LLOYDS BANKING GROUP PLC – 2012 FULL YEAR RESULTS PRESENTATION

FRIDAY 1 MARCH 2013

António Horta-Osório – Group Chief Executive

Good morning everyone, and thank you for joining us for our 2012 results presentation. In the first part of my presentation I will give an overview of our 2012 financial performance, and describe the substantial progress we have made on our 3 to 5 year journey to become the best bank for customers.

George, our Group Finance Director will then give you the detail behind our 2012 financial performance and Mark, our Group Operations Director, will cover Simplification and costs. I'll return briefly to summarise and cover our expectations for 2013 and beyond.

We have significantly improved the Group's underlying performance in 2012 by approximately £2 billion, and our core business continues to deliver strong returns, above the cost of equity. I believe we have a very strong core franchise in place, and the work we have done so far throughout the year, including a further 5% reduction in costs, leaves us well-positioned for future growth.

We have continued to strengthen and de-risk the balance sheets. We have now reached a loan-to-deposit ratio of 121% for the Group and of 101% for the core business and in 2012 we reduced our non-core portfolio by almost a third to under £100 billion, all significantly ahead of plan.

I remain confident in our capital position and we have continued to improve our capital ratios, both on current rules and on the fully loaded CRD IV basis, in spite of the additional legacy provisions.

Whilst we have continued to make progress, I am of course disappointed that legacy issues, including PPI, have continued to impact our statutory performance negatively during the year. We remain committed to resolving these issues as soon as possible.

We have also made good progress on Project Verde. From this summer, we expect Verde to be operating as a separate business, the TSB Bank, within the Group. This will allow us to continue with the sale to the Co-operative Group or, if required, pursue our 'Plan B', an IPO, and therefore ensure we obtain best value for our shareholders, as well as certainty, and also for our customers and colleagues.

As the largest retail and commercial bank in the UK, our success and of the British economy are inextricably linked, as I have said now many times. We are prioritising actions which will stimulate economic growth, and we were therefore the first bank to access the Funding for Lending Scheme in September. We have committed in excess of £11 billion in gross funds under the scheme to businesses and households since its inception in September, having drawn £3 billion so far under the scheme.

Our support for UK SME customers is underlined by our net lending which, for the second year running, grew by 4% in a market that contracted by 4%.

Now, to an overview of our financial performance in 2012.

Group profit and returns increased substantially last year. This is testament to the actions we have taken in simplifying and de-risking our business model. Total costs were down 5% and impairments fell by 42% driven by a further improvement in credit quality, with impairment as a percentage of average advances falling by 60 basis points to around 1%.

These improvements, primarily driven by the substantial reduction in non-core assets, more than offset the expected decline in income given lower margins, in-line with our guidance, as a result of higher funding costs. As you will hear from George, we have seen encouraging signs of greater stability in both income and margin as the year has progressed.

This improvement in underlying performance meant that we report a much reduced statutory loss for the year, despite further significant provisions for legacy issues. On the core business we delivered a robust performance in 2012, in spite of the subdued environment. We had further reductions in costs and impairments, which broadly offset an 8% fall in income. This resulted in a further 10 basis point increase in the return on core risk-weighted assets to 2.56%, given lower RWAs.

Turning now to the balance sheet. In 2012 we delivered above market deposit growth of 4%, through our innovative multi-brand customer focused products. This, together with our non-core asset reduction, has allowed us to achieve our loan-to-deposit ratio targets 2 years ahead of schedule, which represents the completion of our funding and liquidity transformation.

As you will hear in more detail from George, we have made further substantial capital accretive non-core reductions in the fourth quarter, which have further reduced risk. This progress, combined with the transformation of our funding and liquidity position, leaves us well positioned to lend and to support the UK economy whilst continuing to improve our capital ratios.

We have a strongly capital generative business, and in 2012 we further improved our capital ratios. Our core tier 1 ratio increased by over 1% to 12.0% and the fully-loaded CRD IV ratio increased to 8.1%, principally as a result of non-core asset reductions and management profit, and despite taking further provisions for legacy issues.

Our achievements in fundamentally transforming and de-risking the Group's balance sheet have clearly not been without costs as George will mention. However, as already highlighted, our core risk-adjusted returns continue to grow as we improve the risk-return profile of the Group.

I will now cover our core divisional performance and returns in more detail.

In Retail, we have made good progress in driving performance. As a result we have further increased profits and returns, with underlying profit increasing by 21%. This was driven by strong cost control and a significant reduction in impairments that more than offset a 3% reduction in income. Credit performance continued to be strong, considering the economic environment. This was supported by our sustainable approach to risk, focusing on lending prudently and to existing customers, and also the low interest rate environment.

We continued to focus on areas where we can deliver further growth. In 2012 we supported the first-time buyer market, lending to one in four first-time buyers. We have now increased this commitment for 2013. In addition, we delivered strong growth in customer deposit balances, and attracted funds from almost one in every four savers. For 2013 and beyond, given the good work done so far, we will also start to show growth where we are under-represented such as in personal loans and credit cards.

As a result of the achievements in SMEs over the past 2 years, we created our new Commercial Banking division in the final quarter of 2012. This brings together our previous wholesale division, focused on UK mid-market and corporate businesses, and our Commercial business, focused on SMEs, in order to transfer best-practices across areas and accelerate our core business growth with mid-market and corporate clients.

Through this we will also create additional simplicity and generate cost savings, leading to greater capital efficiency and improved returns. I have given you a brief introduction to the division here today but we will be providing an in-depth insight into the business during our Commercial Banking investor event to be held next month and for which you will receive an invitation shortly.

We continued to support our UK SME customers, with 4% growth in loans in 2012, against a market that shrank by 4%, as I said. This now means a cumulative net lending of 7% over the past 2 years against a market that fell by 8%. Profits and returns rose as we delivered further reductions in costs, which were down 3%, and risk, with impairments down 33% causing both underlying profits and returns to increase in the year.

In Wholesale, we saw a significant reduction in impairment, down 40%, and an improvement in other income, which offset much of the effect of lower net interest income from subdued demand and higher funding costs. Costs were broadly flat as we continue to increase investment. Overall, returns were broadly stable, despite a small fall in profit, as a result of a reduction in RWAs in this business.

Now turning to Wealth, Asset Finance and International, where we achieved a strong 27% increase in profit driven by our focus on growth areas and further cost reductions. In Wealth, core underlying profit increased by 25%, with income growing despite subdued investment markets. We believe that we have a strong growth opportunity in Wealth, and expect to continue to leverage our offering as a relationship bank and grow our market share through increased internal customer referrals and new external customers.

In Asset Finance, UK profit increased by 13% as we focused on the growth of higher margin areas such as Motor Finance where the volume of new business increased by 11%, and in Lex Autolease, our market leading contract hire business, where deliveries also grew by 11%.

Regarding Insurance, during 2012, we brought together UK Life, Pensions and Investments, and General Insurance into 'one' Insurance business. This has led to a cost reduction of 8%, and will enable us to drive further synergies between Insurance and the rest of the Group. We are also actively managing the balance sheet, as we look to maximise capital efficiencies between the Group and the division.

Most of the fall in underlying profit reflects the subdued economic environment which drove lower return assumptions on our insurance portfolios, as well as the severe adverse weather we experienced last year.

However, the work we have done in reshaping the business means that we are well-positioned to focus on growth markets and optimise opportunities arising from regulatory changes. We are one of the market leaders for Corporate Pensions, and investment in our Annuities proposition will mean we can compete more effectively in an increasingly open market.

Moving on from our divisional performance, I now would like to focus on how we are building the best bank for customers. As I mentioned at the start of the presentation, the Group is now in a far stronger position than it was 18 months ago. We have reshaped our portfolio by focusing in the UK economy and by lowering non-core assets by almost half.

We have completed the transformation of our funding and liquidity positions. We have significantly simplified the Group from the customers' point of view, and at an accelerating pace as you will hear from Mark, and this is generating £2 billion of capital which we are reinvesting in supporting future growth across the Group.

As an example, to support our personal customers, we have further invested in and developed our distribution channels. We have upgraded our service on the high-street by refurbishing 421 branches, and extending opening hours. Our Digital proposition continues to improve, driving growth to 9.5 million online users and 3.3 million users of our mobile service from zero users only18 months ago.

