration and non-branch property costs, and these are down over 50 per cent on prior year mainly due to the completion of the ring-fencing programme and significantly lower MBNA spend.

Volatility and other items are £465 million and include the costs associated with changing asset management provider, fair value and amortisation costs of £169 million, as well as £85 million of negative banking volatility, compared with a £250 million gain last year.

The PPI charge of £650 million includes £550 million in the second quarter and I will cover this in a moment.

The effective tax rate is 23 per cent and slightly lower than our expected long term effective rate of around 25, and this is despite the PPI charge and due to the one-off release of a £158 million prior year deferred tax liability in the second quarter.

Finally, our statutory return on tangible equity of 11.5 per cent is a strong return, but has clearly been impacted by below the line charges and we now expect the RoTE for the full year to be around 12 per cent, and slightly below our original guidance.

On PPI, it is obviously disappointing to again be reporting another material charge. Processed complaints have been just above our provision at 14,000 per week, however in the second quarter we've seen a significant increase in policy information requests, or PIRs, which are the first stage in the CMC complaints process. Previously we have received around 70,000 PIRs a week, of which around 9,000, or just 13 per cent, eventually resulted in a complaint.

In Q2 the number of PIRs increased to around 150,000 per week and is now running at around 190,000, partially offset by a deterioration in quality and a lower complaint conversion rate of around just 10 per cent.

In our numbers, we have assumed that PIRs stay at this elevated level of around 190,000, and of slightly lower quality, through to the industry deadline at the end of August. And the impact of these additional volumes equates to around 200,000 extra complaints over and above our previous assumptions. And this accounts for almost three quarters of the £550 million increase, with the balance comprising slightly higher cost per complaint and higher related administrative expenses.

Turning next to the balance sheet. Loans and advances of £441 billion are stable on Q1 with growth in targeted segments, including £0.8 billion in the open mortgage book, where we have delivered growth in a competitive market while maintaining our overall margin through the selective targeting of segments including our branch-originated sales. For the full year I still expect the open book to close 2019 in line with 2018.

Elsewhere, as you have heard, SME is up £0.8 billion on prior year and continues to grow ahead of the market, and we continue to target growth in our high quality consumer portfolio, where Motor Finance is up £0.9 billion in the half.

Finally, RWAs are up £1 billion on the start of the year at £207 billion as a result of the implementation of IFRS 16, although down £1 billion in the quarter as we continue to optimise the business mix, particularly within the Commercial division.

And looking forward, as you know, there are a number of RWA changes coming in 2020 and beyond. And while there are still a number of moving parts, we now expect the 2020 regulatory increase to be towards the top end of the £6 to £10 billion range we spoke about previously, the impact of which is included in our free capital build guidance of 170 to 200 basis points per year.

And turning then finally to capital. As you know and have heard, the Group has built 70 basis points of capital in the first half. Underlying capital build remains strong with 97 basis points from banking operations and 5 points from the interim Insurance dividend, offset by the 33 basis point impact of PPI and the 11 points from IFRS 16. And this strong capital build has enabled us to pay an interim dividend of 1.12 pence, up 5 per cent on last year. And as we announced in May, we will be moving to quarterly dividends, beginning in Q1 2020.

Going forward, we are maintaining our ongoing guidance of 170 to 200 basis points of free capital build per year, but in 2019 as you have heard, we would now expect to be at the lower end of this range, due to the below the line charges.

Finally, as you heard at Q1, the Group has a capital target now of around 12.5 per cent with a management buffer of around 1 per cent, with the 50 basis point reduction from the previous target coming from the lower Systemic Risk Buffer and Pillar 2A requirements.

So to conclude, in the first half of 2019 we have made strong strategic progress, delivered good financial performance and increased the interim dividend by 5 per cent.

In the current environment our strategy remains the right one and you see this in the resilience of our results. For the full year we expect the margin to remain at around 290, operating costs to be below £8 billion and the AQR to be less than 30. These will support capital build at the lower end of our 170 to 200 basis points range and a statutory return on tangible equity of around 12 per cent.

And for the longer-term, we are maintaining our targets although, as said, continued economic uncertainty could impact the outlook.

We remain however well placed to continue to support customers, Help Britain Prosper and deliver sustainable, superior performance.

That concludes my presentation and we have now got time for Q&A.

## **Question and Answer Session**

### **Question 1 – Jason Napier, UBS**

**Good morning, Jason Napier at UBS. Two questions around net interest margins please. Firstly we have seen in the market an improvement in credit spreads on flow of mortgages, but you have already mentioned the impact of increased SVR attrition on the back book. So anything you can say about what open book growth and that sort of behaviour means for forward credit spread income for the business?**

**And then secondly just to focus on the contribution of the hedge if we could. I appreciate you have reiterated guidance for NIM for this year and for next, but clearly the yield curve is less helpful than it was and so any colour you can give around the contribution headwinds that you would face if the yield curve stays here? There is an intense interest in maturity profile of the existing positions. Thank you.**

### **Answer–George Culmer**

Okay, so I'll deal with the second one first. The structural hedge remains a fundamental part of how we do business and I think we have been very clear over the years as to what our strategy is and I think we have been very clear in terms of what the contribution is. And my expectation is as we go forward that will remain the case and you will have seen today in terms of just our balance sheet numbers first up the continued focus on the high quality current accounts and the growth in hedgeable balances, that is very much where our focus is and that is very much at the core of the structural hedge as part of our business and that will continue.

In terms of specifics, we are in a different place from a year ago and we are in a different place in terms of market implied rates, five year rates in particular and what that might mean for us. We still think we are in a strong and a protected position and that is the purpose of the structural hedge in terms of bringing that stability to earnings. And as an example just for people to calibrate off, if one was to take the current market implied (5 year swap rate) around about 70 or whatever, you would look at that in terms of impact, in terms of year on year structural hedge contribution of reducing that by something like round about the £250 million mark. That is the sort of equivalent number that you would see if you applied current market implied rates.

