Lloyds Banking Group plc – 2012 Q1 Interim Management Statement

Tuesday 1 May 2012

António Horta-Osório – Group Chief Executive

Good morning everyone and thanks for joining the call. I'm going to focus today's presentation on the strong progress we have made against our strategic objectives, and the resilient performance and strong return on risk weighted assets we have delivered from our core franchise in the first quarter.

For those of you who are not listening through the webcast, the slides are available in the investor section of our website, lloydsbankinggroup.com, and I will indicate which slide I am referring to as I go through the presentation.

With me today are Antonio Lorenzo, Director of Wealth and International and Group Strategy, Juan Colombás, our Chief Risk Officer, Andrei Magasiner, our Group Corporate Treasurer, and Kate O'Neill, Managing Director of Investor Relations.

Following my presentation, we will be pleased to answer any questions you may have.

Turning firstly to the overview and key highlights on slide 1.

We made significant progress in the quarter in strengthening the balance sheet, reshaping the Group and reducing risk, while the returns in our core business, which improved slightly, reflected the strength of our core franchise.

We reduced non-core assets by £12.4 billion, which is ahead of expectations, and as guided the sales were made in a capital accretive way. This means that we have completed around half our target for the year as a whole in just the first quarter of the year.

The total non-core reduction since December 2010 is now £65 billion, which is around two-thirds of the reduction required to get to our 2014 target of £90 billion, and we have achieved this in just 15 months.

Our deposit and funding positions have also continued to improve significantly.

We have maintained strong, above market growth in customer deposits, sustaining the 6 per cent year-on-year growth rate we saw in 2011 into the first quarter of 2012 with a strong contribution in retail

Our success in non-core asset reduction and deposit growth means that we have reduced our overall wholesale funding requirement, and further improved its maturity profile.

As a consequence, our loan to deposit ratio has improved to 130%, meaning that we have achieved our guidance more than two years ahead of target, and we have also improved our core loan to deposit ratio to 105%.

Also, in terms of our funding programme, we have now completed our planned term wholesale funding for 2012.

Finally on the balance sheet, the reduction in risk weighted assets means that we further improved our core tier 1 ratio to a very strong 11.0 per cent.

Turning to the income statement, our core business delivered a resilient performance despite the subdued economic environment, with profit before tax and fair value unwind down only 2 per cent compared to the first quarter of last year.

Core income reduced 11 per cent, reflecting subdued lending demands and the effects on margin of higher wholesale funding costs.

And while these funding costs also affected our net interest margin, we limited the decline in the quarter to only 2 basis points, mainly by further improving the core business' funding mix, with more deposits and less wholesale funding.

The further substantial reductions we achieved in costs and impairments significantly mitigated the effects of the fall in income.

And as a result, we delivered an improvement in the core business return on risk weighted assets up to 2.65 per cent, as you will see later.

Looking now at these trends in more detail and first the balance sheet on slide 2.

Funded assets have fallen by 11 per cent in the last year, driven principally by the reduction in non-core assets.

By comparison, risk-weighted assets have fallen by 12 per cent. This reflects the ongoing improvements we are making to portfolio quality.

And with 6 per cent growth in customer deposits, ahead of market growth, this allowed us to reduce our wholesale funding by nearly a quarter, or over £70 billion, from last year, thanks to an additional £20 billion in Q1 2012.

Moving on to slide 3.

The positive dynamics in this slide have resulted in a continued reduction in our loan to deposit ratio, notably in the core business which now has a 105 per cent loan to deposit ratio, and a further improvement in our capital position.

We have made excellent progress on our Group loan to deposit ratio, reaching our Group target of 130 per cent more than two years ahead of schedule.

We believe it is now possible for us to target a long-term Group loan to deposit ratio of 120 per cent, which we believe is appropriate for a retail and commercial bank. Assuming current market conditions continue, we would expect to achieve this within the next twelve months.

Let's now turn to some key focus areas, and firstly lending to SMEs.

Slide 4 shows that we continued to substantially outperform the market. Year-on-year we have grown lending to SMEs by 4 per cent up from 3 per cent previously, against a market that has contracted by 4 per cent as well according to Bank of England figures.

With £3.25 billion of gross new lending in the quarter, we are well on track to meet our commitment of £12 billion of gross new lending, and to deliver positive net SME lending in the year as a whole.

We continue to be very active in helping start-up businesses, supporting over 30,000 in the quarter, again ahead of the trend required by our target of supporting 100,000 in the year as a whole.

Now looking now at costs on slide 5.I am pleased that the strong cost savings momentum we delivered in 2011 has continued into 2012.

We have now achieved over £350 million of run rate simplification savings in just the first nine months of the programme. We increased this run rate by over £100m in the first three months of this year alone.

These savings were a primary driver behind costs falling 7 per cent year on year.

This first quarter reduction gives us confidence that we will see a nominal cost reduction in 2012 as guided.

However, I expect the percentage reduction to moderate as we progress through the year, given that on a number of growth initiatives, while the spend is front end loaded, the additional savings will be realised later on.

Turning now to slide number 6.While we are reducing costs, we are committed to continue improving the quality of our service for our customers.

Following the substantial improvements we made in 2011, we're on track to achieve our target reduction to 1.3 banking complaints per 1,000 accounts by the end of the year.

And we're also reducing the volumes of complaints referred to the Financial Ombudsman Service. But more importantly, as shown on slide 7, the volume of complaints, excluding PPI, that have been sustained by the Financial Ombudsman Service has declined dramatically, in sharp contrast to our peers.

I regard this as the key metric, given that it represents the complaints that are upheld by FOS, rather than the total number of complaints received by them, which includes those where there is no basis for complaint.
As slide number 8 shows, we are continuing to invest across the business, behind infrastructure and products focused on our customers' needs.

In Retail, these have included over 100 branch refurbishments and enhancements to our internet offerings such as improved international payments capability and further functionality in our Money Manager service, while in products we now have over 750,000 customers signed up for the Halifax Savers' Prize Draw, an increase of over 300,000 customers since the first draw in December last year.

In Commercial, we are committed to supporting our SME customers, including start ups, with over 30,000 supported in the quarter, and through our lending commitments as discussed.

In Insurance, enhanced product propositions have resulted in strong growth in sales of individual pensions up 12 per cent.

