Lloyds Banking Group plc –Results 2010

The Plaisterers Hall, London – Friday 25 February 2011

2010 Full Year Results - Analyst Presentation

Eric Daniels – Group Chief Executive

Good morning ladies and gentlemen. Thanks very much for coming.

Today I will be focussing on the key messages from our 2010 results.

I will then hand over to Tim, who will walk you through the texture and detail behind our results and we will give you a view of our near term outlook as well as the longer-term goals.

Win Bischoff, our Chairman, will then offer a perspective on the Group and we will then move forward to the usual Q&A session.

Over the last two years we have made substantial progress in shaping the business and I am delighted that we have now placed the Group on a clear trajectory to realise the potential within the franchise.

2010 was a good year for the Group, and one in which we made significant progress.

Starting first with our operating performance.

We delivered a step change in our financials, with a management profit of £2.2 billion and a statutory profit of £0.3 billion.

While the key driver was the large drop in impairments, we also saw a good trading performance on a combined businesses basis with underlying income up 3% and expenses down 6%.

We have delivered very good franchise growth, with all of the operating divisions showing progress in growing their customer bases.

We are delivering one of the largest and most complex integration programmes ever undertaken, and are on track to achieve in excess of a 20% reduction in the cost base.
In addition to our progress on improving the operating performance, we have spent a considerable amount of time and resources on managing risk, and we accomplished a great deal during the year.

We made great strides in our 5 year balance sheet reduction plan.

We significantly improved our funding position.

We considerably strengthened our capital.

And, we are pleased that our prudent approach to credit risk has led to a sharp reduction in impairments and far more predictable outcomes in our asset portfolios.

So, a good set of results, even after absorbing the substantial costs of strengthening the business for the future.

You will have seen this slide before, and I wanted to remind you of our plan to realise the potential of the new Group.

On acquisition, our priority was to establish control over the enlarged Group and to address the immediate issues of risk, capital and funding.

While these remain important and we will continue to work them, we shifted our primary focus in 2010 toward the profitability phase of the plan. We are currently addressing the profit model and balance sheet, and this will drive our future financial performance.

We will continue to work on the second phase during 2011, and would expect to see continued improvements in the balance sheet and P&L over the next several periods.

Our longer-term performance will be sustained through building industry leading efficiency and effectiveness and through adding customer value, which will result in deeper relationships and a growth in quality market share.

This third phase will become increasingly the focus for the Group and will drive strong and sustainable earnings growth, generate capital and deliver good returns.

On a combined businesses basis, the Group saw a step change in profitability in 2010.

Our underlying income grew by 3%, while our core income grew by over 7%, as we continued to embed our relationship strategy and to drive the appropriate pricing for risk in our asset portfolios.

We maintained our longstanding, strong focus on costs, and our expenses declined by 6%. With income up and costs down, we once again delivered positive operating leverage and our underlying cost:income ratio improved by 450 basis points to 46.2%.

Impairments fell by 45%, reflecting the conservative approach we have taken to the management of risk ever since acquisition.

The improvements in our performance resulted in a profit of £2.2 billion and this is in contrast to the £6.3 billion loss recorded in 2009.

We have undertaken considerable work to correctly value and restructure the asset portfolios.

The new business volumes are at the Lloyds standards, and the back book is performing far more predictably and impairments fell sharply, in line with our guidance.

Where the economy performed as we expected, in the UK, Europe and US, we have been able to manage our impairments and portfolios to within a tight range.

However, we were disappointed in the performance of the International portfolios, where we have taken higher impairments. This reflects the specific issues facing Ireland and to some extent Australia. These portfolios are small, however, and represent about 4% of assets, and they are subject to very close management.

The major driver behind the improvement in impairments was the UK portfolios. Here, we saw progress across the board with reductions in each asset category.

The major reduction was in the Wholesale book, which was down by 72%, with the most notable deltas in the HBOS Corporate and CRE portfolios, where the business support units successfully managed the assets.

The charge in Retail which was down by 35%, also benefited from more stable house prices, low interest rates, and the improving quality of new business flows.

As we extended our relationship strategy across the Group, we continued to see good levels of new business in what remains a highly competitive market.
In the Retail Bank, we opened up 1.9 million new current accounts. We also opened over 5 million new savings accounts, which contributed to the over 5% growth in the retail savings book. The quality of the book increased markedly as we grew the instant access balances by 14% and burned off 15% of the term deposits which tend to be hotter money

We were equally successful in the Wholesale division and again opened over 100,000 new small business start-ups last year.

In the Private Bank, we opened 17 thousand new relations as we increased the customer base in the UK by 12%. The Wealth business is a key focus within the Group, and these early results are very encouraging.

As a business that is predominantly focussed on the UK, we recognise our critical role in the economic recovery and are committed to supporting our customers.

I am pleased to confirm that we will meet our lending commitments. In 2010, we delivered some £30 billion of gross new lending in mortgages, and we were able to support over 50 thousand first time buyers.

We also lent over £49 billion to corporate and commercial customers. We actually increased net SME lending, in the face of a market that contracted. The successful delivery of our lending targets demonstrates our support for customers that have viable business propositions.

The Integration programme is now more than two-thirds complete, and at the end of 2010 we had delivered £1.4 billion savings run-rate.

From day 1 of the acquisition, we began integrating the businesses and implemented a single management structure and organisational design.

We have now harmonised our staff terms and conditions, which is critical to driving one organisation. We have also introduced changes to our pension schemes to mitigate the risks.

Standardised procurement and property management processes are in high gear and they have made a critical contribution to savings.

This last year we completed much of the systems work that will underpin the consolidation of the customer accounts onto common platforms.

We have a clear route map to closing out the Integration and, given the progress that we have made to date, I have high confidence that we will deliver the £2 billion of savings we committed. But most importantly, as we complete this major milestone, we will be able to turn more of our attention and resources to driving growth and efficiency.

In 2009, we set out a strategy to reduce the size of the balance sheet, as a critical step to managing to the Group's risk profile.

We recognised that this would adversely impact the profit and loss statement, but we believe it is in the long-term interests of the business to drive a smaller balance sheet with the associated funding benefits.

We continue to make good progress, and we have now delivered over half of the planned £200 billion reduction in the first two years out of a five year programme.

I am pleased with the level of progress, given we opted to pursue a value based approach. Overall, we are achieving asset sales within the existing provision levels, in the face of a slow growth environment.

And we have made great progress on restructuring a number of non-core businesses. Last year, we completed the sales of eSure, Insight and Bank of Scotland Integrated Finance.

The Group reduced the funding risk across all of the key measures. Clearly, this has come at a P&L cost, but again we believe it was worthwhile in order to reduce the risks facing the business.

We have a target of some £20 to £25 billion a year for public capital and senior issuance. In 2010, we were very successful, and delivered £50 billion of term issuance.

We continue to reduce our reliance on wholesale funding, which fell from £326 billion to £298 billion. We maintained our maturity profile, with 50% of the wholesale funding greater than one year. The level of short-term funding fell by £13 billion to £149 billion.

We have also reduced the amount of liquidity from government and central bank sources by £61 billion, such that the total amount fell to under £100 billion. We are now ahead of plan in meeting repayments and we are well placed to meet all future maturities. So far in 2011, we have repaid a further £13 billion of central bank funding, ahead of schedule.