These improvements are increasingly being reflected in customer surveys. Over 2012, based on performance across Branch, Telephone and Internet banking, Lloyds TSB has been the leading High Street Bank for customer service, and our surveys show that Halifax and Bank of Scotland have significantly climbed in the ratings.

To improve the experience for our UK Wealth customers, we launched the Private Banking Client 'onboarding' service. This has streamlined the referral process, both for customers and colleagues, with 115,000 referrals into our UK Wealth business in 2012, and is a further step in maximising opportunities for growth.

We have delivered a number of initiatives for our commercial customers. To further enhance our offering of capital efficient products we have continued to invest in Debt Capital Markets offerings and also our Transaction Banking capabilities where the number of clients migrating to our foreign exchange and money market e-portal, Arena, tripled in 2012.

In Insurance, we have continued to invest in areas where we are building a competitive advantage, such as Corporate Pensions and Annuities as I referred to you before. Our strong proposition has enabled us to achieve a 23% growth in corporate pensions in 2012. We have extended our current product range across annuities and protection, and are well-positioned for opportunities arising from the Retail Distribution Review.

All these actions will be key drivers of our future performance, and are central to achieving our strategy going forward.

Together with investing for the future and supporting the economic recovery, we have made substantial progress last year in delivering our commitments to help Britain prosper. We have helped more than 55,000 customers buy their first home, and as evidence of our ongoing commitment, have increased our 2013 target to helping more than 60,000 first-time buyers. We are also continuing to develop our product offering, shared-equity and ownership schemes.

On SMEs, we have continued to grow our net lending in a falling market and have helped over 120,000 start-ups in 2012 alone, exceeding our target. We have renewed our commitment to be net lending positive for our SME customers again in 2013.

We have also expanded our support for mid-market and corporate clients, committing £1 billion to manufacturing businesses and raising £12.8 billion of finance for our global corporate clients in the debt capital markets.

I believe our dedication to helping Britain prosper is underlined by the fact that we were the first to embrace the Funding for Lending Scheme, given our responsibility as the largest retail and commercial bank in this country, and have already committed £11 billion of gross funds, passing on the scheme's benefits to our customers.

Before I hand over to George, I want to take a moment to highlight the progress we have made in delivering on our strategic plan.

In June 2011, we set out our 3 to 5 year plan to transform the Group to create a high performance organisation, focused on our customers' needs, and with a prudent appetite for risk. We said we would invest in our simple, lower-risk, customer-focused UK retail and commercial banking model and would seek superior cost efficiency and a lower risk premium than our peers as key competitive advantages.

Over the past 18 months we have progressively accelerated delivery of our strategy, and as a result, are ahead of our plans and, importantly, we have done all this despite a challenging regulatory and economic backdrop, as well as significant legacy issues. As a result of these actions, the Group is now in a far stronger position. We have highlighted here some of our key achievements:

Firstly, we have proactively managed the run-down of our non-core portfolio, and have now achieved over 90% of our original non-core reduction target two years ahead of expectations. Importantly, this has been achieved in a capital accretive manner, as committed, while also delivering lower impairment charges than we anticipated. We have also exited or announced the exit from 12 out of the 15 countries we targeted to achieve by 2014 in the first 18 months.

Secondly, our balance sheet is considerably stronger, with our core tier 1 capital ratio now at 12.0%. With two years of above-market deposit growth thanks to our multi-brand strategy and comprehensive pricing, our core loan to deposit ratio is now in line with our long term target of 100%, and the Group achieved the 120% level two years ahead of our original target. We have also transformed our wholesale funding position, with a reduction of £126 billion, mostly in short-term funding, which now accounts for £51 billion, from around £150 billion only 18 months ago. This mean we are paying circa £20 billion of wholesale funding each quarter over the last six quarters through deposit growth and non-core reductions.

Thirdly, our drive to enhance simplicity and operational efficiency continues at pace. Through Simplification we have achieved a reduction in our cost base of £1 billion since 2010, again achieving our goal two years ahead of target. Significantly, this has been achieved with a substantial increase in customer service, as demonstrated by our NPS scores in all brands, and by halving complaints in the last 2 years. Mark will highlight in more detail the significant progress we are making across the Group in a few moments.

The progress we have made in reducing the cost base is enabling us to execute £2 billion of incremental investment behind customer-focused growth initiatives, including revitalising Halifax as a challenger brand and investing in more customer focused products and services, in Retail, Commercial, Wealth and Insurance.

As we said in November 2011, we expect the economic recovery to take longer than was generally anticipated at the time of the Strategic Review. However, the progress achieved so far, together with the benefits we are seeing from our investment into our core franchise, gives us confidence that we will achieve our income related targets in the medium-term, therefore achieving returns above our cost of equity.

I will now hand over to George, who will talk you through our 2012 financial performance in more detail.

George Culmer – Group Finance Director

Thank you António and good morning everyone. I'll update you on our financial performance and then cover our balance-sheet, funding, liquidity and capital positions.

Starting with the P&L As you heard from António in 2012 we delivered a significantly improved performance with reductions in costs and risk, more than offsetting the expected lower income. Group underlying profit improved to £2.6 billion with another strong performance from the core business at £6.2 billion and a £2 billion reduction in non-core losses.

Group management profit was £4.8 billion, and includes the benefit of actions following the movement in yields and credit spreads in the second half of the year. Asset sales comprise gains of £3.2 billion from gilt sales, as we repositioned this portfolio given low yields, and locked in our capital position. These gains were partly offset by losses on disposals of non-core assets of £660 million resulting in a net asset sales gain of £2.5 billion.

Liability management and own debt volatility were £229 million and £270 million respectively, and reflect the impact of our tighter spreads and buy back activity. Other volatile items were £478 million, while the fair value unwind was £650 million, and well down on last year due to the lower level of impairments.

Taken all together, these items come to some £2.2 billion in total, in line with last year and offsetting some of the charges in statutory profit.

Going forward we will be simplifying our reporting. This is the last time we will be showing management profit as a separate line item, and we will focus instead on underlying and statutory profit.

Looking now at income. Group income was £18.4 billion, with the movement on prior year mainly due to lower average balances, which are evenly split between core and non-core, and lower insurance income, primarily due to the changes in economic assumptions that we flagged at the half year.

Wholesale funding costs were £239 million higher than last year, while non-recurring items of £233 million predominantly relates to some one-off credits received in 2011.

Core income was £17.3 billion, and again was impacted by the decrease in average balances and increased funding costs. In terms of quarterly trends, we have seen an improvement in the second half, with the stabilisation of core loans and advances, and an improvement in other operating income, driving increases in underlying income in both Q3 and Q4.

Looking next at margins. The net interest margin for the year was 1.93%, and in line with guidance. Within this, the core margin has been very stable at around 2.32%, while the decline in the non-core margin largely reflects the impact of higher funding costs and, in the latter part of the year, non-core's share of the impact from government bond sales. As you know, we expect the Group margin to continue the gradual improvement seen in the second half, due partly to the decreasing proportion of non-core, and the guidance for 2013 is a net interest margin of around 1.98%.

On impairments, our performance clearly highlights the impact of our ongoing prudent risk appetite, strong management controls and the de-risking of our portfolios. The impairment charge was £5.7 billion, 42% lower than in 2011, and significantly ahead of our original guidance of around £7.2 billion.

The Group AQR was 1.02% for the full year and 0.95% in the second six months, with improvements over the year in both the core and non-core books, and with the overall Group ratio again benefiting from the decreasing proportion of non-core.

Impaired loans as a percentage of loans and advances are 8.6% and the average coverage ratio 48.2%. Within this, we continue to see strong trends in the core book. In non-core, the reduction in non-retail assets is the main driver in the movement from 34% to 32% for impaired loans, while the coverage ratio increased from 48% to 51%.

We continued to hold high levels of impaired loans and coverage ratios in our key lower quality portfolios. In Ireland for example, the overall portfolio is 64% impaired, with a coverage ratio of 69%, up from 62% last year. In Corporate Real Estate BSU, 77% of loans are impaired, up from 72% last year, with the coverage ratio unchanged at 37%.