Why that number? Well it is all obviously linked up to things like the run-off profile and the maturity of the structural hedge. If we look out over the next 18 months or so we have about £10 billion of the structural hedge maturing in the second half of this year and about £30 billion or so maturing as I go through 2020. So I am not looking into any cliff event in terms of that structural hedge composition and as I said it is about £40 billion over the next 18 months or so. And in the context of a £172 billion currently deployed, theoretically deployable, £185 billion you need to see that in context of a hedge that is delivering £2.6-2.7 billion per annum.

So this very much remains our focus. We will continue to target our balance sheet strategy so we can contribute to that structural hedge. As I said, I think we are very clear on what our strategy has been and it will remain a very resilient part of our



income, even if today's rates and all that sort of thing plays out. So it remains a core part of what we do and it is a key part of us underpinning our confidence in our NIM.

To the first part, flow mortgages, yes over the last couple of months things have got slightly better in terms of the mortgage market simply through again what is happening on those swap rates and the non passing through of those into customer prices.

So that is a welcome sign and a welcome change. Do we sit up here and call a change in the market or a change in material profitability? No, we are still looking at if we came into the year at about 1 per cent new business, you are up to 1.15 basis points and etc, that is still to come through in terms of completions and that still compares to a back book of around 1.8 per cent. But again I think you will have seen from the slide I presented in terms of the evolution of that overall margin that we are very active in terms of retention strategies and retention policies which are hugely important to us. We are also hugely focused in terms of again as I said in my Presentation, targeting parts of the market that we think are more valuable to us. We prefer first time buyers, it is part of our Helping Britain Prosper commitment. We also see greater value there viz a viz refinance. We are also more interested in things like retention which again is more attractive to us. We are more interested in things like growing our branch market share which is up about 2-3 per cent year on year which is a great evidence of us deploying branches for sales of more complex products. So we see that as a big positive. And overall our share of mortgages in the first half was around 17 per cent versus 16 per cent last year and I think things like the pipeline, I will get this stat wrong, is something up like 20 per cent on wherever it was in the equivalent period last time.

So you know what our strategy is, things have looked a bit better. We are not going to call a turn, but we are also not going to call a change to our strategy. And then going back I think you did ask, we do remain confident of closing this year, as I said in my presentation, in terms of that open mortgage book in line with where we started the year.

**Jason Napier**

Thank you.

**Question 2 – Rohith Chandra-Rajan, BAML**

Thank you. Good morning it's Rohith Chandra-Rajan from Bank of America Merrill Lynch. If I could just follow-up on the mortgage book please. The SVR book contraction has accelerated materially in the first half of the year so down £8 billion in the first half, which is a 22 per cent annualised contraction. I was just wondering if you could split that between Q1 and Q2 if there has been any step up in a particular quarter and clarify what the rate that those customers are refinancing away from?

And then secondly on gross lending, a pick up in the open mortgage book in the second quarter, as you guided to, I think you did £8.7 billion of gross lending in Q1. Curious to know what that was in Q2?

And then just on the competitive environment which as you say the swap rates have benefited new business spreads more recently in the first half of the year. It looks like in the last couple of weeks a couple of your competitors have cut pricing. I was just wondering if that is something you have observed in the market?

**Answer–George Culmer**

In terms of the last one first. Look in terms of activity over the last couple of weeks, it sort of doesn't surprise and this is going back to Jason's question. You know I am not going to call anything, it stays competitive and over the course of this year you have seen different people doing different things. And you can try and define motive and are they doing something very clever or are they doing something very stupid and is this influenced by surplus liquidity or is this influenced by a land grab. It is just part and parcel so I would not read into anything.

**António Horta-Osório**

Rohith as we have been telling you over the calls or the meetings we have been having, people have different behaviours over quarters. I don't think I would call anything, particularly in the last few weeks. Maybe some people in some products have lowered prices. On the other hand you have people exiting the market like Tesco Bank for example. You have other competitors saying on their calls they will be more mindful about margin than volume. I don't think the last two or three weeks have any difference to what you saw in the last eight weeks, which is an improvement as George said on spreads and we have taken a larger share during that period which is already to be completed in the books. So the open end mortgage book will continue to increase as George said.

### **Further Answer – George Culmer**

And then to your other questions. In terms of the reversionary book. Yeah so the attrition ticked up to about 14.5 / 14.8 per cent towards the back end of Q2. The equivalent of that I think at Q1 was about 13 per cent so we have seen a slight pick-up. Some of that was actually due to low maturities into that book. But I probably would expect if I was picking the number for the full year it would be round about that 15 per cent. You are right, well the total book is now about £94 billion compared with about £104 billion at the start of the year. Within that, the Halifax which is the main one in terms of price is at about £33 billion and that is down about £5 billion in the year. But again the actual attrition rate is irrespective. It seems agnostic to actually rate charge and it is pretty consistent in terms of across the pieces.

In terms of mortgage volumes across the piece, I think in Q1 we were looking at I think gross lending of about £10 billion, that has grown to about £12 billion in the second quarter so you have seen that pick up and that is consistent with what we have been showing you in terms of Q1 versus Q2. I think as we said at the start, in that mortgage evolution we knew there was a big redemption so that took the book down which we sort of expected in Q1. But you are seeing that pick up and as I said the application pipeline looks strong and the one thing I don't have a number for though is in terms of what people are moving away from. But I would imagine new business spreads aren't particularly different from the ones that we have talked about in terms of the Lloyds book.

### **Question 3 – Guy Stebbings, Exane BNP**

**Thank you, it's Guy Stebbings from Exane BNP Paribas. First question was just on the credit card strategy. The balances were I think were flat on the previous quarter but down about 10 per cent since Q3 last year. Is the strategy still to grow that book?**

**And a follow-up question there. I saw a pick-up in unsecured impairment rates. If you look at the Trust data which does not include MBNA, there wasn't a sharp move in terms of new NPL formation. So is it fair to assume it is MBNA it is seeing a slight pickup in impairments. That was the first question.**

### **George Culmer**

That was two questions!