The growth in our customer base, allied with the reduction in the balance sheet has led to a 15 percentage point reduction in the loan to deposit ratio which improved to 154% at the end of 2010. This is a significant step towards our target of bringing the loan to deposit ratio to under 140%.

The capital ratios again improved , and we ended the year with a core tier one ratio of 10.2%, while our total capital ratio increased from 12.5% to 15.2%.

The improvement in part was driven by the 18% reduction in risk-weighted assets, which reflects the strong management of risk, reduced asset levels and changes to methodologies in certain portfolios.

We have already taken a number of steps to mitigate the potential impact of Basel III on our capital, and believe we will be well placed to meet the new standards when they are phased in over the next several years.

The Group performed well on the European stress tests and we would expect to do so going forward. In addition to our strong capital base, we have the benefit of ECN's which would provide another 1.9% of capital buffers if required.

At the 2009 Prelims, Tim and I set out guidance on how you could expect to see the franchise develop during the year. We updated you at the half year, and let me now update you again.

In terms of revenue, we delivered core income growth of 7%.

Our margin increased to 210 basis points, up 33 points on the year, which is faster than we had originally expected. In the second half we saw a more moderate increase, which was in line with our guidance at the Interims.

Our underlying cost income ratio improved by 450 basis points.

The integration programme is performing very well.

The level of impairments improved sharply, and we achieved our compound reduction target of 20 per cent per half, over the year.

Our balance sheet reduction programme remains on track.

We are now just over two years into the acquisition and, as a result of the actions we have taken, we have a far more predictable business and we have a strong trajectory for future earnings growth.

In finishing, let me summarise my key messages.

First, we had a good year, and returned the Group to profitability in 2010. We have good momentum in each of the franchises.

The Integration Programme remains on track to deliver the financial benefits promised and, when completed, we will free up investment capacity to support the future needs of the business.

We have greatly strengthened our balance sheet and our funding position, and we have a strong capital position.

We have put in place the building blocks for a strong, successful business with a sustainable profit trajectory, and the Group is well positioned for growth. As we close out the second phase of the plan this year, we will be able to focus more of our resources and attention on driving efficiency, customer value and growth.

Before handing over to Tim, I would like to make a couple of personal comments.

As you know I have been presenting the Lloyds Results for over seven years now, and this is my last presentation.

I would like to thank you for your interest in our business, and for the many questions you have asked. I believe our business is better because of you.

This is a great business with very significant prospects, which will be further realised in the coming years.

I wish you all well and let me now hand over to Tim.

Tim Tookey – Group Finance Director

Thank you Eric and good morning everyone.

This morning I'm pleased to present the results of a good 2010 trading performance, with the Group now having returned to profitability on a combined businesses basis. In addition, I want to spend some time giving you an update on our continuing balance sheet reduction and the further strengthening we have achieved in both our capital and funding positions.

Firstly, looking at business performance.

We achieved good revenue growth, with underlying income, net of insurance claims, up 3 per cent. Growth in core business income of 7 per cent, which is in line with medium term targets, was however offset by the reduction in non-core income of 9 per cent, as a result of the strong progress we made on balance sheet reduction, giving the overall 3 per cent increase.

With expenses down 6 per cent and impairments reduced by 45 per cent, we delivered a profit before tax of £2.2 billion. Within that result, we have delivered a margin of 210 basis points, which exceeded the margin that we guided to a year ago and met the half year guidance of a modest second half improvement.

We saw strong year-on-year improvement in overall divisional performance, which also improved significantly half on half. Divisional profit before tax was up more than 40 per cent between the first and second halves of the year.
At a Group level, however, the liability management gains booked in the first half and the negative fair value movement of the ECN conversion feature in the second half, lead to a half on half reduction in profit before tax.

On a statutory basis, the profit before tax included integration costs, a customer goodwill payments provision of £500 million, and a loss on disposal of a business acquired from a previous lending relationship. These items were partially offset by a pension curtailment gain and positive insurance volatility.

Looking now at our key revenue trends.

The Group delivered a good revenue performance despite subdued growth in lending markets. While total income, net of insurance claims, was 2 per cent lower, this was as a result of a reduction in gains from liability management exercises and the mark-to-market losses on our Enhanced Capital Notes. Excluding these items, underlying income growth came exclusively from net interest income with a modest reduction in other operating income.
Now let me take you through the drivers of net interest income.

The main drivers are of course customer asset and liability volume and pricing, and the equivalent volume and pricing dynamics of non-customer funding sources.

In terms of customer asset volume, we saw a 5.5 per cent decline in average interest earning assets, reflecting subdued new lending markets and continuing customer deleveraging.

On the liability side, we continue to build our current account and savings customer franchises in what remains a competitive market for customer deposits. And we did this by applying our focus to relationship based savings rather than being overly dependent on more expensive term deposits. This strategy delivered good overall customer deposit growth of 3 per cent with 5 per cent growth in Retail.

As a result of further repricing activity across all areas, asset margins have continued to increase. This includes within Retail the benefit of a continued, but slowing, increase in the proportion of mortgages on Standard Variable Rate, which is now 48% of the book. Low base rates and strong competition in the deposits and savings markets meant that liability margins remained at low levels.

In terms of funding as a driver of net interest income.

The fall in the customer funding gap has lead to a further large reduction in our wholesale funding requirement. As we have all seen, however, wholesale funding costs increased in the second half, and indeed remain high today.

Our term issuance last year exceeded our basic needs significantly, giving us a lot more funding flexibility and allowing accelerated SLS repayments. The overall impact of this is of course to increase our weighted average wholesale funding cost earlier than would otherwise have been the case, and this partially brings forward the margin impact of refinancing the SLS and CGS that we have spoken about previously.

But this is clear and unequivocally sound risk management at work, and despite these factors, will delivered the modest margin expansion that we guided to at interims.

Let’s look briefly at other operating income.

The main components of the 3 per cent reduction are the impact of lower overdraft charges, and the fall in income following our decision to withdraw from writing new PPI business last summer.

Before talking more about the future, we need to have a quick look at our underlying economic assumptions to provide you with the right context.

We continue to believe that a slow recovery over the next couple of years remains the most likely outcome for the UK economy. We see GDP growth increasing to 1.9 per cent this year, with a further increase in 2012. As for base rates, in the short term we are actually more cautious than the current market implied rates, although we note the inflationary pressures building in the economy.

House prices are likely to fall a bit more this year before recovering somewhat next year, and a similar profile of value movements is also likely in commercial property prices. Sadly though, we believe that unemployment will rise further, peaking later this year.

Now let me pull together these economic drivers of income, with the trends we see in our own book firstly for 2011.

We clearly have capacity for substantial core business growth, however, in the short term, we expect income trends will be affected by continuing customer deleveraging and subdued new lending demand. This together with a further decrease in non-core assets, is likely to result in a continued reduction in the overall size of the Group's balance sheet.

2011 will see limited asset repricing opportunities, and these are likely to be offset by elevated wholesale funding costs, while low base rates and competitive markets will keep liability margins depressed. As a result of these factors and of course our having achieved the margin expansion from the low point in 2009 faster than previously anticipated, I don't see there being any further margin expansion in 2011 compared to 2010 as a whole.

So if that's our view for 2011, how does the medium term look

Well what I cannot predict is what effect over time the current discussions, including those around recovery and resolution plans and the broader bail-in debate could have on funding costs and therefore margin.