Looking at the performance by division. In Retail, the impairment charge decreased by 36% to £1.3 billion, driven mainly by continued improvements in our unsecured portfolio. The unsecured impairment charge was down 41%, reflecting a more pro-active approach to collections and recoveries, and a further strengthening of our credit management. In the secured portfolio impairments were down 19%, with further reductions in impaired loans, driven by an improved performance in the back-book.

In Commercial Banking, the 30% reduction to £2.9 billion is largely due to lower charges in the non-core Australasian portfolio, where we have now sold most of the lower quality assets, and in Acquisition Finance where specific large impairments taken in 2011 were not repeated. In the core book the 33% year-on-year improvement reflects the good experience in the underlying book and again the non-recurrence of specific large impairments taken last year.

In Wealth, Asset Finance and International, the impairment charge fell by 59% to £1.5 billion, led primarily by lower charges in the Irish wholesale portfolio.

With the high credit quality of new lending, the successful management of difficult exposures, and the further decrease in non-core, going forward we expect further improvement in asset quality across the Group, and a further substantial reduction in the 2013 impairment charge.

Moving now to the statutory results. Here we show the movement from management profit to the statutory loss after tax of £1.3 billion.

Simplification and Verde costs totalled £1.2 billion. Within this Simplification costs were £676 million, with - as you will hear from Mark in a moment - the programme contributing run-rate cost savings of £847 million by the end of 2012. Verde build costs were £570 million. The provision for PPI was £3.6 billion, and I will come back to this in a moment.

Within other regulatory provisions, we have provided £300 million for the cost of redress for interest rate hedging products. We have also allowed for associated costs of £100 million. Also included here is the £150 million provision for German insurance business litigation taken in Q3, and a UK retail provision of £100 million.

As mentioned at the half-year, the past service pension credit of £250 million relates to the move to CPI for discretionary increases within the Group's main schemes. And volatility arising in insurance businesses totalled £306 million.

And finally, the tax charge for 2012 was £773 million, reflecting the trends seen earlier in the year, including the impact of the reduction in the UK corporation tax rate and changes in life insurance taxation.

On PPI, we have announced a further provision of £1.5 billion in Q4, which brings the provision for PPI in 2012 to £3.6 billion, and the total unutilised provision to £2.4 billion. The net volume of complaints and the costs of contact and redress continue to trend downwards. Complaints received in Q4 were approximately 20% lower than in Q3, and around 30% lower than in Q2.

On monthly payments, there is a similar trend, with the average monthly spend for Q4 in line with expectations at around £200 million, a reduction of about 25% on Q3. Going forward, we expect the average monthly spend to reduce further in the first half of 2013, to around £160 million per month, before reducing again in the second half of the year.

Moving on to the balance sheet. As you heard from António, we have continued to strengthen our balance sheet and financial position.

In 2012, we have grown deposits by £17 billion and reduced non-core assets by £42 billion. We have also seen a reduction in core lending of £12 billion, although as previously mentioned, it was pleasing to see this stabilise in the second half of the year.

On liquidity, our balance sheet derisking and changes to regulation have given us more flexibility, allowing us to reduce primary liquid assets by £7 billion.

With these actions we have been able to reduce our wholesale funding by £81 billion, or around one third, in just 12 months. We have also seen a 12% reduction in RWAs, which is ahead of the 8% fall in banking assets and due entirely to disposals and derisking, and with no benefit from model changes.

As António said, all of this action has not been without cost in terms of lower income and margins, but in so doing we have fundamentally transformed our risk profile and balance sheet shape.

Looking now at non-core. The non-core portfolio now stands at £98 billion, significantly ahead of original guidance and we have already met our overall EC asset reduction commitment of £181 billion, almost two years ahead of the deadline. The £42 billion reduction in 2012 includes £12 billion of maturities, £6 billion of impairments and other movements, and £24 billion of asset sales, which we have continued to achieve in a capital accretive way.

Looking at the reduction by asset type, £37 billion was in non-retail portfolios, and included £14 billion in treasury assets, £10 billion of other corporate including shipping, aviation and leveraged finance, £6 billion in UK commercial real estate and a £7 billion reduction in international corporate assets, mostly in our highly impaired Irish and Australasian portfolios.

This reduction in non-retail is reflected in the movement in non-retail RWAs, which were down 42% and ahead of the 30% reduction achieved last year. For the non-core portfolio as a whole, the fall in RWAs was 33%, and in excess of the 30% fall in total non-core assets, and clear evidence that we are not simply selling the lower risk elements first.

Going forward, we are targeting a further reduction of non-core assets of £20 billion in 2013, and we are on track to achieve our target of a non-core asset portfolio of £70 billion or less by the end of 2014, with more than 50% of that being retail assets.

On funding and liquidity, as already mentioned, we have transformed our profile in 2012. Wholesale funding now stands at £170 billion, with less than 30% having a maturity of less than one year, compared with total funding of £251 billion in 2011, 45% of which matured in less than 12 months. We have also fully repaid all debt issued under the UK Government's Credit Guarantee Scheme, and we have just repaid £8 billion of LTRO funds.

Our liquidity position remains very strong. In addition to primary liquidity holdings of £88 billion, we have significant secondary holdings of £117 billion, and our total liquid assets represent four times our short term wholesale funding compared with less than two times 12 months ago. This strong position and our reduced wholesale requirements allowed us to repurchase over £15 billion of our term funding in 2012.

For 2013 we envisage no material wholesale funding activity, but we will continue to look at tactical opportunities. We will also look to further optimise our capital structure ahead of the detailed implementation of CRD IV.

Finally, on capital, in 2012 we further improved our key ratios, with a core tier 1 ratio of 12.0%, up from 10.8% and a fully loaded ratio of 8.1% up from 7.1%. Our total capital ratio of 17.3% is up from 15.6% and is already in excess of the ICB's PLAC recommendations.

All ratios have benefited from management profits, and from RWA reductions in non-core, offset by statutory items and other adjustments, including of course legacy provisions.

Our fully loaded ratio is based on the July 2011 draft rules, including article 45 for insurance capital. We have now however included a benefit of approximately 30 basis points from greater certainty on the resolution for corporate exemptions for CVA and the definition of default for retail mortgages.

We expect to continue to build our capital ratios in 2013 given our strong core profitability and continued capital accretive non-core reduction. However, I would expect greater intra-period volatility partly due to the application of revised IAS 19 rules for pension schemes. As I said at the half year and Q3, I am comfortable with our current capital position and outlook, and we are confident of meeting our capital requirements, and of course complying fully with CRD IV.

That completes my review of the financials and I would now like to hand over to Mark.

Mark Fisher – Director, Group Operations

Thank you George and good morning everyone. I will give you a brief update on our progress with Costs and Simplification. Looking at the total costs for 2012, as Antonio said earlier, we have seen a reduction of £539 million or 5%, to just over £10 billion.

This follows a reduction in 2011 of 4% and I think the strength of our performance here is reinforced when you consider the downward trajectory of our total cost base since 2010 where we have delivered £1bn of savings over the period. Indeed, since the acquisition of HBOS we have reduced costs by more than £2 billion, or just under 18%.

If we look at this in slightly more detail, you can see final savings from Integration of £177 million and then Simplification savings of nearly £600 million which is the primary driver of the overall reduction. This supports the further investment of another £170 million in our Strategic Initiatives, in line with our aim of re-investing a third of Simplification savings back into the business.

Full year costs of £10.082 billion take us very close to the cost target of around £10 billion by the end of 2014 that we talked about when we launched our strategy in June 2011. So we have effectively hit the target two years early and we now expect total costs for 2013 to be £9.8 billion or around there.

As I have said earlier, Simplification was a big part of the cost reduction in 2012. The annual run-rate savings increased by £605 million to £847 million and we remain bang on track to meet the increased target of £1.9 billion run-rate savings at the end of 2014 that we announced last year.

And I can tell you that the Programme is already paying for itself – the savings delivered so far is already more than the cash invested. Simplification however is not just about cost savings, it is changing the Bank and I would like, briefly, to share with you how that is progressing.