### **Further question**

**And the second one was just on guidance around capital generation for the second half of 100 basis points. If you reflect intangible growth, pension contributions, AT1 coupons and things like that, it looks you are guiding for profit after tax of about £2.6-2.7 billion. I think consensus is a little bit below that. Or are you expecting RWAs to actually be down in the second half of the year to help contribute there? Thanks.**

### **Answer–George Culmer**

Okay, I mean on that last one, we are looking at continued RWA optimisation and without being this a comment on your back solved PAT just as an input to your calculations, we are looking at RWA optimisation. We did a bit of that in the first half. I would expect us to do more of that in the second half and that would be for particular things like the large corporate business where we are reactive in terms of returns and efficient use of capital etc. You have heard us talk about that over the last number of years and we certainly have some actions that we would be hoping and expecting take in the second half of this year. So I would expect to see that.

The unsecured, the MBNA, part of it actually, I have got a slight model change where actually I have now aligned MBNA's IFRS 9 numbers to the Lloyds. We were basically using things like Lloyds PDs on them perform with allying collection procedures. So there is about a £40 million step-up which simply comes from a methodology alignment and it isn't actually relating to underlying experience.

And then in terms of card strategy. Prior to MBNA we were underweight and we were looking to grow market share, it was an area we liked, we wanted more of. So it is probably fair to say we were slightly more aggressive in terms of our approach to that market. We are now where we want to be and it is about pursuing what we think is the most successful strategy for that particular part of the market and in that we have seen the most obvious bits are coming in on things like balance transfers where you have seen a material reduction in the terms offered and the period of free periods as part of the product design. So you have seen a slight shift in terms of before and after the MBNA deal. And it is about deploying what is, we think is, the most successful strategy for that book. I mean we would expect the market to be growing 2-3 per cent and we will be there or thereabouts I would have thought.

**António Horta-Osório**

The market has been decelerating lately on credit cards and we should be more or less in line with market, there is no change of strategy. We are very pleased with the integration of the MBNA which is completely aligned and integrated by now with the final RoE of 18 per cent versus the 17 per cent we thought at the onset.

**Question 4 – Raul Sinha, JP Morgan**

**Hi, good morning thanks. Maybe just one follow-up on the hedge and then two separate questions. Just to finish up on the hedge. I think in the past we have discussed as your unhedged capacity rises there is a chance for picking up capital charge as your hedge position moves. Are we expecting something like that in the second half or not really?**

**Answer–George Culmer**

No we don't. I mean you are right, if you take it to extremes then you are the mercy of stress tests and all those sorts of things. You know 172 plays 185, at the moment you are at the margin. We have seen you know in terms of reinvestment and in terms of actions that we have taken, we don't see that there is value there. We don't see what downside is being protected. So we have stood off, but it is not to the extent to which I think I am going to endanger the capital position.

**António Horta-Osório**

And the latest numbers for current accounts we have, we are growing 5 per cent as of May versus a market which is growing 3 per cent. So we keep growing above the market..

**Further question**

**Thank you. And then maybe just two separate topics we haven't talked about. Firstly obviously this maybe a strategy question. But the revenue environment is quite challenging now for the whole industry and this wasn't what you were planning on when you laid out the medium term targets. So I think you have delivered a very good cost performance again in the first half. But I always go back to, you already start with a very efficient cost position, so what more can you do? What other cost levers that you would look to pull? Are you going to start to rethink some of the investment that you have guided to or is there something else you can point to you know, in ten years now where else can you take costs out?**

**Answer - António Horta-Osório**

That is a fair question, I have been hearing that question for 5 years. So I think that question splits into strategic and operational. From a strategic point of view, I am a strong believer that you need a culture of attention to efficiency and costs in order to be able to relentlessly implement a reduction on BAU costs, number one. And number two, strategically as well, I think you should manage your BAU cost base, on the quality. So you have a BAU cost base, you have to look at quality because you could potentially cut the wrong costs. And thirdly, you have to look as you correctly pointed out Raul to your investment capacity. So are you making your company more efficient, but at a detriment of quality or a detriment of investment? Well NPS of course we have shown you increased by of 50 per cent over the last 8 years with another 5 per cent increase this year, both on the multi-channel approach and also on the digital channels which are slightly above the remaining channels.

And in terms of investment, we have stepped up the investment as George showed, we are exactly in line with what we thought at £1.5 billion now at mid-way of the plan and I have no intention whatsoever of cutting the investments which we could as you say. But I don't think it makes any sense to cut the investments except in two circumstances, either if the investments don't deliver the forecast benefits and we are on plan as we showed you and are very excited about all the benefits we are getting. And we tried to show you the results of that. For example after three years in the insurance area and with the plans we have for the Wealth Business.

Secondly, if there is a material discontinuity, so of course if there was to be a no deal Brexit and there is a discontinuity and the paybacks of those investments instead of 3-4 years become 10 years. Of course we could lower the investments and it is true as I just said that we have one billion pounds of discretionary investment every year which about half is immediately expensed and all of it goes out of dividend capacity as you know because everything which is intangible reduces from the dividend capacity. So we have a big lever there, but we have no intention of cutting those investments because they are delivering. Because still the scenario most likely and the one the Government favours is an orderly Brexit. We are seeing the results of those investments and we don't feel under any pressure to do anything differently. So we are not going to cut the investments, but it is true to your question. We have that lever should there be a discontinuity.

**Further question**

**Thank you. I did have one more question if that is okay on the fee income outlook. You can see the current account fees are down half on half despite the higher balances. I was wondering if you could talk a little bit about where the**

**pressures are coming from. Are you seeing any pressure from the overdraft regulations as well, if you would give us a number there that you could give?**

**Answer–George Culmer**

Okay well if I step back. I mean on the whole OOI, you know at the start of this year we talked about having an aspiration to target last year's £6 billion or so. We have reaffirmed that at Q1, there was a lot of questions on that. That is still our target. Has it got a bit tougher? It has got a bit tougher to achieve and we will see how the second half of the year plays out. But that was our sort of aspiration and it stays the aspiration but it has got a bit tougher.