But what we can reasonably see how <u>other</u> drivers of margin will be looking over the medium term.
Our margin outlook of course incorporates our economic assumptions for the medium term. Over time, the economy will become stronger and funding markets more stable. At the same time, our asset reduction program will be complete, improving our funding profile further and reducing our issuance needs – these effects combined we expect will tighten Lloyds' wholesale issuance spreads. As for base rates, we all know they will rise, the question is timing – we still see rates rising to 3.75% by the end of 2014 and this will facilitate higher and more normal, liability margins.

Even with limited further asset repricing, the margin is likely to return to more than 2.5 per cent by about 2014 as previously guided, with the primary drivers being liability margin expansion and reduced wholesale spreads.

Turning now to costs.

We have an excellent track record in managing the cost base, and have delivered another strong cost performance, with operating expenses down 6 per cent despite investing in our core franchises. We are also very pleased with the substantial further integration savings that we captured in the year.

Specifically on synergies.

We have already made significant progress in capturing integration savings with over £1.3 billion realised in 2010 and annual run-rate savings totalling close to £1.4 billion at the end of the year. 2010 saw terrific progress on many of our IT related programmes, the benefits of which will continue to flow through and drive us towards our overall targets. The Group is on track to deliver a run-rate of £2 billion per annum of synergies and other operating efficiencies by the end of 2011.

So what does this mean in terms of costs going forward?

We expect our costs will be roughly flat in 2011. We believe further absolute cost savings are likely to be offset by increased investment supporting the growth of our core businesses, increasing regulatory costs, the rise in VAT and employers' National Insurance contributions, and of course the new Bank Levy. These tax changes alone will add about £360 million to 2011 costs.

With further improvements in core income levels in line with our targets over time and, excluding the cost of the new Bank Levy, we continue to target a cost : income ratio of about 40 per cent in the medium term.

I would now like to spend some time looking at impairments

As we have heard from Eric, we achieved a significant reduction in the impairment charge in 2010, in both core and non-core businesses. The charge was 45 per cent lower, with deterioration in Ireland more than offset by substantial improvements elsewhere in the Group, particularly in the Wholesale division. You can find the usual detailed impairment slides in the appendix to the packs that you had this morning, but let me make some high level comments now.

In Retail, the improvement in credit performance was faster than expected a year ago. The charge decreased by 35 per cent, reflecting the improved quality of new business and effective portfolio management, and the continuing slow recovery of the economy.

The Wholesale impairment charge fell by 72 per cent, year on year, and we also saw a significant improvements in their half on half trend, in both core and non-core businesses and this result includes a modest amount of write-backs on closed out exposures. We have spoken before about trends in underlying impairment charges from traditional trading and manufacturing businesses and these may increase during 2011, but the typical lag effect of such charges as the economy improves should still be less than the benefit of lower absolute impairments from the real estate portfolios.

In Wealth and International, the impairment charge was 47 per cent up, reflecting increased charges in Commercial Real Estate in Ireland and Australia, in particular in the second half. The majority of the increase was in the non-core portfolios and the level of losses continues to be dominated by the economic environment in Ireland (more in a moment on that one).

Overall at a Group level we believe that, based on our current economic assumptions for the UK and Ireland, including of course unemployment and property valuations, we will see further reductions in impairment losses in 2011 and beyond, and we are still targeting an average 50-60 basis points charge by around 2014.

Looking now at our Irish portfolio in more detail.

Subsequent to our Interim Management Statement on 2 November of last year, we all saw a further significant deterioration in market conditions in Ireland, including concerns over the country's fiscal position which ultimately led to the approval of its application for EU and IMF financial support.

As a result of this situation and the possible economic effect of the austerity measures introduced in the Irish Budget, it is likely that economic recovery in Ireland will take longer to achieve, and that asset prices will remain depressed for longer than previously anticipated.

So it was right for us to revisit, in December, the timing and level of value realisation from our Irish portfolio, even though we saw little actual deterioration in exposures in the 4th quarter. As a result, we prudently increased the level of provisions against the portfolio, increasing the charge to Euro 5 billion or £4.3 billion which gives us a coverage ratio of 54 per cent at the end of the year.

As you know, our Irish operations are now closed to new business, and our focus is now on the efficient run-down of the portfolio. Having closed the regulated banking business in Ireland, we are managing the run-down using our UK based expertise. Our focus is on minimising losses and maximising value realisation over time but we have some way to go to manage this portfolio into completely safe territory.

So if Ireland dominates the Wealth and International story, let me briefly update you on the performance of Retail, Wholesale and Insurance divisions, before turning to balance sheet and capital strength.

The significant improvement in Retail profit before tax was driven by a 12 per cent increase in income, combined with the 35 per cent fall in the impairment charge.

Retail income growth, which included core business income up 11 per cent, was primarily a result of the ongoing repricing for risk, the continued though slowing move of mortgage customers onto Standard Variable Rate, and a decrease of the LIBOR to Base Rate spread. A strong increase in net interest income was partially offset by a reduction in other income, largely as a result of product changes as I mentioned.

In Wholesale the return to profitability was largely a result of the significant decrease in the impairment charge, which I mentioned before. That fall in impairments continues to be driven by HBOS real estate and related portfolios.

Although total wholesale income was down in 2010driven by lower interest earning assets in line with the Group's targeted balance sheet reduction, income from core businesses was up by a very pleasing 4 per cent.

Wholesale delivered a significant decrease in operating expenses, 9 per cent down, reflecting reduced levels of operating lease depreciation and further integration savings, and despite targeted investment in core business growth and in the very important Business Support Unit which is responsible for managing troubled assets.

Turning to the Insurance division.

At the half year, I spoke about our focus on value rather than volume, and of our stopping the selling of poor performing products.

That focus has produced the desired results.

So despite a decrease by 20 per cent in new business life and pensions premiums, UK new business profits rose substantially driving overall profits up 13 per cent and the division's margin up from 2.5 to 3.5 percent. This profit generation also relied on less capital intensive products thereby reducing new business capital strain significantly.

We also saw a strong performance in General Insurance. Despite lower income resulting from ceasing to write new PPI business, and of course, the claims related to last year's bad weather, their combined ratio improved to 79 per cent.

I would now like to move on to the balance sheet, the important role played by our asset reduction programme, and the strengthening of our capital base.

Firstly, asset reduction.

Well as Eric said, 18 months ago, we set out our strategy to reduce non-relationship assets by some £200 billion from the relevant asset pools of £300 billion. We remain both committed to this target and to be value focussed in our approach to this run down, albeit we took an exceptional loss this year, as you have seen, on exiting one situation.

During 2010, we achieved further reductions of over £40 billion bringing total reductions to £105 billion. So we have now achieved over half of the targeted reductions in 40 per cent of the time, and we are very pleased with the progress made.

The reductions in non-core assets achieved in 2010 has played an important part in shaping the overall risk reduction in the balance sheet last year.

However, our residual £195 billion of non-core assets - which is about 20 per cent of the group's overall balance sheet - still consumes a disproportionate 35 per cent of our risk weighted assets, thereby tying up precious capital and funding. In addition, they contribute only 18 per cent of income whilst creating two thirds of our impairment charges and are clearly loss making overall. The value approach that we have taken, however, has minimised the earnings hit from managing down such assets, whilst we have increased our capital strength significantly.

But the opportunity for group earnings progression is clear – and in pursuing our value focussed approach for managing down such non-core assets, we will continue to consider the right balance between the earnings impact of disposals and the capital benefit from risk reduction.