I have talked before about how we are simplifying the way we buy services from outside the Group. And we're seeing some really positive results. We have reduced the number of suppliers we use by a further 4,700 in 2012, bringing overall numbers down by 41%, from over 18,000 to now around 10,500. And we are focusing our spend with a much smaller number of key suppliers and we now have over 75% of spend with our top 100 suppliers and indeed over 30% with the top 10.

We're also concentrating on having partnership based relationships with our key suppliers rather than transactional so they better understand our business and provide better solutions at better prices. All of this is showing through in very real terms with over £300 million of savings from this source to date.

We're also on track with our plans to consolidate our back office Operations into fewer larger Centres of Excellence, harnessing technology to automate and move to paperless processing. It gives us more flexibility where we can transfer work easily within and between sites to deal with fluctuations in workload.

To support these within the larger centres colleagues are much more multi-skilled and this gives them more variety in their work.

For customers, we've actually delivered over 200 initiatives to date. They range from significant re-engineered solutions, on key customer moments of truth, through to more modest but important changes that make a real difference. These improvements are being noticed by our customers.

You can see four examples on the screen of services and processes where we have made significant improvements and I will focus on a couple of these to give you a flavour of what we are achieving. As António has already mentioned, we are making great strides in developing our internet banking service. We now have 9.5 million customers banking online, and on Saturday December 8^{th} at 5.22 am, one of our customers living in Surrey decided to log on to the internet and became our 1 billionth log-on during 2012, and that is the first time we have achieved that.

More people are also using our services from mobiles, and smart phones and tablets. We have around 3.3 million active mobile users, conducting 4.2 million transactions per month. This is impressive when you consider it was only just over a year ago that we launched our mobile banking applications. Not only are customers benefitting from greater self-service, we are also starting to see real progress in the reduction of paper and post, helping us further reduce costs.

Turning to specific processes, one of the major enhancements we've made has been the re-engineering of our account switching process for new accounts transferring to the bank, which I spoke about last year as one of the key prospective deliveries in 2012. By introducing more automation, we've removed 23 process steps, and reduced error rates by two thirds and complaints by 50%. It has been a key component in the overall net acquisition of more than 170,000 new personal current accounts for the Group in 2012 and this has been particularly important in our Halifax brand, supporting our strong challenger bank proposition.

We can see on these charts how Simplification is making a difference for our customers. On the left you can see the data published only yesterday on banking complaints which all banks have to report to the regulator. We have reduced the number of reportable complaints per '000 accounts by over 50% since the first half of 2010.

And given this progress we have made, we are bringing forward our target of 1.0 reportable complaints per '000 from the end of 2014 to the end of this year. A year earlier than planned.

If we look at customer satisfaction data we are seeing real progress. We survey, through an independent company, around 35,000 customers every month who have recently transacted with us and the chart on the right shows what we call the Net Promoter Score. This essentially reflects the number of customers who would recommend the Bank to others, offset by those who would not.

What you see from this picture is showing us is that as well as complaining less, customers are also more likely now to be talking positively about our brands and our service.

So, to summarise. Our strong progress on costs continues and we remain ahead of our original targets. This is driven by the excellent progress of the Simplification Programme which is not only reducing costs but building a more efficient, sustainable platform for the Group, and centred on the customer.

Thank you, I'll now hand back to Antonio.

António Horta-Osório – Group Chief Executive

Thank you, Mark.

So our strong 2012 progress in a challenging economic and regulatory environment is evidence that we have the right strategy in place to create the best bank for customers and for shareholders, and that we have the management team to deliver it.

What do we expect to see in 2013? We expect to see the UK economy grow in 2013, although at a gradual pace as some Euro-zone derived uncertainty remains. Policy initiatives such as the Funding for Lending Scheme are helping to encourage this growth. In terms of regulatory matters, we continue to seek further clarity on issues at both European and national levels, including the outcome of CRD IV and the upcoming FPC review.

Through our actions we will continue to achieve cost efficiencies and built a lower-risk model across the Group and we will be continuing to invest in our customer-focused UK retail and commercial banking model, which is based on a very strong multi-brand core franchise.

This is not only aligned with the regulatory reform agenda, it will also enable us to differentiate ourselves from our peers, and rebuild trust by focusing on our customers' needs, supporting growth in the UK economy and addressing legacy issues. I believe we are increasingly well positioned for success, but we will not be complacent. We are all well aware, as a team, that this will have to be demonstrated every day, with every customer, at every interaction. This is what successful retail and commercial banking is all about.

So, what can you expect for 2013? Well, you can expect much of the same, and a bit more. We expect substantially lower impairments allowing underlying profits to increase substantially, and with much reduced legacy issues.

In terms of our specific guidance:

Firstly, we expect NIM to reach around 198 basis points in 2013 in spite of the impact of having sold a substantial part of our Gilts portfolio.

Secondly, given the pipeline of further cost savings, and despite further investment in the business and inflationary pressures, we now expect group total costs to reduce to around £9.8 billion in 2013, our previously revised total cost estimate for 2014, so a year ahead of the revised plan.

Thirdly, we are targeting a further improvement in asset quality and impairments following the better than expected reduction in non-core assets.

We are targeting core loan growth in the second half of 2013, as I said last year, driven by our proactive customer focused approach, and the Funding for Lending Scheme, despite the subdued economic environment and expected continued deleveraging of the UK economy.

And we will continue to reduce non-core at an accelerated pace and therefore expect a reduction of at least £20 billion in non-core assets this year. As a result of the substantial progress we are making, we are very confident in having a portfolio of less than £70 billion by the end of 2014, with less than £35 billion in non-core and non-retail assets.

And finally, given the strong progress to date, we remain confident of delivering our medium-term financial targets over time.

Thank you; we are now happy to take any questions you may have.

Question and Answer Session

Question 1: Tom Rayner, Exane BNP Paribas

Thank you very much, it's Tom Rayner from Exane BNP Paribas, could I have two questions please. First on margin guidance, 198 – could I encourage you to add a core margin guidance to that figure? And I would also be interested in a bit more of how the gilt sales at the end of 2012 is affecting both core and potentially Group margin going forward and deposit repricing as well, if you could update us on your thoughts? And I have a second question on Verde if possible please.

Answer: António Horta-Osório
Okay, address margin and George will address the question.

Answer: George Culmer
Yes sorry I am not going to bust it out into where the core margin will go and the non-core margin will go but I think you will have seen from the trend for 2012 you can see the strength and stability of that core margin. In terms of guidance, there are obviously a number of components to this number, sort of pluses and minuses regards that. Going through the pluses first, obviously you have got things like that decreasing proportion of non core that I referred to in my presentation. You have also got the shift in overall funding of the Group in terms of moving away from Wholesale to the Deposit funding. So those are the positives, you have also got the benefits from things like, the debt buybacks etc that we took action on in the second half of last year.

Going the other way though, accessing some of those changes in deposit and wholesale prices will take time. It could take time for the deposit book to churn. We, as I said in my presentation, we don’t expect to be materially active in the wholesale market in 2013. Also going the other way there is the run-off on things like the structural hedge which will be a slight drag, and then coming to your particular point on the gilts, yes, as I said in my presentation and António did, we were big sellers of gilts through 2012, accelerating that towards the back end as yields came down even further, so we sold out and realised that gain of £3.2 billion with yields around 1.60, 1.70 etc. We did that predominantly for economic reasons, we saw that there was value at that price and I think we have been proven right in terms of what has happened to prices since.

In terms of impacts of that, yes the NIM drag from an accounting perspective you will get, it knocks about 8 basis points off our 2013 guidance, so if we just add on our hands, that 198 would probably be around about 206 etc. we talk about. But the other big benefit it has is in terms of capital. I mean as you know from a capital perspective on current rules on CRD IV you reflect gains as they are realised so it is a big benefit there.

Also importantly I think under new rules it is done on a marked to market basis and by locking in, as I said in my presentation, by selling out and locking in we have probably secured up to about a billion of capital that if we would have just allowed the mark to market to basically grow and then contract as we moved into 2013, we would have lost from our capital position. So there was economic benefit to do it, there was real capital benefit to do it, of course everything comes at a cost and the cost is the sort of presentational impact, it does cost us about 8 basis points in 2013.

Further question
With changing rules on LCR you would be able to switch into some less liquid, higher margin assets that might actually be of benefit?