Within that, what is going on? I know you asked specifically about Retail, but you know when you look through the numbers and in terms of the H1 experience you know Retail is doing a tough job in a pretty tricky circumstance. It is down prior year, but I have taken action in terms of fee charges, I have seen a slight benefit from things like ATM reciprocity which has been going against me. I have done some internal changes in terms of commission payments between Retail and Insurance which have impacted Retail as well. But they are slightly down and will stay pretty tough there.

Commercial which is down around about 13 per cent is probably down more than we expected to be fair. And you know that is a more challenging market environment and in terms of people stepping off activity you know you see it in the indicators, you see it in the comments and you probably hear it talking to businesses. So there is no doubt that is slightly worse than expected. At the same time again going back to what you have seen and heard from Antonio and on the slides, Insurance has been the standout. For OOI to be up 20+ per cent, 21 per cent, it is a tremendous achievement and I think that result is very reflective of the change and the success and the building of that Insurance business.

So for the full year as I said, you know targeting close to £6bn was the aspiration, it stays there. It has got tougher. For the full year I would expect Retail to be sort of much of a muchness. I would expect Insurance to continue to show a strong result. It is not going to be 21 per cent, but I would still expect it to be good daylight between 2019 and 2018. And I would be hopeful that within Commercial that we can claw back some of that territory and some of that ground within Commercial.

**Raul Sinha**

**Thank you, very helpful.**

**Question 5 – Joe Dickerson, Jefferies**

**Joe Dickerson from Jefferies. George I think at the full year you gave us the unrealised gains on the gilt and liquid assets portfolio. If you could give us a sense of what those unrealised gains might be as at H1 that would be great?**

**And then secondly on liquidity, I just note that your liquidity coverage ratio is at 130 per cent and your cash is up 8 per cent year to date. Presumably like other banks you have been having to hold higher liquidity because of uncertainty in the environment. Could you quantify how much of a drag that has been to the net interest margin because it seems to me like on the other side of all of this, next year it will quite a tail wind on the liquidity side to the margin?**

**And then lastly, do you still intend to distribute capital down to 13.5 per cent?**

**Answer–George Culmer**

Okay, the carry costs, the excess liquidity, what I would like to say there isn't a massive opportunity or a massive prize and I haven't got the precise amount. But I don't think it is a big drag on the numbers. And we have not been required to or asked to do anything as regards that. As you might expect you know going back to 31 March type Brexit we sort of took the opportunity to get ahead in terms of funding. If markets were open then we thought we would access them and take advantage of that. So when I look at what we have actually done over the last 15 months versus original plans, we have accelerated and brought forward and I think that was the sensible thing to do. And that kind of remains our overall stance. But I don't see that there is a massive prize in terms of the NI and in terms of the carry cost there.

The unrealised gains. If this number isn't right we will update it, but I think it is just shy of about £200 million

And on capital, look nothing has changed. You are not going to expect me to say anything different from what I am about to say, but nothing has changed. We were pleased to get the reduction in the capital requirement because we believed it reflected real de-risking of the business both from a Pillar 2A perspective and things like contributions to pension schemes and to earlier questions around hedges and things like that. And in terms of scale and size of the ring-fenced banks. So we were very pleased for the reduction because we thought it reflected actions that we had taken. So we were pleased to see that. But the policy has not changed. You have seen our Interim Dividend which will be sustainable and progressive and you have heard

these words before. But the Board will take their decision at the end of the year which is the right time, after we have completed stress tests, after we have completed plans for the subsequent years in light of the information pertaining at that period in terms of what they do with the surplus over and above that requirement of 13.5 per cent.

**Joe Dickerson**

Great, many thanks.

**Question 6 – Chris Manners, Barclays Capital**

Thanks very much, good morning, it's Chris Manners from Barclays. Just three questions if I may. The first one was just back to Joe's point on the capital. 170 basis points of capital generation, that is about £3.5 billion looking at where the RWAs are. 50 basis points drop in your requirement is another billion pounds. That looks like about £4.5 billion of sort of surplus. If we look at what you have indicated with your interim dividend that actually looks like you have got a buy back capacity of well over £2 billion. Just trying to think about is there anything apart from a hard Brexit that we should be considering to stop getting to that sort of level for next year?

And the second question was just about the shape of the yield curve and clearly at the moment the curve is pricing potentially different outcomes. It does look like there is going to be more than a 50 per cent chance of a rate cut over the next 12 months. How should we expect you to be able to react to that? Can you detune some of the pricing on the tactical deposits more? How would your deposit beta in reverse work? How much can you take out of that managed savings book? It would be interesting to think about that.

And the last point was on asset quality. So the gross AQR, obviously jumped up a bit in the quarter, 38 basis points. I know you flagged there was a couple of big corporate defaults in there. How should we think about that gross AQR trending? Should it glide down a little bit from here? Thanks.

**António Horta-Osório**

On the second point that you mentioned, just to emphasise what George said, George gave you an extrapolation of if the curve stays as it is what happens in 2020, that is without any management actions. So as you said, depending on the scenarios we will be taking management actions as we take all the time. As we took in the first half versus the second half, we do. That is our job, right. And don't forget that we look at the balance sheet holistically, we always look at margin as the asset prices minus the liability prices. We look at it by segments. We manage it on a weekly basis. And that has proved the competitive advantage. I just wanted to emphasise the points that depending on the scenario and if that happens we will see what we can do. We have had in the past scenarios like that and we took action. We will be taking management action, but I wanted to re-emphasise that to George's extrapolation assumes no management action, so that you have a sensitivity which is important in terms of should the curve stay as it is. As today, what happens in 2020 but that is without management actions.

**Answer–George Culmer**

So on the gross bit. So what we have guided to is net below 30 this year and, the planning period around 30. We have also said there will be a lower level of write-backs and releases although we would expect to see a continuation it would be a lower level which would guide you into a sort of a few basis points above.

To your question, this times result has been distorted. Those two commercial names we talked about probably added about 5 basis points to the gross so they have given it a little spike to your question that are distorting the trends. So it can happen at any time and those sorts. So give out those warnings. But that is a sort of distortion to the 6 month number.

**António Horta-Osório**

And then to clarify Chris, they are not defaults, they are just impairments we decide to take. They are not two defaults, just traditional impairment charges on two different names we decide to take prudently. They are not defaults just to be precise. They are in Stage 3.