And in Wholesale we are seeing market share gains across most targeted areas, and strong momentum building in OOI driven by customer focused propositions. Good examples of this momentum are the more than 50 per cent growth in customers using the Arena platform in the last three months which has contributed to the 28 per cent year on year growth in foreign exchange, and the very notable improvement in large corporate relationship quality scores as benchmarked by Greenwich Associates, so that we now jointly lead the market on this measure.

And finally in Wealth we continue to make good progress on simplifying the model, bringing together the UK and International businesses, and developing new propositions ahead of the introduction of RDR.

So turning now to the income statement as a whole, which is shown on slide 9.

The strength of our core franchise, and the investments we are making in it, meant that we delivered a strong return on risk weighted assets – improved by 10 basis points despite the challenging environment, to 2.65 per cent.

This was despite core income declining 11 per cent as a result of the subdued economic environment and net interest margin reduction. However, thanks to the significant reductions in costs and impairments we delivered a core profit declining only 2 per cent on a lower risk weighted asset base, so we were able to improve our return on risk weighted assets.

Moving on to slide 10.We returned to statutory profitability in the quarter, with a profit before tax of around £300 million against a management profit of circa £600 million.

The difference mainly results from the costs of the simplification and Verde initiatives, while one-off items such as PPI and a pension fund gain broadly offset each other.

The substantial progress we made on simplification implied the acceleration of some of our initiatives and therefore the costs associated with them which are shown here in our statutory results.

The Project Verde costs shown also reflect the momentum on this project in the first quarter and are in line with our expectations and guidance.

Looking now at some of the key drivers in the income statement in more detail, and firstly margin and impairment trends on slide 11.Given the adverse trends in wholesale funding costs that we continue to experience, we delivered a resilient margin performance in the quarter.

Both Group and Core margin declined by only 2 basis points in the quarter, which was slightly better than expected. As we saw in 2011, the benefits of asset repricing and funding mix improvements partly offset higher wholesale funding costs at Group level.

And, also consistent with the pattern we saw in 2011, margin in the non-core declined more substantially, by 5 basis points, due to it being almost entirely wholesale funded.

For the year as a whole, our Group net interest margin guidance is unchanged and we continue to expect a year-on-year fall of approximately the same amount as in 2011.

There was a significant decline in impairments and an improvement in our asset quality ratio in both the core and the non-core books.

This was in line with expectations and positions us well to meet our unchanged guidance for a similar percentage of decline in 2012 to that which we saw in 2011.

And looking at Group impairment in more detail we move to slide 12.Despite the subdued economic environment, we achieved a 36 per cent year on year reduction in the impairment charge.

The largest fall was, as expected, in Wealth and International, driven by a slowing of the rate of loans becoming impaired in our Irish portfolio, and the disposal of a significant portion of our Australasian portfolio late in 2011.

In Ireland, we continue to increase our already high coverage ratio, which has increased to 65 from 62 per cent at the year end, and 66.6 per cent of the portfolio is now impaired, a slight increase from 66.0 per cent at the year end.

Moving on to slide 13.We are also continuing to see improving asset quality.

In Retail, the trends we saw last year have continued into the first quarter with fewer cases entering arrears compared to 2011, in both the secured and unsecured portfolios. This shows that our prudent risk appetite and the higher quality of new business is delivering what we expected.

In Wholesale and Commercial, we have also seen a very substantial reduction in the rate of assets becoming impaired, as you can see in the lower part of the graph. Looking at divisional trends on slide 14, we saw reductions across all divisions in the first quarter, versus the last quarter of last year as expected.

I have already mentioned the drivers behind the largest fall, in Wealth and International, and also in Retail.

Commercial also saw a decline, driven mainly by the continued benefits of our prudent approach to risk and therefore a further improvement in portfolio credit quality.

The fall we have seen in Wholesale's impairment charge has been driven by continued reductions in Wholesale Markets and Corporate impairments, although the increase against the first quarter last year was driven by impairments on a small number of large exposures.

I would like now to return to the balance sheet, and give you some more detail on the drivers behind our strong funding, non-core asset reduction and deposit performance in the quarter.

Turning first to deposits on slide 15; we continue to benefit from our multi-brand strategy, delivering growth more than double that of the market. It's clear that this strategy has been the right one to ensure that we capture opportunities across all segments in the deposit market.

We saw strong growth across our major brands.

On Halifax, we broadly maintained last year's growth in the first quarter through the ongoing success of our product innovations, such as the ISA Promise and the Saver's Prize Draw, under these challenger brands.

In Lloyds and Bank of Scotland, our growth rate increased, thanks to their strong customer franchises and further success in the ISA and term deposit markets.

And we saw a substantial increase in our other brands, driven by our enhanced term deposit offerings, particularly in Birmingham Midshires and C&G.

And, as you can see also on slide 16, we continued to achieve this strong growth through our focus on designing products which address customer needs, and not by paying market leading rates, as you can see from this ISA example.

Looking now at the non-core asset reductions we achieved in the quarter on slide 17.

We reduced non-core assets by over £12 billion in the first quarter as mentioned, which meant that at the end of the quarter we had achieved half of our target for 2012 as a whole, and in a capital accretive way as I mentioned before.

And while we continued to reduce treasury assets, which accounted for £7 billion of the total, we also continued to make significant reductions in other books.

For example, CRE reduced by £2 billion, including £0.7bn of disposals in the UK CRE BSU, and we made further reductions in the highly impaired Irish book of nearly 500 million Euros, excluding impairments.

As a result of the excellent progress we have made in this quarter, we are now increasing our expectation for the non-core asset reduction in the year as a whole by an additional £5 billion to at least £30 billion, and we now expect to achieve our 2014 target of £90 billion of non-core assets in 2013 so one year at least ahead of target.

Turning now to wholesale funding on slide 18.I am very pleased to have completed our 2012 term wholesale funding programme by now, especially given this quarter macro economic environment versus the previous one, resulting in a significant reduction in balance sheet risk under uncertain financial markets conditions and prospectives.

This slide shows the breakdown of public and private issuance towards our 2012 target, but excludes our participation in February's LTRO.

Our issuance showed a good balance between secured and unsecured funding, with the latter accounting for 45 per cent of total issuance, and a good diversity of sources, with the usual split of around two-thirds public issuance and one-third private.