I have said a lot about risk reduction so far, so let's see the impact on risk weighted assets that has been achieved this year across the whole book.

Well RWA's have reduced by 18 per cent, driven by reduced asset levels, tighter risk criteria for new business, and the improving credit outlook. Reductions were also achieved through changes to our credit risk measurement methodologies.

Over the medium term, we expect further reductions in the Group's risk weighted assets, resulting from further asset reductions, less capital intensive new business and a positive procyclical effect over time.

Our capital ratios improved significantly during the year, primarily reflecting the reduction in risk weighted assets, and liability management transactions. At the end of 2010, our core tier 1 ratio had increased to 10.2 per cent, the tier 1 ratio to 11.6 per cent, and the total capital ratio to 15.2 per cent.

Over the medium term, we expect capital ratios to continue to strengthen through both the contribution from improved underlying performance, and further reductions in our RWA's

Before I move on to funding, let's look at the potential effect of Basel 2.5 and Basel 3 proposals on our core tier 1 ratio.

We believe that the implementation of the Basel proposals will only have a very limited impact on our capital ratios. What this chart clearly shows is that the impact from Basel 2.5 and Basel 3, which is expected by the end of 2013, is likely to be more than offset by the already announced asset reduction programme over that same period, thereby mitigating the effect of the proposed new regulation on our core tier 1 capital ratio, and this also demonstrates that we have significant capacity for core business growth.

In 2014, we expect the impact of the insurance deduction on the core tier 1 ratio under the transition rules that then kick in to be about 0.3%. This is before any mitigation or further repatriation of capital from our insurance subsidiaries.

To re-iterate our views on this topic, we are targeting returns on equity of over 15 per cent, in the medium to longer term. However given the uncertainties in the regulatory and capital environment, we cannot be more specific on ROE's at this stage.

Turning now to funding and liquidity

Well I am really pleased with our excellent progress here, it has been excellent,

During the year, we have substantially reduced the absolute level of wholesale funding - by £26 billion to under £300 billion, reflecting a combination of good retail customer deposit growth and a reduction in balance sheet assets. We are also very pleased with the significant 22 per cent reduction in the Group's reliance on short-term wholesale funding over the last two years.

Over the next few years, we expect the combination of customer deposit growth and balance sheet reduction will further reduce the Group's wholesale funding requirement.

Pleasingly, the tenor of the Group's wholesale funding base has been maintained, with 50 per cent of wholesale funding, including bank deposits, having a maturity date greater than one year.

The Group continues to benefit from a diversity of funding sources, which have been enhanced by the establishment of a US Medium Term Note programme, a second regulated covered bond programme, and new issuances in Japan, Canada, Switzerland and Australia.

For the next couple of years we continue to expect our public capital and senior funding issuance to be £20 billion to £25 billion per annum. We made excellent progress in 2010 on our term issuance plans, achieving £30 billion of publicly placed term issuance. In addition, we issued a further £20 billion of privately placed term funding, a level we do not expect to repeat in 2011.

We made terrific progress in reducing our liquidity support from public and central bank sources, achieving reductions of £61 billion in 2010, leaving £97 billion outstanding at the year end, and indeed a further £13 billion of repayments of funding across all programmes has been made since the year end.

Of course, the main focus of those who write about this topic has been on SLS and we are well ahead of our contractual maturity profile having made significant early repayments and we are very comfortable about meeting future maturities.

And to clarify our funding position further, the Group currently receives no liquidity support from either the US Federal Reserve or the European Central Bank.

The Group has also made good progress in reducing the loan to deposit ratio. By the end of 2010, our loan to deposit the ratio, excluding repos, had improved to 154 per cent and the ratio for our core business improved from 128 per cent to 119 per cent. For the avoidance of doubt, the core ratio includes all the assets and liabilities of the proposed retail business disposal required under our state-aid obligations.

We expect the combination of continued increases in customer deposits and reductions in banking assets will deliver further improvements in the Group's liquidity and funding position. As a consequence, we expect steady improvement in the overall loan to deposit ratio to below 140 per cent over the next few years, in line with previous guidance.

We welcome the introduction of the Liquidity Coverage Ratio and Net Stable Funding Ratio. The actions already in plan to reduce the balance sheet are expected to ensure compliance with the future minimum standards, by their respective effective dates.

Let me therefore summarise our key messages on funding.

We have successfully continued to reduce the absolute level of wholesale funding and our reliance on shorter term funding, whilst growing our base of high quality relationship based customer deposits.

We are maintaining a substantial and high quality, liquid asset buffer, and we have substantially reduced our public and Central Bank support.

We have successfully completed £50 billion of term issuance, well ahead of plan, and did so by drawing on a very diverse range of funding sources.

The flexibility we have created is ahead of our previous guidance and we expect to continue to achieve further reductions in our wholesale funding requirements in the medium term.

So in summary.

I have taken you through all the material aspects of our progression in 2010 towards the medium term targets we set out last summer.

We have made good progress. We have strengthened the foundations of the Group by delivering continued strong progress on balance sheet reduction and by further reducing the risk in our business. We have improved our funding and liquidity position, and significantly strengthened our capital ratios. We have achieved a substantial fall in impairments and have delivered our initial margin targets earlier than previously expected.

Our medium term targets remain unchanged, however, as you know, António Horta-Osório will be appointed Group Chief Executive on 1 March next week. He will commence his strategic review at that time with the management team and with the Board, to further develop the strategy and actions needed to realise the Group's full potential. He expects to update the market on the outcome of the Board's strategic review at the end of June.

Having returned the Group to profitability on a combined businesses basis, we are now solidly on track to deliver further improved returns to our shareholders.

Looking forward therefore, and despite the headwinds we see in 2011, we have capacity for substantial core business growth and believe that the Group has strong prospects over the medium term.

And with that, I will hand you over to the Chairman before we move on to question time.

Sir Winfried Bischoff – Chairman

Good morning ladies and gentleman. Thank you Tim and thank you Eric. Before we move onto your questions, I thought it might be both appropriate and useful if I added a few words on our 2010 performance, secondly thanked Eric for his contribution as CEO and to comment briefly on the year ahead.

As you have just heard, we have returned to profitability. Risk in the business has been substantially reduced and we have seen a material improvement in our capital, funding and liquidity positions. It is this latter which I consider a particular highlight of our year. We start 2011 as a stronger business. However while 2010 may be characterised as the year in which the Group has turned the corner, challenges still remain.

The economic environment in the United Kingdom and its impact on our customers is one such. Also as in 2010, we will continue to devote a lot of effort to improving further our liquidity and funding positions. In addition, we will need to deal with a number of uncertainties around regulation and the outcome of the deliberations of the Independent Commission on Banking.

As you know, this is Eric's last Presentation before he steps down as CEO in three days time. And I would like to thank him for his service over the last 7 ½ years as CEO. He became CEO of Lloyds TSB in June 2003 and built it into a solid, high performing business with its focus on relationships and has through the cycle approached a risk management that has for long distinguished this bank.

Following the acquisition of HBOS in September 2008, and the onset of a financial crisis that subsequently impacted our industry, he ensured in the most testing of circumstances that the combined businesses created a strong platform capable of future growth. His leadership and organisational expertise leave us well on the way to delivering on the promise of the acquisition of HBOS.

As announced last year, Eric will be retiring in September in line with his contractual commitments. His knowledge of the Group and of our customers will, I am very pleased to say, remain available to the Board and myself until then.