Answer: George Culmer
That flexibility, I mean to your point, now we’ve sold out, we now have that flexibility.

Answer: António Horta-Osório
I think to add two things here Tom. So we have said here quarter after quarter that we thought that as interest rates were going down. We did not think that our shareholders money should be used in 10 year gilts sub inflation. So as George said, as interest rates continue to decrease and reached very, very low levels in Q4, we have accelerated that for the reasons you have heard. I think it is important to add the following.

Going forward you have two impacts: One is the mere accounting impact which is these gilts that were in the portfolio were growing at much higher yields and we have switched that through a capital gain. But there is a second which is given that rates were very low and we still think they are low, we are keeping our liquidity assets much shorter duration than before and then you have obviously an opportunity cost which is the 10 year gilts are now at 2, and shorter money at 50 basis points. That is a real opportunity cost, but it has a risk as well, but you have the two impacts. So the 8 basis points that George is telling you that would otherwise been added to the NIM guidance, so the 198 plus 8, equals 206, is both part of an economic impact and an accounting impact. On the economic impact we think we should continue to put your money at lower durations. The accounting impact is just a change between future gains and locked in present capital gains which are already in the capital position.

Tom Rayner
If a Verde IPO were to become an option, I would just like to get a sense of what if any incremental costs there might be of going down that route than continuing on the route you are on?

Answer: António Horta-Osório

Well as we said here before, we are absolutely committed to our Plan A which is to sign the SPA after the MOU sign with the Co-op last year. And we have said before we were expecting to sign that SPA by the end of Q1 as we are in March 1st. So at the same time we said that Tom, we also said that we thought the right thing to do was to prepare this deal to be done as a fully fledged bank. We were building the bank and you are going to see the TSB bank in the summer, in August in the high street competing with the other brands. So either we proceed with our Plan A which we are absolutely committed to doing, either we can divert to Plan B which is IPO as it has always been, but up to now the path is the same because we are building the bank. We are now putting the customers across from all the bank, the branches of Lloyds in Scotland and Wales into Lloyds TSB Scotland, Lloyds TSB Scotland is what is the Verde project and will become the TSB bank, and we will be there by the summer. So if you ask the Co-operative Group which you should probably ask that question, as we have asked, they say they are completely committed to completing this deal and we are trying to help them as much as possible in order to do it. That is where we are focused on.

Further question

The incremental costs might not be material, is that a fair?

Answer: António Horta-Osório

It is fair to say that we are under Plan A and so far we are not so focused at this stage about the Plan B, but both are following the same path so they don't change from alternative to alternative at this stage.

Tom Rayner

Thank you very much.

<u>Question 2: Raul Sinha, JP Morgan</u>

Morning gentleman, its Raul Sinha from JP Morgan. If I can have two questions please. Firstly thanks so much for the disclosure on PPI and the claim rates. It looks like the claim rate that is currently being seen across the market is quite low and if I compare that to the relative provision that you have remaining on the balance sheet, I think you say £160 million a month for the first half of the year, you would need a significant pick-up in the rate of claims to take another PPI provision. Is that a correct way of thinking about it?

Answer: António Horta-Osório

I think it is a difficult question, better George answers.

Answer: George Culmer

I have had practice at this one! We said at Q3 that come the year end we would have more information than we have. That is part just the passage of time, but partly it gives us a full seasonality. We have got a full month actually of PPI at sort of full throttle coming through. What we have done is, you see at the end of the year had an un-utilised provision of £0.9 billion, and additional £1.5 billion, which gives us an un-utilised position of £2.4 billion. What we have done reflects a bit of what we have seen in terms of uphold rates, costs etc. but we have also taken a revised review of the ultimate likely cost. Yes the charts that we have shown show you how complaints are coming down and consequently costs are coming down. And you can see these sort of 20% falls Q4 on Q3 etc. On the average spend, that average monthly run-rate I think we said we expected it to be round about £200 million for Q4 per month and it was, December was about £150 million, there is a December effect in that, so the normalise for that about £160 million etc. Given the trajectory as I said in the Presentation, I expect that £160 million to stay at about that level because we were doing some past business reviews of the first half of 2013 and then to fall away after that. Now that is based on our expectation, that is based on our outlook. And if you do the maths and you see that we have significant monthly coverage. Now uncertainties do remain. You know I should say that. But what we have tried to do is put a provision that provides for a significant number of months of our expected claims.

Further question

The second question was on capital for Antonio. I think it was a positive surprise to see the fully loaded Basel 3 number up to 8.1%. And especially given if you note that one of your peers which operates somewhat more risky a business model, has raised the dividend with a similar core tier 1 ratio recently on a fully loaded basis, would it be right to think that it is pretty much that shrinking statutory loss that remains between the dividend?

Answer: George Culmer

I didn't catch the last part of that question?

Further question
Is it just the statutory loss that remains between you declaring or restarting the dividend now?

Answer: George Culmer
The key bit of the question as well wasn't it!

Answer: António Horta-Osório
This was not agreed with Basel, but this is the third results presentation I have to tell you the same thing. We have a highly capital generative model as you know because we have decided as you know because we have decided as you know to given the difficult economic environment lower interest rates, we have decided to focus the bank creating a competitive advantage in costs and in lower risk and therefore the consequence, All the nominal costs decreases we are achieving and the significantly lower impairments, not only from the core bank, but especially from the reduction of non core assets. Because as we sell there are no more impairments going forward. All that flows directly through the bottom line as you were saying. So we are generating as much capital as possible, going into the direction we believe of Basel. We don't know yet exactly what the intensity is. And given that lending in the UK is not growing, we are not using capital to support lending because, in net net terms the economy is not growing in terms of lending. So everything is in our strategy is capital generative. So what is going to happen now?

Finally I think that after this bonus cap approval, the CRD IV paper is going to come out and then the CRD IV paper is going to come out and we have been going in the right direction I think, are going to see the specifics of the paper, what is going to happen mainly with insurance deduction where we are being very conservative because we are assuming Article 45 and not 46. And as we see the paper, as I said for the third time, I will be able to discuss with the FSA and Andrew Bailey what is our capital plan, what is the stresses that FSA wants us to do and agree with him what is our path to dividend policy which I will come back and tell you. So I think this is probably the last time I am giving you this answer. But in any way we are working more than we thought, so as you said, quicker than we thought towards that capital ratio that we thought we would be at the end of 2014.

Raul Sinha
Thanks very much.

<u>Question 3: Chris Manners, Morgan Stanley</u>
Good morning everyone, Chris Manners from Morgan Stanley. Just three questions if I may. So I was looking at page 130 at the fully loaded Basel 3 leverage ratio, 3.1% and I thought given Carney's comments at the Treasury Select committee about leverage ratios as well being high up in his thinking, as well as risk based capital measures and the Parliamentary Question on banking standards suggesting that the Vickers 4% leverage ratio may be implemented, what sort of leverage ratio would you like to be running on a consistent basis? I know you give your core tier 1, you want to be above 10%. Do you have a leverage ratio in mind?

Answer: António Horta-Osório
We feel very comfortable with whatever of the ratios is approved. Our ratio that you see on that page as you just mentioned is not comparable with what other banks presented, not presented on the same basis. We are very comfortable with either 3 or 4. And what I think so from an industry point of view, that you have to be careful going to 3 instead of 4, because if you go to 3 instead of 4, there are two important points; Mainly mortgage banks in the UK, it would have a restriction. But for us given that we are a much broader commercial and retail bank, either 3 or 4 would not be relevant in our case.

Further question
Thanks. And I had a question on loan growth. Obviously you are talking about loan growth in the second half of the year. Just trying to work out where specifically in core where that would be and also you have got 120% LDR in core, [repeat, Retail core LDR of 120%] are you comfortable with that or would you still continue to run down or are you happy with that?

Answer: António Horta-Osório
Right, well we consider the loan to deposit ratio on a Group basis because I think that is the right thing to do, given that for example wealth which is highly deposit generic is not included in retail. So to look at it in retail alone I don't think is the right thing to do. We also have an online deposit business outside of retail so you have to look at it as a whole. And as we said in the Strategic Review, I thought at the time, and remember this bank came from a loan to deposit ratio of 169%, just to put it into perspective. That achieving by 2014 less than 120% in the core would be a good achievement. We are now at 101% in the core. And we are at a 121% in the total Group. I think this is correct because as we continue to shed the non core assets, the Group loan to deposit ratio will trend to the core and will become close to 100%.