We have no plans to issue any benchmark covered bonds or senior unsecured for the remainder of the year, but will remain open to modest further issuance as opportunities arise and if supported by the conditions in the market.

And as slide 19 shows, this issuance, together with a falling overall wholesale funding requirement, resulted in a further improvement in the maturity profile of our wholesale funding, with 60 per cent now with a maturity of over one year.

And with an £11 billion increase in primary liquid assets, these now exceed all our funding with a maturity of less than one year and our unsecured funding with a maturity of between one and two years, providing a substantial buffer in the event of further and sustained market dislocation.

And, as you can see on slide 20, with an increase in our total liquidity of over £20 billion, we now have a 245 per cent coverage of all our short term wholesale funding, up from 179 per cent at the end of the year.

So to conclude with slide 21 we made substantial progress in the first quarter against our strategic objectives.

We further strengthened the balance sheet and reduced risk by growing core customer deposits, by completing our 2012 term wholesale funding programme, and by making substantial reductions in both our wholesale funding requirements and our non-core assets.

In turn, these actions meant that we further improved our loan to deposit ratio, and strengthened our capital and liquidity positions.

And we delivered a resilient performance in the core business despite a challenging macro environment. Although the environment affected income growth, we broadly offset this with further substantial reductions in costs and the impairment charge, as well as lower RWAs, and therefore increased the core return on risk weighted assets to 2.65 per cent in the quarter.

Given the strong investments we are making behind our core franchise, I believe the Group remains well positioned to further deliver on growth opportunities.

And as I said at the year end, in Retail and Commercial banking, those banks who can create competitive advantage through a lower risk premium combined with best-in-class efficiency will be the ones that will achieve superior returns in the present economic environment and that will capture the opportunities as economic conditions improve.

Lloyds is quickly implementing this strategy, and we remain confident in the delivery of our financial guidance, including the enhanced guidance for non-core asset reductions and for a further improvement in our loan to deposit ratio.

Let me stop there and I will be happy to take any questions you may have.

Question and Answer Session

Question 1: Raul Sinha, JP Morgan

Hi, good morning. If I can have two or maybe three questions please? The first one is on PPI. Could you kindly disclose how much of the PPI provision you have taken so far, you have paid out already as of the end of the first quarter? Should I give you all of my questions straight away?

Kate

Well I hope you have only got two.

Further question

Okay, the second question would be on the LTRO. Antonio could you talk a bit about the margin and what impact we should assume on the margin for the rest of the year from your take up of the LTRO? Thanks very much.

Answer: António Horta-Osório

Okay Raul, thank you very much. I will make a brief introduction and then ask Juan Colombas to elaborate on PPI and Andrei on the LTRO.

So on PPI we made £375 million on the quarter. This is basically because there was a general industry increase in complaints in February and March. And it was because of more complaints, partially driven by CMTs. The main assumptions on our plan were exactly the same as when we made the provision last year. We think given with what happened in February and March that the appropriate thing to do in line with what we did, was to increase our provision by around 12 per cent. And this is our best estimate with the present available information.

Juan would you like to give some more colour on this please?

Further answer: Juan Colombas

Yes. The use that we have done on the provision so far is £1.8 billion.

António Horta-Osório

So therefore around 50 per cent use in terms of our renewed provision of around £3.6 billion as a whole.

Juan Colombas

Yes.

Answer: António Horta-Osório

Right, on the LTRO. As I said at the year end results Raul, we felt that the LTRO was appropriate for us given risk management at the bank. We felt that on one hand we could fully utilise our Spanish country lending risk by fully matching our assets and liabilities locally, accepting the LTRO through the Bank of Spain for our limited Spanish funding gap which was around 3 billion Euros. And we have accessed the rest through the Central Bank of Holland. Overall we said that we wanted to use around two thirds of our funding gap on our Euro non-core assets which will then repay the LTRO as they mature over the next 2-3 years.

In the meantime, I also said at the year end results, that given the overall exercise that the rating agencies, especially Moody's, are doing for all the banks in Europe, we thought it was prudent for the time being to leave the LTRO at the ECB where it is costing us some money, because the remuneration is 25 basis points and we pay 1 per cent as you know. And we have been doing that and we will do that until May/June until we decide on what happens to the Industry in terms of overall ratings, what we should do best in terms of optimising the excess liquidity we now have. You want to give some more colours to Raul, Andrei please?

Further answer: Andrei Magasiner

I think that was pretty much the whole story. I think in terms of the way we scaled it, we looked at the Euro denominated assets and liabilities on the balance sheet, the customer assets and the customer liabilities, and if you looked across our European customer assets, customer liability franchise, we had about an £18 billion equivalent funding gap which was largely funded through wholesale funding. So taking about an £11.4/£11.5 billion LTRO draw hedged about two thirds of that, closed that gap, and we are confident obviously you can see that run down schedule. As those assets run off we will use it to repay the LTRO, I think in terms of getting to the margin impact which is Raul's, the second part of Raul's question, giving him the numbers to answer it.

Answer: António Horta-Osório

So a mild, negative impact on the margin.

Further question

That is currently, but obviously as you deploy it you would expect there to be a positive impact for the second half?

Answer: António Horta-Osório

Yes I would expect that to happen, but as I said to you, we will decide exactly what we will do at the end of Quarter 2, after we see what happens with all the ratings agencies, with all the banks movements given the rating agencies' future announcements.

Raul Sinha

Okay, thanks very much.

Question 2: Chris Manners, Morgan Stanley

Good morning guys. I just had a couple of questions for you. Firstly, was on the impairment charge, obviously a lot better in the Quarter and I know you are saying it is too early to improve the guidance. But just on the sustainability of the core impairment charge, it did drop in the quarter, 36 basis points, and I think that is below your sort of longer term guidance. Should we expect that core impairment charge to sort of tick up in the future?

And secondly, was just on the core loan growth. Obviously down a couple of percent in the quarter. I mean should 2 per cent a quarter core loan growth shrinkage be a run-rate? It seems a little bit quicker than we were anticipating. Thank you.