**Answer–George Culmer**

Antonio has talked about the rate cut and how we respond. We have responded before. I think you would expect to see to see us respond again in terms of taking appropriate action, in terms of product pricing and thereafter to Antonio's answer on costs and all those sorts of things as well. We would look across the business in terms of what we might or might not do.

**António Horta-Osório**

And to your question on capital as George said, I mean the Board policy is unchanged. And I think we have a prudent (progressive and sustainable) dividend policy so the ordinary dividend grows as we told you before so we increased it 5 per

cent. But the Board retained capital over the year post stress test, post PRA buffer, with all the information available, as usual we will take the decision (at the end of the year). Our target is around 12.5, plus around 1 per cent and we will decide what to do with the excess. And that is exactly the same procedure as we have been doing in previous years. There is no change whatsoever.

#### **Question 7 – Fahad Changazi, Mediobanca**

**Good morning, just a very quick couple of questions on Insurance. Are there any CMI related releases in the Results?**

**Second, on the Solvency II ratio, the 149 per cent, again the 10 year swap has come down since end of Q2. So I am sure it is the case that you still don't impact on your growth aspirations within the risk products that you are doing?**

**And just the final question. On bulk annuities, the growth outlook just keeps getting better and better. Will you be looking to change your reinsurance strategy to perhaps grab more market share?**

#### **Answer– Antonio Lorenzo**

Well let me start with the latter. As I said in my Presentation, we are managing bulk annuities on pricing and we don't have any issues. We see the right pricing in the market and the right proposition to go the capitals. But we don't see any issues like I said. And the returns are okay that we are having now. People are looking for growth, and this is an opportunity for growth for us as many others that will have in the portfolio.

Your second question was?

#### **Further question**

**The Solvency II ratio?**

#### **Answer - Antonio Lorenzo**

Well probably there are different impacts in the capital ratio, we have the equity. We have the interest rate. We have credit. Obviously the interest rates are hitting us but obviously there are other things that we are doing in terms of reducing the risk and we have some changes in the models that we are managing in order to be in the right place with the capital. So we, obviously this is discussed on impact, but we are doing other actions, we are taking other actions in order to be about 140.

#### **Further question**

**Can I follow-up and ask you what kind of actions is it?**

#### **Answer– Antonio Lorenzo**

I think we have a lot of opportunities to manage longevity because obviously we are broadly in terms of the competition, most of the people have a lot of longevity risk hedge. We are keeping a lot of recent longevity in a good way. But I think that this is an opportunity always to manage capital as we been already doing.

#### **Question 8 – Fahed Kunwar, Redburn**

**Hi it's Fahed Kunwar from Redburn. Sorry to come back onto NII, it just feels like that are two quite big shifts here. So I think in the strategy there you had structural hedge income increasing as a proportion of revenues that were coming in a larger share of revenues and obviously you had one rate rise in per annum. We are looking at flat or a rate cut and swap rates where they are. So I understand the £250 million guidance but the flat margin guidance is predicated on those assumptions. What would need to happen for that flat margin guidance to change? How would margins come down from here considering those two material shifts potentially aren't adjusting that guidance? So just some flex and understanding on what kind of economic environment we would need for that flat margin guidance to be challenged would be helpful?**

**And on the second question on OOI, I understand the £6 billion for this year is difficult, but the Insurance growth is very, very good at the moment and other operating income. When should we start getting growth from that line? So when should the Insurance kind of benefit start to offset the impacts from Retail and Commercial? Thank you.**

#### **Answer–George Culmer**

Yeah, that's a good question. Look the OOI, it has been tough for different reasons you know in different parts of the market and we have talked this year as I said in answer to an earlier question, of targeting £6 billion. I would be cautious about giving any longer-term guidance. The number of uncertainties out there are huge. What I will try and reassure you is that we are doing things in each of those individual businesses in terms of generating top line. You see the evidence in our Insurance today.

Within Retail in terms of some pricing actions that we are taking and in terms of product enhancements, again we are doing all the right actions. Commercial it is tough and there is a market dependency that you know that would stop me saying precisely what I think that is going come out and makes it tough for this year let alone next year. So I can tell you internally we are doing all the right stuff, but the external market dependency in terms of business activity would caution me against giving you any type of long-term projection that says it is £6 billion this year and it will be £6.2 billion or whatever.. It is too uncertain, there are too many things that are beyond my gift, beyond my ability to control.

And then in terms of margin, what throws me off? Look going back to the start, our core assumption is still there for some kind of orderly withdrawal. We thought there would be a rate rise this year, there obviously won't be. Our current view on rate rises is back end of next year on an orderly withdrawal type basis. You know trying to stress myself to death you know if that doesn't come through and if there is some kind of no deal and whoever was talking about the market implied, which is actually it will either go up or it will come down. And if I do move into negative rates in terms of what that means is something we will have to work through. But it is volatile and proven that over the last few months in terms of where that market implied has gone. And let's see what happens going forwards. So yes we are in a slightly different scenario obviously from when we sat here 2 or 3 months ago. I think there is a testament out to what this business about and how it is run that within that scope of change I am still able to stand in front of you and present these types of numbers. And that goes back to stuff we have bored you with before around the shape of the business model and how it is run, the levers that are available to me right across the business. And if I have to pull different levers at different times so be it. But I know what my objective is and that is how we will continue to manage the business. That is probably the best I can do.

#### **Further question**

**Can I ask one quick follow-up on AIEAs, sorry. Closed mortgage book deduction, obviously we know the new gross for those coming on the open mortgage book. Shall we start to see AIEA pick up from now in the second half of the year with the increase in the open book offset the closed mortgage book or are we still looking at net flat?**

#### **Answer - George Culmer**

In terms of AIEAs, you have got, I mean it is just because of how the comp works, we will be through the Irish stuff, that has gone. That drops out of the calculation, that is fine, that makes it easier for a start. You are right, they don't really go anywhere unless that mortgage book goes anywhere because as the mortgage book grows the rest of it has to run so hard, the simple math doesn't work. So I will be stable this year, but I have still got a slight run-off in terms of about £18-19 billion closed mortgage book and that will lose a billion or a billion and a half a year. So I would probably have to convert. If I am stable and I have got a £1.5 billion closed headwind then I could probably just about get net flat in terms of consumer finance and then SME. A bit depends where I go on things like large corporate. And as I said in answer to an earlier question, we probably will be still looking to continue to optimise large corporates, though they are more likely to go down than up. So if you put all those pieces together you are probably closer to flat than growth at the moment still.