So you can expect us continuing to increase deposits although at a slower pace, we will probably increase deposits more in line with the market, because we have already two years ahead of target reaching our target for 2014 and also our long-term target for the core.

What will happen in terms of lending and my comments in terms of lending, as I said in the Presentation, you have to take them in the context that I believe business lending to UK non financial corporations will continue to be negative in 2013. So as I told you at the Q3 results I continue to expect SME lending in our case to be positive. It has been positive now for two years, 7% against an 8% fall in the market and we will continue to grow at around 4%. Our pipeline absolutely sustains that and I am very comfortable about that.

Second segment, mid corps, that is one of the reasons why we have now put mid- corps together with SMEs because we want to put across the best practice of SME into the mid corporate space and have it growing. And I think as I said in November that the mid corporate segment and the large corporate segments will both turn positives in terms of net lending in H1 2013. And then give the colour on the total loop. As you know we wanted to achieve an around 25% market share in mortgages in line with our branch market share post Verde. And also to get the core at the100%, I thought, as I told you in November, we would reach it around Q2 and therefore our mortgage growth in net terms will start growing with the market after Q2 as the market in the UK is growing 1% and I think it will continue to grow 1% in net terms. You can expect our mortgages from the third quarter onwards to increase 1% and therefore all of our core lending as a whole in each of the segments is going to be positive net lending growth from Q3 onwards. That is quite precise answer. In spite of a falling market! And I feel that some research reports still don’t believe it, but we do here.

<u>Question 4: Manus Costello, Autonomous</u>

Thank you. It’s Manus Costello from Autonomous. I just wondered if you could give us some more colour on your decision to issue equity to pay the coupons on the tier 1 bonds? Because it seems something of a surprise given the confidence you are talking about in your capital generation and the fact that you are calling a lower tier 2 bond the other day, there seems somewhat contradictory actions.

And just as a follow-up on that, I wondered if you could give us an update on what your plans are for the stake in St James’ Place and what any sale would do for your capital position?

Answer: George Culmer

Yeah I will do the first bit. I would quite happily reiterate our confidence in our capital position and how that capital is developing, and how that capital position will move as we move forward. But in terms of those particular instruments what we are doing is applying a policy that is entirely consistent with last year. And that is all I would say.

Answer: António Horta-Osório

Relating to St James’ Place which I am going to reiterate. I find it is a great company, it is doing very well, I think it will probably be a winner out of the RDR. Prices are increasing in the market in line with good performances they delivered yesterday and we are very happy with the way the share price is going.

Further question

Just to follow up on that, George, accepting that it is the same policy you adopted last year, but in the numbers you are showing is your capital position is materially stronger this year and your outlook on capital is more optimistic, so why do you adopt the same position? Is it your decision or a regulatory decision?

Answer: George Culmer

Well thank you for those comments on our capital position, it’s not material and we are just being consistent with last year.

<u>Question 5: Ian Gordon, Investec</u>

Good morning, it is Ian Gordon from Investec. If I could have one request and two questions. The request is in order just to follow your progress against the core balance sheet footings, guidance, do you think we could have some divisional disclosure at the quarterly statement please?

And then the two questions are first of all on other income. Could you just provide a little bit more colour on the expected weak performance in retail other income and the encouraging performance in corporate other income?

And then thirdly, I am not asking for quantification, but would you be prepared to hazard a guess as to whether the reports of an end of summertime scale for your LIBOR settlement with at least the UK and US authorities is ballpark correct? Thanks.

Answer: António Horta-Osório
Can you repeat the last bit of your question, I think you asked three questions, but the third one wasn't..

Further question
The third one was asking if you would hazard a guess whether the reports of an end of summer settlement for your LIBOR settlement with the UK and US authorities is likely to be ballpark correct? I am not asking for quantification just a guess in terms of timescale.

Answer: George Culmer
Look LIBOR as we have said, you will see from our disclosures that our position is fundamentally unchanged. You know we are not the focus of the authorities be it in London, be it in Europe, be it in New York. And that is not something that we passively sit back and wait on, we are very proactive. So we are not the focus of their attentions, there may be others who are better informed in terms of likely settlements or whatever, but we are not the party to be speaking to.

To your first question, your requests on the reporting bit, I will take that on board. We are trying to simplify and shorten our reporting which may fly slightly in the face of your request, but I will take it on board.

Answer: António Horta-Osório
And I will answer your second bit which is I think the way I look at divisional performance is retail has very good performance this year where impairments and costs more than offset slight decrease in income which is basically originated by interest rate movements during the year and also a decrease in volumes as we have just discussed, and the OOI in retail specifically, you have to see it in a context where the markets have not been good. So you have less investment sales. In terms of bancassurance they also normally go down when economic circumstances are more difficult. So I would see it is in the context of the year. I think retail has been very good performance and has set up a basis to have an even better year in 2013. And you have to see that we have a very powerful retail franchise with three leading brands really complementary between themselves. So with a clear multi-brand approach to our customers with segmentation, where I strongly believe that the additional costs of serving customers in a multi-brand approach much more than compensated by the higher value that we give to the different needs of the different customers in the different brands. And as you can see, the Halifax brand for example has a very different strategy to Lloyds and it is absolutely in line with the culture and the DNA of each customers' brands.

In commercial, which is in a different stage of development, and you will hear more about this in the Investor Day with Andrew who is just sitting in front of you. Commercial has to set the basis to start growing in a proper way in terms of mid corporate and large corporate and get a higher share of wallet in the process where, by the way, as you know, is where we are investing most of our capital in terms of growth initiatives on the commercial area. So we have had very good results with the money markets and the affects portal arena where we treat our customer base, that uses it. We are substantially enhancing our transaction banking capabilities which are weak and we have to develop them further. We are the main bank to 20% of the UK mid corps and large corporate but we have weak transaction banking capabilities. We are investing heavily on those. And therefore you should know that in the future, see the commercial area increase their profitability. As I said before, through an increase in revenues, especially OOI and a decrease in RWAs and therefore capital allocated to the division.

<u>Question 6: Michael Helsby, Merrill Lynch</u>
Hi, its Michael Helsby from Merrill Lynch. I have got two questions and if I can have a request as well actually. Could you give us an average balance sheet that gives me the yield on your assets and liabilities? There are a lot of questions about margin. I think that would be really, really helpful.

So just on the margin. That is the first question. You have helpfully given us the 8 basis points impact from the hedge. And we have got a 13 basis point underlying increase for want of a better word, you have also identified quite a lot of changes. But could you help us by breaking down that 13 basis points into how you see it from asset spread, deposit spread? You mention the wholesale funding buy-backs and also the negative impact of the hedge? The reason I ask is because there has been a lot of movement within deposit pricing recently, so I would just like to get a gauge of what you are factoring in, that would be really, really helpful.

The second question is just on costs. I was wondering if you could give us a split of where the rest of your simplification costs are going to fall? Is that all in core or does an element of that go into non core? And if you can give us a gauge of how you see the non core cost base in 2014?

Answer: António Horta-Osório
I will answer the costs as it is the easier bit and leave the difficult one for George on the margin split. Look on costs I think what I saw this morning very quickly on the notes, I think it is a bit equivocative because what we basically did on costs is very simple, we brought the guidance of 2014 a year earlier into 2013. So I saw some people thinking, oh this is higher than consensus and therefore it is not as good. I don't think you should read it that way because we have not finished the year yet. What we did is basically bring the guidance of 2014, that 10 being brought to 9.8, we have now brought it to 13 which shows that we are very confident that we continue to go ahead of plan. As you see on the rest of the numbers right, the broad picture. And in terms of this bit between core and non core. As we said before in these presentations, we try to allocate only variable costs to the non core because non core will disappear.

So most of the costs in non core are variable and you should expect them to disappear over time. Not totally because they cannot all be variable, for example if you are in a region, costs in that region that only disappear when you exit the region. But they will be reasonably variable, so you should expect the costs in non core to go down as the non core assets go down as well. Okay. And we feel very confident as Mark said that we are only half way in terms of our simplification benefits and I would like Mark to give some colour, but before I do that I want to make an additional point which I think you should really think about.