Answer: António Horta-Osório

Okay, thank you very much Chris. Relating to the impairments, you were a bit sceptical when I told you about the impairment guidance at year end. We were very comfortable then, and after one quarter we are even more comfortable now because one quarter has gone, that impairments are going to go down according to our guidance in the same percentage as last year across all our major divisions and especially through International. We think that although impairments came out a bit better than we would expect, and I'll give you some more colour on this, we think it is too soon to say anything about the full year. We believe that the minus 0.2 per cent of GDP growth in Quarter 1 is not very significant. I mean the market was expecting 0.1 as you know. I already had a few questions this morning on my media press about this. I really think that this number doesn't mean anything. Because there was one additional day of holidays in the quarter, a significant proportion of the data is too sensitive, so I don't think it changes our guidance for the year in terms of macro economic assumptions. We continue to think, as I said at the year end, this is going to be a tough year. It is going to be broadly flat in terms of GDP, and we expect for 2013 a significant improvement with GDP growing between 1.5 and 2.0 per cent. So we think it is going to be a long and difficult recovery. And I think that the latest data absolutely sustained that. For example, the unemployment number was a bit better and decreased last month. But as we just talked about, the GDP number was a bit worse. We do not think it will change our macro economic outlook and therefore we are not changing our impairment guidance.

Nevertheless, in terms of impairment it is important to say two things in terms of giving you more colour and I will ask Juan Colombas to add a bit on this, and I will just mention two points. The first one, two of our portfolios have improved better than we thought, i.e. the mortgage portfolio which I told you I would expect around flat NPLs during 2012 or slightly upwards given unemployment trends, they have continued to go down on Quarter 1, which was a pleasant surprise. And second, our retail mortgages in Ireland went up as we expected, but not as much as we thought, given the change in the law in Ireland. So these were two specific examples where things went better than we thought, but still we are one quarter out of four. So I want to wait for Quarter 2 to give you more colour on this.

And I would ask Juan to also give some more colour on the other portfolios which behaved as we expected.

Answer: Juan Colombas
Yes pretty much what you said Antonio, so in the core book it is true that the number has come up better than we saw on the outlook for the long-term. I mean the Q1 is almost always a very seasonal quarter so could be subject to that. So I think as Antonio has said we are keeping the same guidance as we have set in the past for the core and non-core.

Answer: António Horta-Osório
Chris on the second part of your question, I think this question is more broad strategically because it is correct that our core loans went down 2 per cent. But they went down 2 per cent exactly because we wanted them to go down 2 per cent and very much in line with the guidance I gave you at year end. Going portfolio by portfolio, we think that in the Retail Book we have a stock market share of 28 per cent in mortgages while we have a 23 per cent market share of stock in savings and we thought we should equilibrate this market share so that it is 25 per cent, which is our overall market share in Retail post Verde sale, and therefore as I previously mentioned, we deliberately increased our market share of gross spending in mortgages by around 16-17 per cent instead of 20 per cent the previous year. Simultaneously we are repricing upwards new business in mortgages where the market followed us. And therefore you can see that mortgage prices have been going up over the past 5/6 months and we have been the major player and the major beneficiary of that movement. That movement is in my opinion a necessary movement because on the other side of the balance sheet, as we have discussed in depth, we have deposits being repriced upwards, and therefore both of the costs, the additional cost of deposits and the additional cost of wholesale funding from all banks in the industry, have to be passed on to a certain extent to our customers. So we have decided to decrease our mortgage book slightly because we have more repayments than any market share of growth lending of 16/17 per cent, but you have to see that together with the substantial improvement in new business pricing which will reflect as the year will progress because we write business 3-4 months later than the application is received at price.

But when you look at Retail as a whole, and as we have shrank the asset side of this for these reasons, we have increased significantly the savings side, and on the savings side we have increased our market share significantly again, where we have increased deposits in Retail by double of the market growth. We are estimating the market to have grown by 2.9 per cent in the first quarter, up from 2.6 last year and we have grown around 6 per cent with a very good behaviour again from Halifax growing 7 per cent and Lloyds accelerating to 6 per cent. And here our growth has doubled the market's rates has been done because of the segmentation. Our multi-brand strategy allows us to segment and attack or defend on a multi-brand, multi-channel approach depending where we have funds maturing or not in each channel or each brand, which is very helpful for us in terms of pricing. And therefore as you saw on our slide on pricing, and all of you can check that on the internet because the ISA campaign is ongoing at the moment, we are paying significantly lower prices than other competitors and still increasing pricing, increasing volumes by twice the market rate. This is basically in two examples I have given before, because our loyalty product in the Halifax lottery savings product has attracted a further 300,000 customers in the Quarter. And also because our ISA promise that gives the customer same value date of the date of the request is highly valued by customers and has not been copied by our competitors.

So I would say that on the Retail book, to summarise, loan growth has gone down 2 per cent in the total core. The majority of it is on mortgages and it was a deliberate movement for us as I told you. But as that part of the book shrank, I think you have to look at the liability side where we are gaining substantial deposits which, although they do not provide value today, they are, number one much cheaper than wholesale funding, and number two provide substantial value for the future when interest rates will increase as you know they are strongly inelastic.

And when we go to the second segment which is Commercial, compared to the market trends, where according to Bank of England's numbers of last Monday, the SMEs lending year-on-year is going down by 4 per cent, we have increased our growth on a net basis to 4 per cent. And we are also increasing deposits in SMEs above the market rate. And therefore on SMEs, we are growing market share in both assets and liabilities on our core book.

And finally on our mid corporate and large corporate segments, here we are decreasing in line with the market. We estimate the market is going down around 6 per cent year-on-year. And we continue to do a shift between exiting large corporates and multinationals and focusing our efforts in growing our mid size corporate book. The mid size corporate book has not yet started to increase, but we expect as the year goes by, for us to show similar patterns in the mid corporate space as we have shown through all of last year and in the first quarter in SMEs. So when you look broadly, I think you cannot extrapolate the loan growth of minus 2 per cent for the whole of the year. I think as I said at year end results, you should expect to see a loan growth behaviour in line with what you saw last year. And I think we are trying to grow where we see value and where we see market share opportunities. And we are decreasing where the market is decreasing and we think a margin/volume trade off is not appropriate for us to increase volumes.

Chris Manners
Perfect, that was really helpful. Thanks for the comprehensive answer.