2011. Turning to 2011. As I have already mentioned, 2011 may well be impacted by the evolving regulatory environment, where however we expect greater certainty to emerge. 2011 will also be impacted by our own actions and of course by the economic performance of the UK. We alongside four other UK banks have reached an agreement, as part of the Project Merlin, to support gross new lending of £190 billion to credit worthy businesses. We have also committed ourselves to a number of other initiatives to show more clearly the value, utility and contribution to the country of our institutions. As the largest UK focused bank, we expect to play a full and important part in helping the economy to grow and our customers to prosper.

Finally, having joined the Board on 17 January, and António Horta-Osório will be taking over the role of Chief Executive on 1 March next Tuesday. We are delighted to have attracted someone of his experience and understanding of our Industry. His track record of prudent balance sheet management and experience of integrating three well respected UK retail banking franchises, is well known and highly regarded. His drive and enthusiasm, his commitment to the customer, along with his proven ability to build and lead strong management teams, will be of significant value to all our stakeholders. He will share with shareholders his strategic review of the business at the end of June. The Board and I look forward to working with him to ensure the success of the next stage of the development of our Group.

I will now hand the Session back to Eric Daniels for questions and answers.

Question and Answer Session

Question 1: Cormac Leech, Canaccord

Firstly on the liquidity coverage ratio (at 71%) and the NSFR at 88%. I was wondering if you could give a rough idea of where those might have been at the Interim stage and perhaps the rough drag on the overall PBT of any change in those ratios over the six months.

Answer: Tim Tookey

We didn't actually calculate those numbers at the half year. The regulations have been evolving and this is the first time we have been sharing with anyone how those ratios look. So I am in the unusual situation of being unable to answer your question.

Further question

One of your UK banking peers has a structural hedge in place against its deposits. I am just wondering to what extent you have a similar, perhaps rolling swap, programme in place? And whether you might consider ramping that up a little bit given you have a lower expectation for the outlook for rates in the UK than the market rates?

Answer: Tim Tookey

We do indeed have such a programme in place that covers a portion of the relevant parts of the balance sheet. That is something we have had in place in Lloyds for many years and HBOS had a similar programme. The impact of that rolling hedge is of course factored into both our income and our margin guidance and we are mindful of the trends in the market and keep a very close eye on that through our Asset and Liability Committee. We are quite flexible and we regularly review our position to make sure we are optimising our earnings potential.

Further question

Could you give us some idea of what the impact of a 50 basis point boost to the Bank of England base rate might be? I did some back of the envelope calculations suggesting it might have been about half a billion. Is that in the right ballpark? Can you comment on that?

Answer: Tim Tookey

It is an interesting question. I can imagine you have probably got that number from how other banks have responded to the question. It very much depends on how we use a base rate change and how it is deployed. My view is that if you took a 25 basis point rise and you applied that for a full year, then based upon how I would currently think about how we would use it would probably be around £100 million of annual benefit from a 25bp rise. So if you want to think about 50bps you roughly double that. But it would depend on the management decisions that we took at that time.

Further question

You guided house prices in the UK down 2% [in 2011] in this current presentation. I think at the half year we were talking about a rise of 3%. I think the derivative market is talking about a 10% implied decline this year. Could you give some guidance on what the impact on your loan losses is going forward? What would those look like? What would the delta on those be if you plugged a 10% decline in house prices into your micro models? I assume you do have a model that links house prices to your loan losses?

Answer: Tim Tookey

Yes of course we do. It is very hard to predict because it is not a linear progression. What you have to reflect on here is that a movement in house prices would only flow through directly into perhaps our repossession stock which is a very, very low number indeed. Far more relevant to how the Group would be impacted however is what is really going on in the economy and of course the biggest driver here would be what that meant for unemployment. As they say, the Englishman's home is his castle. For people who would perhaps get into a situation of negative equity in your scenario, that would not give us any issues per se. Far more important as a driver would be what happens around the economic performance and unemployment.

Further question

I think in your Presentation you pointed to non-core RWA's of about 35% of the total, or perhaps £140 billion, and then non-core assets of £195 billion which is expected to drop to £100 billion by 2014. Does that mean we should be thinking about non-core RWA's of around £75 billion by 2014 or will it be slightly higher than that given that the less liquid stuff is likely to stick on the balance sheet?

Answer: Tim Tookey

If you are getting to £75 billion, I imagine what you are doing there is taking 95/195$^{\text{ths}}$ of £140.9 billion. That gets me to £68.3 billion. So if we achieve a linear reduction in line with the remaining three years then I am talking roughly sort of £68 billion and that is assuming that we run it down from an even spread across the portfolio. I certainly wouldn't guarantee to hit that on the nail, but I would have a go.

Question 2: Manus Costello, Autonomous

One of the big drivers behind your drop in risk-weighted assets this year was the shift from advanced back to foundation predominantly in the HBOS portfolios. You are one of the few banks in Europe now who has a predominantly foundation approach to the corporate work. I wondered how long you were planning on staying on foundation for the whole Group and whether there is any regulatory pressure to move the whole thing back to advanced?

Answer: Eric Daniels

There is no regulatory pressure to move, but what we clearly wanted to do was to run the whole portfolio on a common set of risk systems, we think that is terribly important. What we will be doing is evolving toward advance status over time.

Answer: Tim Tookey

I think it is an important point, which is why I brought it out in my prepared words today. The impact of moving some of these models back to foundation is about £23 billion of RWA reduction. That is only 26% of the risk-weighted asset reduction that we achieved this year. So by far and away the dominating impact on risk-weighted assets has been better risk management in the business, the run-off of high risk, non-core assets. And that is why I feel really very good about the risk reduction we have achieved in the balance sheet. So this element of moving on models, is very much driven by giving us pace to deliver on integration and move forward. Of course it is being done with full hindsight and approval by the FSA. But it is a very small proportion, only 26% of our RWA reduction.

Question 3: Ian Smillie - RBS

Just on the RWA point. Are there any other buckets of assets which you think there could be a shift in terms of how you model them that we could anticipate leading to a further reduction going forward or is that it now?

Answer: Eric Daniels

I would anticipate that most of our RWA reduction will come from the old fashioned way, actually having to work the portfolios.

Further question

Thank you for the forward looking guidance on various parts of the balance sheet and P&L. To fill in some of the missing gaps could you comment on non interest income which as you pointed out, lagged in 2010, whether there is an ambition for that to grow this calendar year? And if so, from where?

And secondly on deposits which was a good performance in 2010. If you could give us some colour on what you expect looking forward, if we should anticipate more of the same?

Answer: Eric Daniels

What we would expect on deposits is, we will continue to raise the quality of the deposit book. As I mentioned in my prepared comments, what we are clearly doing is opening a lot of instant access accounts. These are very high quality, they stay with us for a long time. And they are a higher quality of deposit. What we are taking down are the hot money term deposits. So what you saw in a net of 5% growth in Helen's business, which was a very creditable performance, that it is actually a 15% increase in instant access and a 14% decrease [in term deposits] and we intend to continue that going forward.

Answer: Tim Tookey

The mix of other operating income as a proportion of total income will remain broadly constant over the next few years. I am excluding from that, obviously, any variations that come from movements in the equity conversion feature of the ECNs. The one feature you will see in 2011 of course is the annualisation of the drop in income following the cessation of PPI sales. And we have pulled out of that product last summer so you can get to that very quickly from the information on the slide.