It is very easy to cut costs, very easy, I mean I have done it all my life, very easy to cut costs! What is really difficult to do, what is really difficult to do is to cut the costs and with a proper trade off between costs and revenues and without impact on quality. And that is why we showed you that as we have cut nominal costs now for two years in a row and controlling with the general wisdom, our NPS scores are all going up.

Lloyds is now independent assessment, the best brand in customer service in the high street[1] and our complaints have more than halved in two years and are now per customer, the complaints per customer are now less than a third of our three main competitors. So I think this all combined shows how industrialised process we have and how we are doing this in the sense of cutting nominal costs. But as I always said from the customers point of view and therefore simplifying the customers experience and therefore having their feedback has higher quality and less complaints, and it is really the difficult thing to do.

Mark give some more colour on this please.

Answer : Mark Fisher
Yes clearly, the very easy job I have to do of reducing costs! It is really, if you think of it as portfolio, that I talked about relationships with the suppliers and sourcing. Those things we got on with very quickly at the start of the programme because you can do them quickly. Things like the reshaping the organisation through its spans and layers. So those are the early deliverables that have given a lot of the progress that you see to date. Meanwhile we are working very hard actually doing the heavily lifting of re-engineering customer processes, claims handling, those things which take time. They are big builds, particularly a lot of IT. They typically take 12 to 18 months to do, so clearly it is only now those things are starting to mature and flow through. So the latter part of the programme has much more coming through from a heavy lifting re-engineering point. Having said that, the supplier side is going so well we have actually got more to go there as well. So that is why we are confident that the second half of the programme as it were can hit the targets that we have set.

Answer: George Culmer
Your question on margins and request for average balance sheets, I am starting a list obviously of disclosure things. But on the NIM projection, you know I am not going to give you a detailed breakdown of where I see assets or where I see deposit pricing going. Obviously as you said, deposit prices are coming off, but it is not just a question of new pricing, it is obviously the interaction between maturing deposits and the new prices and we are obviously as you know seeing significant movements on the asset side of the balance sheet as well. So I don't want to frustrate you entirely though. The number I will give you though is in terms of the structural hedge, we would expect that to have about a headwind of round about 6 basis points in 2013.

Further question
Can I just come back on costs, because I am not doubting for one second that you can cut costs. I am just asking and maybe I am misunderstanding, but you have identified a simplification costs you have got left, so I am just trying to ask, is that all, that sounds like it is all in the core, that is all going to come off the core cost base?

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[1] *Compared to the other major High Street Banks (defined as Barclays, Halifax, HSBC, NatWest and Santander), using a composite weighted score of main current account holder's satisfaction with brand, telephone and internet services (among those using those channels in the last month) © GfK NOP Financial Research Survey (FRS), 12me December 2012 c. 45,000 adults surveyed*

Answer: António Horta-Osório

Well no, that is a good question, the simplification was the main programme that we have designed. We are going ahead of our simplification targets as you heard, but at the same time we are doing a systematic benchmarking of all the bank versus the best area in the world in that specific area. So we have a best programme ongoing on top of simplification which is to compare productivity metrics, you know organisation, in all the areas we are comparing ourselves with the best in each of the areas and we continue to reassessing how we benchmark and we want to be either the best in that area in the field or not to be in that field at all. So that is on top of what we are currently doing and that is a process we started in the second half of last year and that has more room to go.

Further question

But you are not prepared to go? I am just trying to gauge the non core because you have got your plan, so you have got your vision of where non core assets are going to be. So I am just trying to gauge what the cost base is because clearly the non core is going to get sucked back into the bank and I am just trying to gauge what that?

Answer: António Horta-Osório

I cannot tell you everything Michael. As you say the retail assets will come back to the core. So you can make an estimation of how much of the costs are under retail assets, they will come back to the core. We have assets that will go to zero in time, so less than 35 by 2014 and then to zero in time. And those are the assumptions that you should make and you should also see that they are as variable as possible with the caveat I told you about when there is a region it is not totally variable; it's semi-variable.

<u>Question 7: Rohith Chandra-Rajan; Barclays</u>

A couple just on your impairment guidance if I could please. Just in terms of the significant reduction that you anticipate for 2013, I wondered if you could comment on how consistent that is with I think consensus for impairments to fall by close to 20% and whether that is primarily driven by non core.

Answer: António Horta-Osório

You are speaking about the consensus for impairments?

Question

Yes consensus for impairments is down 20% in 2013, how does that? Is that consistent with your guidance?

Answer: António Horta-Osório

Well we cannot give you all the variables. Okay, we already gave you the volumes, the margin, the costs, we are not going to give the impairments. But I think without looking at the consensus number, I think the way to think about impairments is our core business will continue to perform at approximately the same level and the non core reductions will imply in additional significant decrease in impairments as it happened last year. So I think given we have been shedding risk across the board, I think you should split core and non core. Core is very close to its average long-term AQR and the non core is going down at an accelerated pace and impairments of non core will go down with it. That is the way I would look at it. If you want to add anything George?

Further answer: George Culmer

I think that is the best way to look at it, yes.

Further question

That's very clear thank you. And then just a follow-up to that is, to what degree your guidance reflects any work the FSA has been doing on asset valuation.

Answer: António Horta-Osório

That is a very good question, one of my favourites. I think the best confirmation that we have a good, appropriate and prudent provisioning policy and the proper marks is the speed at which we sell non core in a capital accretive matter. We told you last year we would sell £25 billion and we have increased that to £30 billion. When we got to £31 billion we said £38 billion and we finished at £42 billion, so we sold £42 billion in a capital accretive matter, generating £1.2 billion in the process which is interesting in an FPC context because we are generating capital as we sell the non core assets. And when you look at it you can see that the £42 billion in percentage terms are bigger, larger than the previous year as you saw in the presentation.

So we have increased the rate of decrease of non core, and when you look at risk weighted assets you see that assets, the £42 billion decreased 30%, the RWAs of 33%, so risk decreased even more than the assets. And the 33% decrease in RWAs which is £36 billion is larger in absolute terms, than the previous year's reduction which was £35 billion. I think that says everything about our marks and our capacity to sell non core assets in a capital accretive way.

Question 8: Peter Toeman, HSBC

Peter Toeman from HSBC. On a similar point, the FPC has been concerned about inappropriate risk weightings for banks and obviously a lot of commentary about your 16% risk weighting on the mortgage book. So I presume you are not expecting any push back from Andrew Bailey when you have your discussion?

Answer: António Horta-Osório

As George and myself, we both said, and George may give some colour on that. We are very comfortable on our capital position and you can see the capacity of generating capital when quarter after quarter both our core tier 1 ratio on a normal basis, on a fully loaded basis, increased by 25 basis points a quarter on average in spite of legacy provisions which will be substantially lower going forward. So we have an enormous capacity of generating capital. The marks I just answered, conduct we have answered before. And in terms of the risk weighted assets and those models, they have been agreed with our regulator. We think we are reasonably in the middle of the pack. And we are very comfortable as a whole.

I think the main point in the UK last year was actually the shift in focus from pure financial stability view into a balanced view between financial stability and growth and support to the economy when you saw in the summer substantial changes in the liquidity rules and the implementation of the Funding for Lending scheme. I think those are the facts as I said in our Q3 IMS and in our conference call that changes a balance that shows a much more balanced approach towards a realistic solution of the problem which I think is the right one and I do not think you are going to see significant changes to that approach.

Question 9: Chintan Joshi, Nomura

Good morning, Chintan Joshi from Nomura. Can I ask you on core loan growth from the second half, in case UK GDP doesn't grow would you still expect to grow core lending?

Answer: António Horta-Osório

I hadn't thought about that. We expect UK GDP growth of around 1%. So we expect slight improvement and we think the Funding for Lending scheme will help. If GDP disappoints and stays like last year around zero, I still think we will grow because what we are doing is not GDP driven, it is internal policy driven. So minor changes of GDP will not change our actions. We may have to make a bigger effort or slower effort, but I expect to grow our core lending in a falling lending market, small changes of GDP will not change that, they will change the intensity of our actions.