<u>Question 3: Tom Rayner, Exane</u>
Good morning everybody. Tom Rayner here. A couple of questions please, both on similar areas. Thanks for the very comprehensive answer. But I am just trying to get a sense when putting all that together, you might expect to see the core book actually stabilise and how that ties in with the guidance for 120 per cent LDR? Because the deposit growth looks pretty good, so I am just wondering, how, to get the consistency between the growth or the decline in the core book and that target?

And I have a second question on impairment guidance, but maybe I could have the first one first.

Answer: António Horta-Osório
Let me take the first one because that is quite comprehensive as well. Well Tom, what I think is the following. Given that we are going much quicker in terms of non-core run down and we have advanced this 2014 target by one year. I think we should now target long-term the same core loan to deposit ratio as the Group loan to deposit ratio. Therefore our long-term target is 120 per cent and as we go through time the two will obviously converge. So that is why we have advanced the targets from group to the core targets of 120 per cent.

Second, given the present market circumstances, we think that we are significantly improving deposits as I mentioned, cheaper than wholesale funding. And therefore together with non-core reduction, we expect to reach these targets by March next year which would be our medium term target. But we will reach it in twelve months and we think the sooner we reach it the better because I repeat; non-core, we want to exit this in a capital accretive way, and core deposits are very valuable and we are raising them at much cheaper rates than wholesale funding.

So how is that fit with the overall guidance in terms of the core and where are we going to see the inflection point? Well as I have said at year end results, I expect that our core margin will make an inflection as we reach 100 per cent core loan to deposit ratio, because what is driving the core margin down by 2 basis points in the quarter is again the wholesale funding costs which are less and less, but they still exist in the core book because our core loan to deposit ratio is still 105 when it was 109 in December, but it is still 105 per cent.

So our repricing on the asset side in the core book, again more than offsets our increase cost of deposits on the liability side and our funding mix as I said was positive. So our core margin only decreased 2 basis points. As throughout the year and into the first quarter of 2013, we reach 120 per cent group loan to deposit ratio, I believe we are going to reach the 100 per cent practical, I repeat practical loan to deposit ratio. This is as long as deposits continue to be cheaper than wholesale funding. And when we reach that point, our core net interest margin will have inflected and start to increase.

Of course as I said to Chris on the previous question, our volumes for the year should have a similar pattern to last year and therefore they should be mildly down. Therefore volumes will be mildly down but by Quarter 4, Quarter 1 next year, the NIM will start to increase. And then it will be trade-off between volume and margin where our aim on the core book is to make the holistic picture of NIM and volumes as a whole positive, which is something which I believe will happen during 2013 to be more specific.

Tom Rayner
Okay. Thanks very much.

Answer: António Horta-Osório
I think, you see absolutely coherent with the whole picture that I just described to Chris on the previous question.

Further question
Okay and just on the second one on the guidance. I understand the core is partly driven by the macro, but the non more impairments obviously is more a function of the pace of the run-off. I am just wondering, is your full year guidance which is unchanged, does that give you some room perhaps to run-off the non-core by even more than the new targets without challenging the guidance? Or would you think the new £30 billion full year guidance is pretty much consistent with what you are still telling us? I am just trying to get a sense of if there is any, there is a link between the non-core impairments obviously and how fast you choose to run the book down?

Answer: António Horta-Osório
I think you have a very good question Tom which you also asked me relating to the year end results. I will give you the same answer I gave you then, but with different numbers. Given that Quarter 1 was good in terms of the LTRO impact on buyers and in my opinion in making banks more complacent about selling non-core assets, we were able to sell £5-6 billion more than we thought in our internal plan, and keeping the guidance for impairments. And I think this is a positive trade-off because we want to do this in a capital accretive way and therefore the more we can do with the appropriate trade-off between sales and hits to the book value as you were saying, the better.

So now we have revised the guidance upwards and we think that what we did in Quarter 1 was a discrete upward movement. And we are keeping the rest of our original plan for the rest of the year. And therefore we are going to do at least £30 billion while keeping our original guidance in non-core impairments. So if circumstances allows us to do better, we mean on impairments guidance, we are going to do it. As you are saying, there is always some trade-off between non-core sales and impairments. But our commitment is to do at least £30 billion within the guidance of impairment that we have given at year end, and that we are reaffirming that now.

Tom Rayner
Thanks very much, that was very clear.

Answer: António Horta-Osório

And it is important as well to point out as you were saying, that I think we should look at margin for the core book as per my previous answer to Chris on the inflection point. And as you said, on the non-core book, I think the equation is very different. The more we run down the less NIM we have and the less net interest income we have. But of course if we do it in a capital accretive way, not only that is positive for capital, but with less provisions, as you were saying, we have for the future. And that is very important, indeed it is another reason why our impairment guidance goes down, because in the non-core book we have less 27 per cent than we had the previous year, and we have the same risk pattern. And therefore if we do 26-27 per cent down again, we are just following the decrease of the non-core book's total volumes.

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

Morning everyone. I actually just wanted to follow-up on that last comment you made Antonio, where you said that the risk profile of the non-core book remains the same as you run it down. But I noticed that this quarter, assets actually fell by 9 per cent where risk weighted assets only fell by about 5 per cent I think. So the RWA intensity of the non-core book is actually increasing and I wondered at what point you would expect assets and risk weighted assets in non-core to start to come down in line?

And then perhaps in addition to that if you could just quantify how capital accretive the non-core run-off was? You have in the past given a number on that. I wondered if you have that for Q1 please?

Answer: António Horta-Osório

Manus, I think you are absolutely correct on the numbers. But if you look at those numbers compared to Q1 last year you will see very similar numbers. And therefore as a consequence I think you are going to see for the overall year of 2012, you will see as well very similar numbers to last year i.e. like in Quarter 1 last year, where financial market conditions were especially good, we have accelerated our non-core reduction mainly through the sale of non-core Treasury assets. And those non-core Treasury assets which are not worrying for us in terms of risks, they have much lower risk weighted assets and that is why you have this picture of non-core going down by £12 billion, but risk weighted assets going down by around £4-5 billion. So I think it is very much in line with Quarter 1 last year, where we did, if you remember, the same. And as the year progresses, and we do more percentage on the non-core assets portfolio and reach at least £30 billion you will see a very similar picture. So I am not at all worried about that, I think it is very much in line with last year. We did say, in a capital accretive way that we are not going to show them on a quarterly basis. Like last year we are going to show them on a six monthly basis. So you will see in H1 what we did. But you can see that given that our statutory results after tax were close to zero because we had to adjust our differed taxes from the change in the tax rate in the UK, our core tier 1 increases again because we have had decreased risk weighted assets substantially and with marks close to book value. That is why our core tier 1 increased another 20 basis points, very much in line with the previous year.