#### **Fahed Kunwar**

**Thank you very much.**

#### **Question 9 – Martin Leitgeb, Goldman Sachs**

**Good morning, Martin Leitgeb from Goldman Sachs. If I could ask maybe start with a broader question just on Brexit and Brexit impact on your business and just thinking about the usual variables, loan growth and credit quality. I think you alluded to that you saw in particular an impact on business confidence, I guess business loan demand. Could you shed a little bit more light on what you have seen across the business as Retail and Corporates in terms of loan demand and also asset quality whether it has been any pockets of deterioration that you have noticed at this stage?**

**My second question is just with regards to loan provisioning and general loan provisions. I think some of your peers have made general provisions regarding specific macro risks facing the UK. I think Lloyds hasn't. Just your thinking behind that?**

**Just to follow up on the various NIM questions, if we were just to think about NII progression from here, assuming the rate environment were not to change, how should we think about NII progression from here? Would you expect the decline we have seen over the last 2 or 3 quarters would continue? Thank you.**

#### **Answer - António Horta-Osório**

Okay I will take the first question and George will take the other two. Look to separate this in segments. You have the retail side and you have the corporate side. We are mostly a retail bank as you know for most of our loans and most of our activity. And on the retail side we see as I said in my introductory remarks, we see no change whatsoever. Mortgage growth continues at

more or less the same pace as the previous year around 3 per cent stock year on year as you know. We have seen a slight deceleration in car finance, but continues to grow in single digits. We are watching in the latest few months a slowdown in credit cards but it is positive and UPLs are also growing positively in single digits. So we don't see in terms of growth any significant change, a slight slowdown.

In terms of impairments, we don't see any signs of impairments on the Retail book. You see as we mentioned before some deterioration in second hand car prices which we have both on OLD and a little bit in provisions. That if you remember was something we were anticipating last year and did not happen and we kept the provisions and it happened this year. So we have adjusted accordingly and as George said we also changed the model to have the through the cycle provision which had some impact. But so apart from the second hand residual car prices which I would say is more of a catch-up which we expected last year, it happened in the first half. The Consumer book is in the same position, we don't see any significant deterioration. I am not surprised about that Martin as I think I said as well because when you look you see employment continues to grow, that obviously improves demands and contributes to GDP consumption, is two-thirds of GDP. The real wages are now growing to 1 per cent or more for more than a year which also supports consumption and GDP. And employment is at a historical low since the statistics began being made as you know. Interest rates are very low and getting lower. So I am not surprised that on the Retail side you see no changes in the current environment. Obviously subject to no discontinuity.

On the Corporate side as I also mentioned, and we had those already mentioned in Q1 that there was some softening of business confidence. That softening has continued and I showed you the PMI intentions, hiring intentions and business confidence. In terms of what the translation is in business demands, we have seen a slight deceleration again in SME and Mid Market lending. And we are now growing at 2 per cent. You might remember that in the past we had been growing at 3-4 per cent. We are now getting near 2 per cent so slight decrease, but not very significant in the market according to our members is growing between zero and one per cent.

And in terms of impairments on SMEs or Mid Markets as George mentioned as well, we don't see any change, any systemic change. We have made, as we mentioned before, two additional impairments for two specific cases on two larger corporates in different sectors so specific things which sometimes happen in large corporates. But it is a fact as you know that business confidence is having a progressive softening between the small impacts in terms of business demands and we don't see any signs in impairments which again should not be the case with our level of interest rates, with our level of employment, consumption etc. That is a bit more colour going segment by segment and I hope that is helpful.

#### **Answer—George Culmer**

And then your two other points. I mean the loan provisioning bit should be making specific provisions for specific macro. I mean I don't know if it is a reference back to coming into the Brexit scenario, but I mean IFRS 9 provisioning as you know. You know I have my base, I have 30 per cent, my upside 30 per cent. My downside 30 per cent and my extreme 10 per cent which sort of seems quite obvious. But I think as we went through it last year I don't think everyone set off in that position in terms of having that spread. And there were some changes as they moved through the year. We didn't move because we had already captured an element of that. That severe were in our 1 Jan numbers and were consistent in the deployment of that as we moved through the year.

Now what we have done in terms of this half, as I say our core assumption is still orderly withdrawal. But we have within that, I think as I said earlier, reflected the current environment and that current environment is slightly lower GDP, is slightly lower HPI. At the same time slightly better unemployment. And when I flow all those through my Multiple Economic Scenarios it had an adverse impact in the sort of tens of millions in terms of that H1 impairment charge you saw. So our central prognosis of orderly exit hasn't changed and our percentages on the various scenarios hasn't changed, but the backdrop, we have slightly weakened, but that is not a Brexit, that is simply going back to some of Antonio's comments about the economy, just observing what we are seeing around business confidence, GDP, HPI etc. But there is an offset in employment. So we feel that that is appropriate and reflective of how we see the world going forward.

Then to your last question. If I assume the rate environment won't change what happens to NII, which I think was the question. And I think I just said AIEAs are going to be relatively flat. We talked about a resilient NIM and we have talked about in the current rate environment of the market implies I will lose about £250 million. So in that scenario we will just be working harder Martin.

#### **Question 10 – Alice Timperley, Morgan Stanley**

**Good morning it's Alice Timperley from Morgan Stanley. I think most of my questions on NIM have been addressed you will be pleased to hear. But just a quick follow-up on PPI please. The 190k weekly information requests is**



obviously a bit step up. Could you give us a sense of the uphold rates on that 190k and how that compares to the past?