Question 4: Joe Dickerson, Espirito Santo

If you look at your margin guidance for 2011, it is a slight downgrade on the H2 run-rate and I am wondering if that is because you expect your wholesale funding costs to increase in 2011 relative to 2010?

In some of these meetings in the past you have discussed the potential return of capital to shareholders either via dividend or what have you. Potentially even in 2012. If I look at your post Basel III core tier 1 ratio of 14.7%, even if consensus is 50% wrong, in the increase in RWA's from Basel 2.5 and Basel 3, are two times worse [than expected], you are still at a 12% core tier 1 ratio. So in my view it would be relatively over capitalised, relative to say a 9% target, so what would be your preference in dealing with that level of over capitalisation?

Answer: Eric Daniels

In terms of our margin, we are up 33 basis points year on year. And that was certainly far ahead of where we had expected to be at the beginning of the year. We were guiding to about 200 basis points. We ended the year with 210bps. What we expect going forward is we will have some of the same forces that were exited in 2010, we will clearly have higher wholesale funding costs and we are going to have some slowing of our transfer into SVR as the majority of that book is now done. And so that is why we are guiding toward more moderate margin expansion. But I would remind you that we got there early.

In terms of capital, we have never made any reassurances, but we have said there is a dividend prohibition until January of 2012. And I would imagine at that time the Board will look at the quality of earnings as well as the forecast for future earnings and will make a decision in terms of what we wish to do if anything in terms of return of capital.

Answer: Tim Tookey

Your analysis of that slide and your maths is impeccable. What I think you are spotting is something we have been calling out for the last couple of results, which is that the underlying momentum of the business and the earnings progression is clearly one that is going to generate significant amount of capital over time. What that gives us is a lot of optionality and flexibility both to grow our core business or indeed to take other actions which of course we won't comment on at this time, but can be available for consideration whenever we get there.

Question 5: Ed Firth, Macquarie

In terms of Basel III, the number you give us I think is including transitional arrangements. Could you tell us what the fully loaded number would be?

Obviously you have got the ECNs and the liability management gains which are big swing factors. Could you tell us what we should be putting in our models for next year for those?

Answer: Eric Daniels

I wish I could guide you in terms of what the models are going to be next year. Those tend to move with a mind of their own.

Answer: Tim Tookey

In reverse order. On the ECN's. The slightly bizarre feature of these is the stronger the Group performs, the less valuable the equity conversion option within the ECN's becomes. Because quite clearly markets are looking at the significant increase in capital strength in the Group, 25% higher in 12 months. And looking at the likelihood of conversion and saying well if it was remote before it must be even more remote now. So we are subject to volatility as to how the market perceives the value of that conversion feature. It is frustrating noise in the numbers which is why I will make sure and continue to make sure that I pull it out for you and talk about how the true business is performing underneath it. I wish we could predict it better.

Further question

Just in terms of the comments you were making though on non interest income, what were you assuming for those two big swingometers?

Answer : Tim Tookey

I am not making any projections going forward on how the ECN equity conversion feature embedded, will perform.

As far as Basel III is concerned, like other banks, to help you with consistency, I have given an impact at the end of December 2013. Recognising that transition is important and perhaps more important for us because of the treatment under Basel III of insurance, that is why I flagged on the very top right hand corner of that slide, the first one year impact of the five year transition on insurance at about 30 basis points. Based upon all the other numbers in the graph. So if you wanted to have a full impact on insurance, you would quite simply take those 30 basis points and multiply by 5. What I would stress however is of course that is before any further mitigating actions that the Group could take prior to 2013. I have only factored in the ones that we have done and have completed. We achieved £2.3 billion of Basel III mitigation during 2011. Credit to Archie and his team for the way they have approached this.

Further question

If I look on your website, I think you have got pretty much the highest standard variable rate in the market. I think you are charging almost 4% and I think you have even changed the name of it, in order to avoid breaching earlier commitments. So I guess my question is, if I look at your slide, you seem to be assuming that even in a rising rate environment, you are going to hold your asset margins. So are you assuming that that sort of margin on the standard variable rate remains robust through a rising rate environment? And I guess my question is, how realistic is that? Particularly when you look at the regulatory investigations that are going on at the moment into your market position.

Answer: Eric Daniels

Well I don't agree with your assumption that we have one of the highest standard variable rates. On the contrary I think we are a price more towards the bottom end of the market. But let me ask Helen Weir, our Head of Retail, to comment.

Answer : Helen Weir

In terms of our standard variable rate, actually we have some of the lowest rates in the market. C&G is at 2.5% and most of the Halifax book is at 3.5%. That actually compares very, very well with pretty much everyone else. Most of the other banks out there are 4% plus. So I wouldn't agree with that particular point.

In terms of looking forward, we clearly don't assume that mortgages are going to stay on standard variable rate. Clearly as base rates increase, more and more customers are going to roll of standard variable rate and we have taken that into account in all our modelling, looking at the various different tranches of customers, what their likely behaviour is and so forth. So that is all included in the guidance that has been given.

Further question

When I talk about standard variable rate, I think you have changed the name to Homeowners Rate or something [similar]?

Answer : Helen Weir

Yes, the Home-owners rate which is 3.99% which is still lower. As I have said, the vast majority of people in the market are at 4.2%, others are at 4.84% and some people are over 5%. The Homeowners Rate came in about 9 months ago, so actually we haven't got any mortgages that are sat on that rate right now.

<u>Question 6: Michael Helsby, Bank of America, Merrill Lynch</u>

It is quite interesting when I look at some of the new disclosure and the changes in the near term guidance. It feels like the influence of the new Chief Executive has already been felt, maybe ahead of the strategic review? That said, it is very interesting to note that you are still very much sticking to your medium term RoE target. So I was wondering if, we should take from that that he has given a blessing towards that RoE target?

Thanks very much for the non-core details. I think everyone has been asking for that for quite a while. What direct costs if any, can we allocate to the non-core business? And when you break out as you have done what is left, and clearly we have all been able to have a guess at what is left, they don't look very desirable assets based on what everyone thinks about the market at the moment. So I was wondering if you could give us some sort of view on how you think you are going to get out of those assets, be it run-off or disposal? And what disposal costs if any we should start to think about in that going forward?

Answer: Eric Daniels

We have been very successful in our asset disposals. As you know we have been disposing at the marks we have made. We are a prudent organisation, we mark assets conservatively. And when we dispose we are at or above our marks in most circumstances. So we have a very nice track record. Very clearly what we have in terms of the disposals coming up, we have some natural maturities in the Treasury and Trading Book. We clearly won't be renewing those. Those will run-off and no losses are expected from them. In other cases we have now spent more than two years with our very successful business support units working these assets. And what we do in the business support unit, unlike many workout units which simply seek to dispose of the asset as quickly as they can, we hope to manage those for value. So in many cases those assets/loans are now in much better shape after two years. They are much better run businesses, past the crisis point. So we fully expect that we will be able to dispose of many of these assets as we have in the past at or above the marks. So no, I don't think they are the ugly stepchildren.

Answer: Tim Tookey

Firstly in terms of guidance, obviously as you would expect, before we make any statements to the market, the Board has a medium-term plan. Everything that we talk about, how we expect the business to perform comes from that medium-term plan and therefore is subject to detailed analysis on its way through to, and then including Board challenge. So that is the derivation of it. As I have said today when Antonio joins as Chief Executive next week, he is going to start a strategic review. We expect that the conclusions of his review will be shared with the market towards the end of the first half.