Further question

Thank you. So just to be clear, a loss of the remainder of the non-core reduction for this year will continue to be Treasury assets. So we should expect

Answer: António Horta-Osório

No I said exactly the opposite. Like last year we had a very good Quarter 1 of financial markets and therefore the proportion of non-core Treasury securities sold in Quarter 1 both this year and last year is higher than the average of the year. You should see throughout the year a similar pattern in non-core as a whole, similar to what you have seen in 2011.

Manus Costello

Sorry I misunderstood, thank you.

Question 5: Rohith Chandra-Rajan – Barclays Capital

Hi, thank you, good morning. I was just, on the exactly the same issue actually. I was just wondering if I could just clarify your comments a little bit. So if I understood correctly, the risk weighting of the assets that were disposed in the first quarter was about 40 per cent overall non-core is about 80 and if I understand correctly your guidance is that for the rest of the year the RWA reductions should be more likely 80 per cent weighting than the 40?

And then just related to that actually just in terms of understanding the capital impact, the disposal loss in the first quarter was about 8 per cent of risk weighted assets, as you change the type of asset that is disposed during the year, would you expect that to go up? And also in relation to that, just if you can give us any guidance on the mix between I guess run-off and disposal for the rest of the year?

I have a follow-up question actually on core book, but perhaps we could deal with non-core first?

Answer: António Horta-Osório

Rohith, we do not disclose between run-offs and disposals for commercial reasons. And so we are going to continue with that line. But relating to the numbers to clarify what you ask in the first part of the question. Last year, and we can give you the numbers again offline if you want to, I by memory I think we have decreased our risk weighted assets by around £50 billion with £35-36 billion in non-core. So you have a ratio of around 70 per cent and that is the ratio that I would expect more or less to be the same during the whole of 2012.

And in Quarter 1, given that the weight of non-core Treasury sales is higher, yet Treasury is lower, as it was as well on Quarter 1 in 2011. Okay. So we had last year £50 billion as it were reduction, from memory £36 billion/£35 billion in non-core and the rest split between core and between less risk profile of the books.

Further Answer: Kate O'Neill

Rohith if you have a look on Slide 8, there is a breakdown of the RWA's that might be helpful.

António Horta-Osório

Can you repeat the middle part of your question?

Further question

It was just in terms of loss expectations I guess for the rest of the year? So in the first quarter, it was about, the disposal loss was about 8 per cent of the RWA reduction, just if you can give any guidance on expectations for the full year?

António Horta-Osório

Where did you get the 8 per cent?

Rohith Chandra-Rajan

So 8 per cent is the £5 billion RWA reduction. And I think it was about £200-300 million loss on sale?

Answer: António Horta-Osório

Well we are not saying exactly the accounts about the capital accretion. So that is your own assumption. But what we have committed to do is to do the non-core sales in a capital accretive way. It is what happened on Quarter 1. We are going to show as we did last year at Half Year, and at Year End, the calculations that we do. And on top of being on a capital accretive way, I have said before, you have to also take into consideration that the quicker we sell the non-core, the less provisions you have in the future from those non-core assets which are no longer in the books. And that is our commitment. So we are going to do at least £30 billion within the present impairment guidance. And if we can do more as I said, we will do more and we are very confident that the impairment guidance will be kept.

Further question
Okay, thanks. And just on that actually. So I guess you are saying £30 billion this year at least takes you down to £110 billion. And then you expect to get to £90 billion a year earlier than planned. Does that change your sort of, I know it is a long way off, does it change your expectation for 2014 at all that you know you make substantial inroads to that £90 billion? Or is it just for that £90 billion residual is a lot more sticky?

Answer: António Horta-Osório
No, no. What you say is absolutely correct. We will be updating you on our new 2014 target at H1 which will be lower again than the £90 billion. We will continue to run down, I mean if you look at our non-core book, I think this is important. Our non-core book is not exactly a bad book. We have things there that are behaving well and which are there just because they are non strategic. So on the good part I would say that that book you have the mortgages which is a closed book of self certified mortgages which although they have high risk and therefore they are out of our risk appetite, they are behaving well in terms of the price we charge for them and in terms of the impairments and they are around £30 billion, we cannot sell them because they are SVR with the customer option of repaying them in advance, so they are quite sticky.

And on the other extreme of the book you have Ireland where they are practically no transactions. We were able to sell £500 million in the quarter which is very much in line with what we did last year in the whole year in Ireland which was £2 billion. Given we cannot sell, we continue to provision I think much more conservative than most of our peers or all of our peers, as you can see on your comparison. And the more we provision, the more likely we will be able to sell in the future.

If you take the two combined, Ireland is £15 billion and mortgages are £30 billion, you have £45 billion. So when we reach the £90 billion, we still have a lot of assets we can sell which are in the International books; In Wholesale CRE, in Wholesale other areas and therefore you can continue to expect us to go down. And we will tell you the new targets for 2014 at H1 Results which will be lower, obviously significantly than £90 billion.

Further question
Okay, thank you. Could I also ask..

Kate O'Neill
I think we are done Rohith, sorry.

Further question
Just one quick question on core....

Kate O'Neill
Rohith we will move on, thanks.

Rohith Chandra-Rajan
Thank you

<u>Question 6: Mike Trippett, Oriel Securities</u>
Morning, it's Mike Trippett. I just trying to piece together the new guidance on loan to deposit and non-core run-off. Just looking over the next year, if you take the £412 billion of customer deposits as the starting point, it is just a quick back of envelope, but if you do 6 per cent growth again, and apply a 120 ADR to that, loan to deposit ratio, you are going to have a non-core of about 100 per cent I think. That suggests still quite a bit of shrinkage in the core book. And in fact a loan to deposit ratio in the core that could be below 100 per cent. Is that the right way to think about it on a one year view? I appreciate you will update the longer-term guidance. But it still feels to me like there could be quite a bit of core shrinkage over the next 12 months?