**Answer—George Culmer**

It's not so much uphold, but it is the sort of conversion factors. So I think I said previously the rule of thumb is when we were talking about our sort of 13,000 provision previously which was what we assumed and what we were observing in terms of complaints process per week, that used to be about 4,000 direct from customer and about 9,000 from CMC originated. And that CMC 9,000 was basically of the back of about 70,000 of these PPI information requests. And so that is a 13 per cent conversion rate. And then what we have seen as I said in the Presentation, first to 150 then to about 190 but we have seen that complaint conversion rate drop to, and it is still moving around, but just below a sort of 10 type per cent. So that is the conversion rate. And you know we will process this, we will work on this. The important thing in all this is we are four weeks away from the deadline. You know it is hugely disappointing to have to announce a big PPI provision again and it is also hugely disappointing to have to say uncertainties still remain. But we will be through this and we will get through this and we will move to a much better place beyond. But at the moment it is just a question of dealing with that surge ahead of the deadline.

**Question 11 – Edward Firth, KBW**

Thanks very much, it's Ed Firth here from KBW. Just two quick questions. The first one was on Centrals. I think Centrals is now making a bigger contribution than Insurance if I strip out the £136 million in Q1. So we don't really see that much guidance as to what is in there and what is driving that number. I mean it bounces around all over the place. So I wondered if you could help us a little bit with actually what is actually in there and how we should think about that as it rolls forward? So that was the first question.

And the second question, I am just getting quite concerned about credit and I know we have had a couple of questions on this. But if I just look at your numbers, you have got an increasing charge and a fall in cover at a time when as you have rightly pointed out, the economy is going pretty well, unemployment is at all time lows. Interest rates are very low and yet you don't need to be fanciful to think of any number of shocks we could hit in the coming 6-12 months. And yet it doesn't look obvious that you are well prepared for that or that you are adding to your buffers at the moment. So could you just guide us to where are you and how are you looking at that and how are you getting yourself ready for what could be a pretty tough time?

**Answer - António Horta-Osório**

Well just to cover and George will deal with that. I think we are very well prepared for that because the first thing I would tell you which I said in my introductory remarks, that is why I have included a long series on the Presentation. The best preparation for a potential, not likely potential as you say, credit shock, is the rate of your credit growth. Our core loan book is exactly the same as it was 8 years ago as I mentioned with a £22 billion growth in targeted segments where we were under-represented. So consumer finance and SMEs. And the corresponding offset on parts of the mortgage book that we did not like and on large corporates where we thought the risk return was not appropriate. So apart from having shredded practically all of the £200 billion of toxic assets following the HBOS acquisition, we have kept the core loan book at around £440 billion. So for me having done banking for 30 years that is the best indication that you are well prepared for a potential shock. On top of it as we have told you repeatedly, our model is a prudent model so not only on the growth rate which is zero over 80 years. We only do prime business in the sectors that you know very well. So absolutely concentrated on prime business. We don't chase business so we have always emphasised margins and capital and risk versus growth and in certain moments of the past we have been questioned about it. So we are very comfortable about it, we have a risk appetite that we review every year and we are well within our risk appetite. And as a third point before George may want to add something, we think we are prudently provisioned that is what our internal opinion, and of our external auditors. And we have different scenarios to Martin's question, what do we have, a 30 per cent downside, a 10 per cent extreme. So high capital levels, zero net debts, any external shock we are as well prepared as we could be.

**Answer—George Culmer**

I would add to that, it touches every part of what we do from risk approval to book shape to portfolio construction in terms of that secured, in terms of where we play and in terms of where we don't play, it covers every bit. And then to bring it down to some specifics. You know the work we have done on single name exposures, yes we have talked about a couple of names that impacted, but the work we have done over the last few years in terms of the books that we inherited, to making sure that our exposure to single names are brought down and they are the names we want to be is massive. We show you the loan to value on the mortgages, it is a completely different space.

Let me touch briefly on what we ended up doing on something like motor finance and we have always talked about being prudently covered. Prices were off a bit this period. We used to allow for about a 4-5 per cent reduction. Came through, I have

taken that, I could have easily have stopped there, but our numbers actually now allow for a further reduction. So I have reset up my prudent provision. I could have stopped short. So you know it goes across the whole piece. Anyway, so that is that.

So then to your first question, a couple of things. First up, I really wouldn't strip out the £136 million for Insurance, I mean I really think that is about recognition of a better deal, lower expenses and a real business benefit to Insurance. Yes under insurance accounting one PVs the benefits. That is the way it is done, but that is a real reflection of the business being better run than when we are producing better returns. So I think it is completely wrong to strip out the £136 million. There is also if you look at, they benefited about £240 million this year from assumption changes, one of which is the £136 million. The other is improvement in longevity. These are real business benefits that are coming through to the benefit of shareholders within the business. So I wouldn't strip it out.

And then in terms of what is in the centre. As ever within centres, you have got a mixture of balances. But some elements, the main elements that sit within there, I have got my gilt gains, so I have got just under £200 million. I have my LDC which goes through there which again is about £150 million. I have my Vocalink which sits in there which is about £50 million so all those are kosha balances. But I also have above there basically the net of things like internal transfer pricing which doesn't net out to zero mainly for some technical factors. So for example things like the cost of AT1s which will appear in a P&L perspective go below the line, but in my internal transfer pricing, I charge them out to the businesses so actually the centre which is GCT from a P&L respective, gets the money back but isn't actually paying out the cost of that because that is below the line. And that kind of makes up the delta. So those are the main things that are within there.

#### **Question 12 – Alastair Ryan, BAML**

**Just a question on current account strategy please. You talked about balance growth, but the CASS data shows that Lloyds has gone from being quite a net gainer until about the middle of last year. The figures last week show you are the biggest net loser in balances by number and that is across the brands. The number of people switching away, Lloyds is the number one loser along with both Halifax and Bank of Scotland. So just to understand that shift please?**

#### **Answer– António Horta-Osório**

That is a very interesting thing and we were discussing that and you can see in the Appendix that we show that our market share of digital which we always present went down from 21 to 18 per cent. And we are looking at why and the reason is exactly the reason you mention, because the challenger banks in general have been opening lots of current accounts and of course that impacts our market share in spite of us continuing to open current accounts.