Further question

So if I take that forward, you have given some disclosure in the appendix regarding your share of remortgage which is below the market levels. Is that an area you would look to pick up your market share in and therefore might need to be more competitive?

Answer: António Horta-Osório

No, as I said before, in mortgages we only, our objective is to grow with the market from second quarter onwards, because of the reasons of core loan to deposit ratio, 25% market share. And we are going to continue to be focused on first time buyers because we think that is the real important part to support the UK economy so that is our focus. And the rest will grow with the market. Where we are going to significantly outpace the market is on the business lending, keeping SMEs for the third year in a row positive in a falling market and turning around the mid corporate and large corporate into positive in the falling markets within prudent risk criteria.

Further question

George if I could just follow up on Michael's question, I understand it is very tricky to give this margin moving guidance, but broadly speaking deposits are improving, wholesale funding is improving, so in that mix it is asset pricing that is probably giving you some back, so that net net you are at 198. Is that fair?

Answer: George Culmer

That is not a bad assessment, there are other headwinds going on as well, other sort of factors but that is not a bad summary.

<u>Question 10: Sandy Chen; Cenkos Securities</u>

Just well two questions. One on mortgage arrears and just a read across. Looking at slide 19, it looks like the mortgage arrears have been relatively flat for quite a while, trying to put that together with the properties and repossession which has come down, and also the guidance on mortgage forbearance which has also come down. Putting all those things together, does that imply a lot of restructuring of loans into interest only that are not included in the loan forbearance numbers or have I misread that?

Answer: Juan Colombás

I think forbearance, we include the restructure of interest only mortgages, the important thing in forebearance is the trend, and the trends are decreasing so there is nothing that is being cumulated behind the numbers we have in arrears. So our views on the mortgage portfolio is a flattish trend. The news is in the non core book because as we have said, it is a time for this book to season and you are starting to see the decrease in arrears of our core book which is good news. So I think what you could expect in the mortgage market is a kind of flattish trend.

Further question

Thanks and the other question that I had was on the core tier 1 ratio. The 8.1% I think that you have given, does that include the pension, IS19 pension corridor adjustment, the £2.1 billion? And what would your estimate be of how much you know fully loaded would come down?

Answer: George Culmer

No as I said in my Presentation that becomes effective from 1 January and one of the things I think it will bring is a bit of intra-period volatility. What I would say is though that stepping back I genuinely expect our core tier 1 on the current rules, under fully loads will continue to increase because of the core earnings and the continued accretive non core reduction. The IS19 will bring some volatility. It is not the full 2.1 in terms of impact because what happens at the moment is we will move from, we have got an asset that we recognise on the balance sheet and we will move to a deficit. But for capital ratio purposes you can't count the assets so actually it is not the full movement. So we estimate actually the impact on current rules would be around, it came in around about 40 basis points, it is probably now down to about 30 basis points in terms of the impact. It will be quite volatile. One of the things we are doing internally is working with the pension scheme trustees just to see if there is a way we can actually reduce that volatility. But it would be about 30 basis points on current rules.

<u>Question 11: Claire Kane, Royal Bank of Canada</u>

Hi there, it is Claire Kane from Royal Bank of Canada. I have a question on your, the best way to look at liquidity from your perspective. You have given us some ratios on slide 21 and the liquidity portfolio is pretty much flat year on year. But relative to your wholesale funding it is really increased. I was wondering if you could confirm whether your compliance with the LCR or if there is something you are working towards? And how we should think about the liquidity portfolio in absolute terms coming down over the course of 2013?

And then my second question, I was wondering if you could give us some more details on your comments on your plans to optimise the capital structure this year please?

Answer: George Culmer

Yes I won't get very specific on the second point. Obviously we have got rule changes coming up and we will continue to scrutinise our balance sheet and plan and to see what is the most appropriate structure for go forward. So sorry, very obvious sort of commercial reasons, I am not going to sit here and tell you what we might do. But what we are doing is looking at the balance sheet. As I said in my presentation, there is no need for any material Wholesale funding but we will probably look at tactical opportunities as I say and we will continue to scrutinise our balance sheet and see what we can do to make it as efficient as possible in the regulatory world to come.

In terms of the first question on liquidity, yes we don't disclose in terms of compliance with liquidity requirements be it ILG and LCR and obviously there being the recent rule changes in LCRs. We feel very comfortable in terms of our liquidity position and in terms of compliance with the regulatory requirements and we will always be looking to deploy that liquidity we have got as profitably as possible and look to, always I think look into putting it to use. But what I can tell you is in terms of regulatory compliance we are very comfortable with both ILG and LCR compliance.

Answer: António Horta-Osório

And I think you should look at our liquidity in the context as I also said in my speech of the journey. Because 18 months ago this bank had £300 billion of wholesale funding, half of it £150 billion short term wholesale funding, funding a 5 year mortgage portfolio. And now of the £150 billion we only have £50 billion. So we have repaid £100 billion of short term wholesale funding and £126 billion of wholesale funding together which completely changed the funding and liquidity position of this bank.

Of course it is a big cost because short term funding costs you LIBOR and wholesale funding or deposits probably cost you 2% over LIBOR. So that debt implies as you can imagine, that implies more than half, one and a half billion pounds of less income, but I would argue that it is income that should never have been there in the first place. And second it is complete and therefore given it is complete you will no longer see this impact going forward.

Question 12: Fahed Kunwar; Redburn

I notice I think it was about a week ago now, there was a sale of some non core assets, Countrywide assets to your, Oakshott. In the sale of the assets you provided some debt financing to Countrywide. My understanding was that vendor financing is not done in the non core business. I was trying to get an idea of does that debt facility remain in non core or does that get transferred to the core business?

Answer: António Horta-Osório

I would not comment on specific transactions. But I can tell you the way we are monitoring the non core disposals. So the staple finance that we are doing to non core deposits is minimal. Our policy has been not to do it. I have to tell you it is not an exclusion. So in the cases we think it is appropriate we do it, but our policy has been to do the non core without any kind of vendor finance.

Further question

Does that financing stay in the non-core, or does it transfer to core?

Answer: António Horta-Osório

It depends on the transaction. If it is a minimal. It is very, very small.

Further question

And one more question on margin. Obviously you talk about an 8bp headwind, but how much unrealised gains are left in the gilt portfolio? Are you going to continue to sell them and what kind of headwind does that have on the margin?

Answer: António Horta-Osório

Well as of December 31st, we have then as George said, most of it, but we still had some and we have continued to sell them. So I cannot sell much more, but we have continued to sell them, although now we have stopped because now interest rates are about 2%. But we have continued to sell them through January. Most of it had been done. So the £3.2 billion you saw was most of it to put it into perspective. So we have some left. We have done part of the sum left, still have a bit of the sum left. The point is very clear. I think you should take. We thought for a long time and that is why we acted according to what we thought that we should not have shareholders money in 10 year gilts sub-inflation, that was the basic thing. So as rates went down we sold more and more, as rates started to come up, we sold less and less. But fortunately we have almost finished.

Question 13: Michael Helsby, Merrill Lynch

Thank you. Michael Helsby, Merrill Lynch. Just two points of detail actually. You mentioned in your comments before about how your CRD4 deduction is still on article 45 and not 46. Can you just remind us again what the benefits of moving from one to the other would be?

Answer: António Horta-Osório

It would be at least 20%

Further question

And just on your DTA deduction, is all that on UK business, i.e., all UK corporation tax?

Answer: George Culmer

Very, vast majority of that yes.

Answer: António Horta-Osório

Very little international presence.

António Horta-Osório

Any other questions? Manus again, what have you found this time?

Question 14: Manus Costello, Autonomous

It's what I have not found actually. Just a quick follow-up. The fair value unwind, we don't have any guidance on it for 2013, 2014, 2015 and you say it is now moving below the line. So I wondered if you could give us an idea of what the impact will be for the next two years?

Answer: George Culmer

My take on fair value unwind, we used to give guidance on it and then be wrong all the time. So we stopped doing that. I mean I think for 2013 we have moved into a negative and I think it will be about 0.3 negative of that order.

António Horta-Osório

Any more questions? Okay so we are done. Again, thank you very much for coming and we will speak a little more if you want us to.

End of Q&A