Answer: António Horta-Osório

Well that is not the only option Mike, but I think that all the parameters is still correct. I mean in one year's time we will be at a 120 per cent core loan to deposit ratio. I think the non-core is going to be reduced further. And I think the core will trend to 100 per cent. And therefore all the parameters are correct. The proper trade-off between deposit growth, core shrinkage, and non-core shrinkage is maybe not exactly the one you think. And I already guided in a previous question that core shrinkage which I repeat is delivered from us in terms of Retail mortgages. And you have to see it together with margin uplift in mortgages which does not effect only new business, but all the internal transfers. And with saving significant market share gains in Retail, you have to see it all together. That is deliberate. You have to consider so that mortgages are going down because we want so that we could change that picture if we thought was the best combination for our shareholders. I think that you are going to see, as I just said, a significant non-core reduction and the core as a whole very much in line with last year. Deposits are going to grow above the market rate, that is our commitment. The rate, the specific rate, will depend on the trade-off between pricing, competitor behaviour and wholesale funding costs. This quarter, given that we were able to do it at good prices, through multi-brand strategy and innovation. Wholesale funding was very expensive, and our competitors did different things, we were able to grow at twice the market rate. But of course we have to adapt to the circumstances.

So I think broadly speaking you are correct about the ratios. I do not expect as I said before that our core will behave differently from last year. And I just told you that the different behaviour in mortgage specifically is more because we think the best trade-off at the moment is to slightly decrease the stock of mortgages and increase new business pricing where we are leading the markets. We have been the largest in the market, we are the main beneficiaries of that movement.

Further question

Okay, but I am arguing this from a positive perspective, not a negative. But it does look like the core loan to deposit would be below 100 per cent which is an amazing position?

Answer: António Horta-Osório

Anyway you have to see that our core loan to deposits ratio in the long-term will be 120 per cent and the reason we are trading down to 100 per cent is because our deposit gatherings in the Retail franchise and the SME and corporate franchise are being done, I repeat in a customer segmented way at lower prices than wholesale funding. And therefore as long as deposits are much cheaper for us than wholesale funding, we will continue to build and the trends, if the current trends continue, will go down to 100 per cent loan to deposit ratio. But that is tactical because we think that our core, and Group long-term loan to deposit ratio on a sustained basis should be around 120 per cent. Of course tactically we will move according to the markets and competitors' behaviour.

Mike Trippett

Thanks very much.

<u>**Question 7: Ian Gordon, Investec**</u>

Good morning, can I have two please. The first is a quick one on Ireland. Can you give me a rough split on the £526 million provision between Retail and CRE in Ireland?

And then the second question. Obviously within the current period you have deliberately taken some pain on income by accelerating run-down, partly offset by a better than expected margin. You haven't explicitly changed your margin guidance looking out to 2013 and 2014, but I think even we can do the maths and see that with the faster non-core run-off the NIM averages up and that is even before we make any assumptions for LTRO deployment or indeed your reduced vulnerability to wholesale repricing. So just on that point and with a core tier 1 already at 11 per cent above your previous guidance of maintaining core tier 1 comfortably above 10 per cent, when do you start to think doing something about emerging capital surplus? Thank you.

Answer: António Horta-Osório

Ian I am going to start with the second question and I will ask Juan Colombas to comment on the first question in case we have specific numbers on that specific question.

I think you are right that our core tier 1 ratio is improving significantly and sustainably. Our commitment was to be prudently above 10 per cent in January 2013 when Basel III transition begins which we have continued to think will be the case. So our 11 per cent now is not 11 per cent in a year's time. We said at year end results that the 10.8 per cent core tier 1 at December would mean under the same rules as of January 2013 and without the results of the year and any mitigating actions, would actually be 10.0 per cent in January 2013 under transition rules. So the improvement from 10.8 per cent to 11.0 per cent you might assume although I am not saying this specifically, that it could represent next year in January going from 10 per cent to 10.2 per cent, if you understand me. We want to be prudently in excess of 10 per cent in January 2013 as we are going to. We are very confident about that, as you also said, and I agree with all the trends you mentioned, our capital generation is going to continue to increase on a sustainable basis. We know this is very important for shareholders and it is a prime priority for us. As I said at Year End, I expect clarity in terms of the ICB paper in June as the Government publishes the White Paper on the ICB. And I expect clarity on CRD4 as Basel publishes the paper as well in the summer. So after H1 Results, I think I can be much more clear with you in terms of when we will be able to start paying dividends, which in any case we are doing everything in that direction. So we are just not having the conversation now because we need clarity, but we are doing everything we can in terms of risk weighted assets, non-core, margin versus volumes and capital generation in order to be able to pay dividends as soon as possible, And I intend to give you some time line and more specific guidance after we present our H1 results and see the two papers I have mentioned to you.

Ian Gordon

Perfect.

António Horta-Osório

Juan do you have any comments?

Answer: Juan Colombas

I think you can make up the numbers from page 18 of the IMS, but just to give a line on this. In Retail the increase in impaired assets have been about 1 per cent up from 20 up to 21. We are keeping the same coverage ratio of 70 per cent as we had at the end of December. And the amount of right-offs that we have done is very low, so you can make out the numbers from that. The majority of impairments that we have are from Wholesale. You can see also that the number of nil impaired assets in Wholesale Ireland have increased only by 1 per cent from 84 to 85. As we said, the possibilities of new impaired assets in Ireland is limited because we have impaired almost the whole book. And in terms of coverage, we have increased the coverage from 61 to 65 in the Wholesale book. So out of this you can see that most of the impairments are coming from the Wholesale.

Answer: António Horta-Osório

Ian just one point I forgot to add which I think is important in your first question which is in terms of dividend capacity for the future. When you look at our core book, the return on risk weighted assets has increased by 10 basis points as I said, to 2.65 per cent, and therefore if you allocate a 10-10.5 per cent core tier 1 to that ratio you can see a pre-tax return on equity and therefore dividend generation that the core book has. And as soon as we exit the non-core which we are doing as quickly as possible, in the proper trade-off for shareholders in terms of capital accretion, the more the core will emerge and the more I think dividend potential on the core book will be clear to everyone.