#### **Further question**

**Sorry but just in the switching data though the challengers are very small, it is HSBC and Nationwide and all that stuff is going to so that is the net shift. So just understanding?**

#### **Answer -António Horta-Osório**

No in terms of switching data, well first don't forget that the switching data is not everything, it is a small part because you have the openings and closures which do not show on the switching data. So in current accounts the picture is clear as I think we showed you. The number and we showed you that on the slides. The number of active current accounts continues to increase and much more important the quality of those current accounts is improving very significantly. The average balance per customer has improved 50 per cent since 2014, significantly above the market. And just to give you the latest available number which I said earlier, as of May we are growing on PCAs 5 per cent versus a market that is growing by 3 per cent so we continue to gain market share and that gives you I think the best indication of quality in current accounts which are in the UK contrary to other markets, are the most important product from a loyalty point of view. So our customers growingly use us and we think that the digital offering is a big contribution to that. Those deposits are convenience deposits not price orientated. They are growingly putting those deposits with us and our market share is increasing so that is I think the best indication.

And I was going to make the point on the challengers, everybody is opening current accounts on the challengers because as you know the price is zero. So for you to have more current accounts doesn't have any cost and there are specific things that people like to do with them, but I think the right criteria to monitor going forward is the quality of those accounts, the average balances and the potential revenues that they produce to be seen.

#### **Question 13 – James Invine, Soc Gen**

**Good morning it's James Invine here from Soc Gen. Can I ask about the non banking net interest expense please? I guess this is for you George. I think I guess it has gone up and become more negative because of IFRS 16. I think last time we saw you, you were saying it wouldn't get near to £100 million but I mean we are already there just in 6 months of the year. So is there anything funny in the first half that has made that number more negative?**

**Answer: George Culmer**

Are you sure I said it wouldn't get near to £100 million?

**James Invine**

**I thought you did, sorry.**

**George Culmer**

No I am pretty certain I didn't say that. We expected it to up because I mean this is the funding costs of basically non NII generating aspects. And we saw £70 million or whatever in the first half which is, it is slightly down in terms of H1 last year. But it is more in line with the second half of last year which I think was about £60 million and I would expect the full year to be about double that. I mean IFRS 16 is £34 million of that. It is basically tracking to where we expected it to be. So I would expect the full year to be about double this and there is an IFRS 16 pick-up. It moves around dependent on because you know, how much type of business, the commercial in terms of predominantly fee generating income that they do. But elsewhere it is the funding of LDC, the funding of Scottish Widows and things like that. But I would expect to be about double that for the full year.

**James Invine**

**Okay thanks.**

**António Horta-Osório**

Thank you. Just before I close I would just say a few words. As you know this is George's last set of Results before he retires this week. George has been a crucial member of the team and of the turnaround we did here at Lloyds. So I think he has been an outstanding CFO and on behalf of myself, the Group Executive Committee, The Board, I would just like to publically thank him and I would like to really recognise your greatest contribution to the Bank. Thank you very much George.

**George Culmer**

Thank you António.

**António Horta-Osório**

Thank you everyone, good to see you here.

#### **FORWARD LOOKING STATEMENTS**

This document contains certain forward looking statements with respect to the business, strategy, plans and/or results of the Group and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about the Group's or its directors' and/or management's beliefs and expectations, are forward looking statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will or may occur in the future. Factors that could cause actual business, strategy, plans and/or results (including but not limited to the payment of dividends) to differ materially from forward looking statements made by the Group or on its behalf include, but are not limited to: general economic and business conditions in the UK and internationally; market related trends and developments; fluctuations in interest rates, inflation, exchange rates, stock markets and currencies; any impact of the transition from IBORs to alternative reference rates; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the Group's credit ratings; the ability to derive cost savings and other benefits including, but without limitation as a result of any acquisitions, disposals and other strategic transactions; the ability to achieve strategic objectives; changing customer behaviour including consumer spending, saving and borrowing habits; changes to borrower or counterparty credit quality; concentration of financial exposure; management and monitoring of conduct risk; instability in the global financial markets, including Eurozone instability, instability as a result of uncertainty surrounding the exit by the UK from the European Union (EU) and as a result of such exit and the potential for other countries to exit the EU or the Eurozone and the impact of any sovereign credit rating downgrade or other sovereign financial issues; political instability including as a result of any UK general election; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; natural, pandemic and other disasters, adverse weather and similar contingencies outside the Group's control; inadequate or failed internal or external processes or systems; acts of war, other acts of hostility, terrorist acts and responses to those acts, geopolitical, pandemic or other such events; risks relating to climate change; changes in laws, regulations, practices and accounting standards or taxation, including as a result of the exit by the UK from the EU, or a further possible referendum on Scottish independence; changes to regulatory capital or liquidity requirements and similar contingencies outside the Group's control; the policies, decisions and actions of governmental or regulatory authorities or courts in the UK, the EU, the US or elsewhere including the implementation and interpretation of key legislation and regulation together with any resulting impact on the future structure of the Group; the ability to attract and retain senior management and other employees and meet its diversity objectives; actions or omissions by the Group's directors, management or employees including industrial action; changes to the Group's post-retirement defined benefit scheme obligations; the extent of any future impairment charges or write-downs caused by, but not limited to, depressed asset valuations, market disruptions and illiquid markets; the value and effectiveness of any credit protection purchased by the Group; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors, including non-bank financial services, lending companies and digital innovators and disruptive technologies; and exposure to regulatory or competition scrutiny, legal, regulatory or competition proceedings, investigations or complaints. Please refer to the latest Annual Report on Form 20-F filed with the US Securities and Exchange Commission for a discussion of certain factors and risks together with examples of forward looking statements. Except as required by any applicable law or regulation, the forward looking statements contained in this document are made as of today's date, and the Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward looking statements contained in this document to reflect any change in the Group's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. The information, statements and opinions contained in this document do not constitute a public offer under any applicable law or an offer to sell any securities or financial instruments or any advice or recommendation with respect to such securities or financial instruments.