In terms of non-core, it is difficult to give much more information because at the simplest level, we run the place as one business. And therefore there is a risk of spurious accuracy in trying to strip out expenses and say, "well this pound belongs here and that pound belongs there". I have seen one or two analysts start to think about it using the Group's cost:income ratio. And in reality that is probably not going to be a million miles out from looking at the overall proportion. But even from what you can see today, if you just take the percentages or, we have given you the absolute pounds of income and impairment, you can see that the non-core assets are indeed loss making. What I flagged in my prepared words is the flexibility that we can therefore increase in the business as we run down those portfolios. But there is a very careful balance to get. And I think one of the very satisfying things of the last two years is that we managed that balance really very well, with the exception on one exceptional loss we have taken this year on one particular situation. To have got rid of over £100 million of assets within the provisions that we have made, shows that you know so far we have got the balance about right. And the benefit of that comes through in a stronger capital base and lower risk-weighted assets.

Further question

Could you give us a view of the provisions in your balance sheet at the moment, how much of that allocates to the non-core assets you have identified?

Answer : Tim Tookey

The Group coverage ratio is 45.9%. The non-core is around 50%.

<u>**Question 7: Arturo de Frias, Evolution**</u>

14.7% core tier 1 is a very high number and even if you assume organic growth and you assume that the UK 'finish' is going to be 10% core tier 1 and some people think it is going to be lower, it looks more-or-less clear that there is at least 2-3 points of core tier 1 in excess in 2 or 3 years time, which on £400 billion of RWA's implies we are talking about anywhere around £5-7 or £8 billion of potential excess capital. I am not asking you to tell me that figure is right or wrong, but I would like to know, what would be the stance of this Group? Would that capital be spent on buying back shares or would that capital be spent on future growth which probably should be outside of the UK, given markets here etc, or maybe a combination of both?

On impairments, if I go to this very useful core versus non-core disclosure. If one third of the impairments of this Group is core, we are talking about around £4-4.5 billion. I am very inclined to use that as a number across the cycle, and assume this impairment level for the bank in a couple of years time. Would you strongly disagree with me on that?

And specifically on Ireland, 54% coverage looks clearly low given the loss experience in Ireland, particularly in commercial real estate etc. So what kind of coverage would make you feel much more comfortable going forward?

Answer: Eric Daniels

What we feel is that the 54% in Ireland is entirely adequate. Our actual impaired loans did not go up by much in the fourth quarter. What we thought was, that as Tim suggested in his prepared comments, that in fact the economy was going to be weaker and we would have the loans on our books for longer. And therefore we boosted the ratio. If you look at external benchmarks, for example, at NAMA provisioning, which we think is very conservative, that tends to be at about 59% but that has 5% capitalised costs in it. So we are just about bang on the NAMA numbers. We feel very comfortable with the level of impairments. And again it is not because we have new loans becoming impaired, but simply the view that we will have those on for longer.

In terms of guidance on through the cycle impairments, as you know, we are putting the place onto the old Lloyds traditional standards. We have said 50-60 basis points on our assets given our mix seems about right. And we have seen nothing to change that guidance so far. In terms of usage of capital, I can only repeat what we have said before, that we still have some capital uncertainties. We don't know where some of the significant pieces are going to land in terms of significantly important financial institutions counter cyclical buffers and so on. So we can't give you much more precision than we already have. But what we do believe is that we will be capital generative as you expect and that if and when the time comes we will be making an announcement to the market, but I think it is very premature.

Question 8: Rohith Chandra-Rajan, Barclays Capital

Three questions if I could please. Two on asset reduction and one on costs. Just in terms of the asset reduction just to come back to non-core. Non-core reduction has been running at about £20 billion for both the last two halves. I am just wondering if you can give any guidance in terms of what your expectation is for 2011, particularly in terms of what you see as the natural run-off versus disposals that may or may not have to take place?

Secondly, on asset reduction. Just if you could provide an update on the EC required branch disposals in terms of timing, P&L impact, and how you think about funding that may be sold with the branch disposals?

And then finally on costs, the guidance for flat costs in 2011, £360 million increased tax related expenses that you have highlighted (but if I understand the slides correctly, there is still £600 million of the integration benefits achieved in 2010 to come through in 2011) and further improvements in costs from the synergy benefits in 2011. So I am just wondering if you can provide a bit more colour around the cost guidance?

Answer : Eric Daniels

Let me talk about the branch disposals and then ask Tim to comment. Basically, what we have said on the branch disposals is that we would focus on the integration, and that is now coming to an end. We are more than two thirds through it and so we are going to begin to focus on the branch disposals. I think that we are giving you reasonably clear disclosures: our intentions are that we would complete the process by 2013, or earlier, and this is clearly going to occupy our time and attention as we finish the integration and then can free up the system's resources. We have made no further comment than that.

Answer: Tim Tookey

Your first question was on non-core run-off rate. Traditionally I have held back on guiding on the pace of non- core run-off. We have found that it actually can prejudice the discussions you have with potential buyers if they believe that you have got a public target to hit in terms of your run-off. They tend to see you coming and that can affect price. So I will keep mum, if you don't mind, on a target. But in terms of the run-off pace we have achieved, we have been pleased with that in 2010 second half. That was more than I had expected to do or needed to do in terms of plans. You obviously can see that we are confident of achieving the residual 95 over three years, so your 40 or 95 times 3 would imply something not materially different. If you did take your kind of number which is yours, not mine - then I would tell you that a meaningful proportion of that would be natural maturities of assets during 2011 which of course is an important contributor to the balance sheet reduction we are looking to achieve which is an important part of managing funding, and further improving the risk profile of the business.

You were also asking about costs. You are absolutely right, about £360 million of cost headwind comes from the Bank Levy, VAT and other tax changes. Yes there is about £600 million of synergies still to come, although of course the £600 million is the end of 2011 run-rate rather than a commitment of value realised in

2011. It may not be materially different, but there will be some kind of a difference. There is of course however inflation; there is a significant amount of investment going on in the business and this is investment in growing the core business franchises. This is investment in training. Our training budget was 9.5% up in 2010 versus 2009. That was the increase in training costs. We are spending more time training people in the call centres and the customer contact centres. We have invested in complaints handling. And we were particularly pleased with the 12% reduction we achieved in the second half last year of banking complaints. That comes from investment in people and investment in better processes. We have also, in the Wholesale Division, been investing in the support unit and that has been a critical area to help us manage so successfully the troubled assets and bring down impairment levels. So we are dealing with a very focused investment programme and we have to manage the headwinds coming to us through additional taxation costs that go through the expense line. Sorry for the full answer, but there is a lot going on in there.

Further question

Could I just ask for clarification on that. In terms of the synergy benefits coming through, so in 2010, the run-rate was £1.4 billion and the amount recognised in the year was 827 I think. So does that not mean there was a full year £600 million positive impact in 2011, even before you get to the synergy benefits that are created during the course of 2011?

Answer : Tim Tookey

The £825 million you are picking up is the incremental in-year synergies over and above the in-year benefit banked in 2009, which was £556 million. So we have low £1.3 billion's of in-year synergies in 2010. That includes a small amount of one off items that would not appear in the run-rate. I am afraid we have religion on what we allow into a run-rate number, to make sure we are only telling you what carries forward into future periods.

<u>Question 9: John-Paul Crutchley, UBS</u>

You gave some very useful detail on the dependence you have on central bank funding. The number for December 2010 is £51.2 billion which you flag is for SLS and the reserve bank of Australia. I know you can't give detail on the Bank of England, but can you give any kind of indication of your dependence on the Australian authorities so we can make some assumptions ourselves? And the £55 billion-odd we have seen over the course of the year, I wonder if you could comment on how that compares to contractual maturities and how much you have overpaid because of the funding and balance sheet management you have been doing?

Answer: Tim Tookey

There is very little central bank of Australia funding, which is their equivalent of a CGS type scheme. The CGS numbers in the other half of the disclosure is the UK, there is very little from the CPA. As far as the reduction that was achieved last year, if I compare the year end position to where we were from a contractual maturity profile 12 months ago, then we would be about £32 billion better than that contractual profile. You will be aware from comments that the Governor has made, that there were agreements with banks over some voluntary repayments, and we are actually inside our voluntary repayment line, but obviously by less than the £32 billion. But that is the order of play.

<u>Question 10: Steve Hayne, Morgan Stanley</u>

To be clear on revenue, do I take it that if interest earning assets are declining by call it maybe 5%, and you are saying flat margin, and other operating income may edge up a little bit, but not much, then are you saying revenue will be down in 2011 versus 2010?

I can see from your slide that you are assuming that base rates get to about 1.75 to 2% by the end of 2012, and you are at 48% of your book on SVR at the moment, which as I recall was already above 50% when we last heard, could you perhaps either Tim or Helen provide a bit more guidance as to how you expect that to decrease from here as base rates increase? Thank you.

Answer: Eric Daniels

Well just a quick clarification, SVR balances are still continuing to rise. So I am not sure where the number came from. We would expect that our portfolio going into SVR will continue to rise, but more moderately into 2011.

Answer: Tim Tookey

You are actually right on SVR. Last summer it was either 44.5% or 45.4%, I can't remember which one. What I would have been saying last summer was that we expect, and of course this is driven by customer behaviours, that we would have been around 50% this year end. That is why at 48% I refer to continue but slowing. And this is a trend that we will, as Eric said, we do expect to see it continue to increase. That will depend totally on customer behaviours, and how customers want to manage their own mortgage costs, if and when base rates start to move. So it is hard to predict and as we see base rates start to move, then customer behaviours will become more difficult to predict.

As far as income levels, one of my slides is heading "Limited core growth in 2011". So we were absolutely delighted to achieve our medium term target of 7% growth in the core income in 2010. That slide tells you I am not expecting to achieve that 7% core growth in 2011. Where that pushes over the overall income numbers will depend on the success we have in managing the non-core portfolios. But as I said, bearing in mind what we are doing with that, and what we are seeing as customer behaviours and deleveraging, then my judgement today is that the balance sheet will be smaller, as you quite rightly picked up, in 12 months time than it is today.

<u>Question 11: Chris Manners, Morgan Stanley</u>

I just have a question on retail secured impairment charges. Obviously they rose quite sharply from a small base in the second half of the year. You point to falling house prices, rising arrears in the second half influencing the charge, and also suggest that the charge should rise into next year. Still the basis point charge at 8 or 9 is pretty low. Where would you see the normalised charge for mortgages?

And also, you have been very helpful in giving us the guidance on the impact of rate hikes on your margins and how much extra income that could give you. If you were to get rate hikes, obviously that may put a squeeze on the ability for your customers to pay their mortgage payments. How much do you think base rate increases could impact the impairment charges in that book?

Answer: Eric Daniels

Let me try and give a little bit of context to start with. Firstly we are very pleased with the performance of our mortgage book. You can see that in terms of repossessions as well as arrears, we are running at a fraction of the Council of Mortgage Lenders. So it is a good book. Now very clearly the specialised book is performing differently and we have broken it out for you in the appendices, the buy to let, the specialised book and the normal book. But the great majority of the assets are in the prime book which is performing very well. Pretty clearly, what we have seen, is an increase during the fourth quarter and hence we have taken higher impairments. But what we believe is that this is a very clean portfolio and as Tim suggested earlier, we are much more sensitive to what is going on with the general economy and employment rather than house prices. In terms of affordability, very clearly one of the things that has been driving the very good performance across all mortgage portfolios in all institutions is that low interest rates are helping affordability. Clearly if base rates start to move up, that affordability becomes less, but what we would also expect is that as base rates move up, we will see some more recovery in the economy. So we will have to continue to measure and monitor, but by and large we are pretty happy with the performance of the book.

Answer: Tim Tookey

You will see that the customers new to arrears is actually flat. I am not going to play around with ones and twos, but it is flat for each of the last four halves. So that gives us a lot of confidence in how we are managing the book. The issue that Eric just referred to in terms of the slight trends in Q4, is particular to the buy-to-let portfolio, whereas in terms of repossessions you will actually see that the flow of properties into repossession has been on a steadily declining trend since about early 2009. And that is a trend which we are obviously very comfortable with. So it is a good example really, if you think about where we have been managing the business during 2010. We have been looking to absolutely get on top of and manage very well, all the things that we can control and we can influence. And that puts the business in a very good position today to deal with some of the headwinds of 2011, and deal with some of the things over which we don’t have so much direct influence.

Question 12: Ian Gordon, Exane BNP Paribas

Three very quick ones. Firstly just to follow up on Chris’ point there, if I am hearing you correctly, the take away on impairment sensitivity to interest rates you are giving us, is broadly similar to that which RBS gave us yesterday, i.e. a very small number to offset against the positive impact on the NII line.

Second point, tax. Are you able to give us any guidance on the effective rates in 2011, which hopefully will be a more meaningful number?

And as a supplement to that, are you able to more generally guide when you expect to be paid a normal rate of UK corporate tax again?

And then finally, an observation really. The combined business basis, profit before tax, in my view ceased to be particularly meaningful or useful. Personally I don't calculate it other than for putting it to your good selves for calculating consensus. I know it doesn't purport to drive book related valuation metrics, but I don't think it is a particularly useful guide for earnings related metrics either. So may I suggest for consideration that it is either reformed or abolished.

Answer: Tim Tookey

On tax you are right about the effective tax rate. What that reflects this year of course is that a number of the businesses have been loss making, particularly those overseas and therefore there is, we don't carry those losses for tax or anything going forwards. So that gives us some distortion. In terms of paying corporation tax, I would love to be paying corporation tax. What that would be doing is having the wonderful situation of paying tax on profit and delivering value to all of our shareholders which obviously will include taxpayers through the shareholding held by UKFI. I look forward to getting there as soon as we possibly can. Obviously the larger the profits you make the nearer the effective tax rate would actually trend towards the statutory rate. But that is probably all I can tell you in terms of guidance going forwards for an Effective Tax Rate.

In terms of the presentation of results. I think you have hit one very important point there, which is the relevance of the combined business basis to consensus and therefore what we try to do is make sure we are giving analysis of the results that matches the way the majority of analysts look at us so they can look at us and say, is this what I expected? Is it better? Is it worse? But I will reflect on your comments, thank you.

Closing comments: Eric Daniels

Okay with that, why don't we end the session. What I wanted to say again was I thought we had a very good year in 2010. The P&L is up, the balance sheet is much, much stronger and risk is reduced.

Thanks once more for coming and for your questions and I wish you all well.

End of Presentation