Ian Gordon

Absolutely. Thanks very much.

<u>Question 8: Arturo de Frias, Santander</u>

Yes hi, good morning. Two questions as well please. One short-term and one very long-term. The short-term one is the improvement in the funding mix that we have seen in this quarter, which I think has been quite substantial with a long-term funding of more than one year funding now being 60 per cent of the total versus only 50 by year end [2011]. Can we extrapolate this degree of improvement going forward or do you think that this quarter has been especially good?

And if you could give us a kind of guidance on or impression on where in the medium term this long-term versus short-term mix should stabilise, that would be very helpful?

The very long-term question, you almost answered my question in your previous answer. I am talking about long-term ROE for the Group. As you say the return on risk weighted assets of core pre-tax is 2.65 per cent, post tax is around 2 per cent. So allocating slightly more than 10 per cent core tier 1 as you just said, you get to an ROE for core of very close to 20 per cent. And as you say, you are reducing non-core as fast as you can. So once you get rid of non-core and that is probably going to be somewhere in 2014/2015 max, the core ROE which is around 20 per cent should be the Group ROE. So are you telling us that Lloyds is going to be generating in the medium term an ROE of close to 20 per cent? Thank you.

Answer: António Horta-Osório

I think you are absolutely right. And let me start with the second question and I will pass on to Andrei on the first one. I think everything you said is right. I will conclude your comments by saying the following which is slightly different. I think that given we will have some non-core as I have discussed, for example in terms of the mortgage non-core portfolio, and the Irish portfolio that you have to take that into consideration in terms of the sustainable return on equity. We are not going to exit those mortgages soon given the SVR, and they are okay as I said, and Ireland has a long way to go, number one. And number two, our core tier 1 and Basel III includes the deferred tax assets, because they are on the balance sheet, which (when excluded) is around 8.6/8.7 per cent. So we still have some way to go towards the 10 per cent of fully loaded Basel III by around 15-20 per cent. So if you can see those two combined, I think our ROE at the moment in the core book, which you described perfectly, is absolutely coherent with our long-term targets, which should be after 2014, around 2015, possibly 2016, of between 12.5 and 14.5 per cent. So we are very comfortable and I think that the return on risk weighted assets on the core book should give you confidence that we are going to reach the target we have set up for the whole bank of having a return on equity on a statutory basis between 12.5 and 14.5 per cent in the next 3-4 years.

Further question

Sorry, if I take the 20 per cent ROE and I take out as you say the impact from Basel III and I take out around 15-20 per cent from that, that is 4 points, that is 16 per cent. Once I take out Ireland I pretty much get to around 15. So I get to something that is about the higher part of your current guidance range?

Answer: António Horta-Osório

I am not giving any new guidance and I am not going dispute your maths. But you also have to consider the closed book of the self-certified mortgages. Okay, and of course we will discuss as we go because our aim is to do this type of performance quarter by quarter because we also want to be a boring retail and commercial bank in order for the predictability of our earnings to really come through.

Relating to the first part of your question, I think you are absolutely right. We did £20 billion in the quarter. I think that the £20 billion was, as you said, higher than what we would have targeted, and in any case, although it was higher, it was exactly the same speed as we did last year. Because if you look at last year we did £50 billion of wholesale funding. And we did an additional £30 billion of primary liquid assets. So together it was an £80 billion net reduction of wholesale funding needs. So £20 billion per quarter. So this first quarter was exactly the same rate as last year, £20 billion. Because our increase this quarter of primary liquid assets was eleven and a half billion pounds which was exactly what we took on the LTRO, so I think we have now five quarters at the same pace but of course the pace during the next three quarters will depend on the trade-off between the different variables of the environment, and I will ask Andrei to give you some more colour on this and what our targets should be.

Answer: Andrei Magasiner

Yeah, I think if you think back to 2-3 years ago and you think about the targets we were giving back then of about 40 per cent greater than one year, and the events that have played out over the course of the last two years, obviously you know it has been the right strategy to reduce non-core as fast as possible and improve our loan to deposit ratios as quickly as we could. I think the events of last summer and the continuing events in Europe have just underlined how that was the right strategy. Obviously all of that balance sheet deleveraging, and all of the cash that we have generated from that, we have targeted a reduction of short term wholesale funding. And so, as you point out, the wholesale funding proportion, the greater than one year proportion, has gone up to 60 per cent. Obviously there is an element of that which is wholesale funding is obviously a stock number. And to the extent that you generate cash, it is logical that as you generate cash you use it to reduce the short term wholesale funding piece.

I think your point it does beg the question which, we are not going to give you any guidance on at this point, and I think it is too soon given Eurozone events and the outstanding rating agency review that is going on for us, to give you any updated guidance. But it certainly begs the question as to whether the volumes of term wholesale funding in that £20-25 billion, whether we dial that back, and what the right answer is from this less than one year, greater than one year proportion and those are questions which we are obviously giving some thought to in the context of the environment. We need a few more months to see the outcome of the Moody's Review and what happens in Europe, and we will give you more guidance as we develop our thinking. But right now continue to focus on balance sheet deleveraging, derisking and reducing short term wholesale funding, because that is just a sensible thing to do in this environment.

Arturo de Frias

Okay, thank you very much.

Answer: António Horta-Osório

Arturo just to compliment this. I think, as you said, I mean this obviously has a finite environment. I mean the short-term funding has a finite environment in terms of we are very close probably to the percentage we will think is the appropriate one. And you should consider the very significant costs that we have incurred by changing and eliminating this very high risk that we have on Lloyds' balance sheet, between short term wholesale funding and long term for retail and commercial assets. And the impact that they have on our income line, because our wholesale funding costs are around 250 points on average and the short term wholesale funding costs are LIBOR. So all this very significant shift from £150 billion of short term funding we have on the balance sheet at the beginning of last year, going down to £90 billion. And on top of that having fully repaid the SLS, had a very significant impact on our income line. Fortunately we are very close to the end in terms of this balance sheet impact and we will be able to see the core trends in March as well on this area.

<u>Question 9: Michael Helsby, Merrill Lynch</u>

Yeah, thanks. Morning everyone. Just two questions please. On slides 13 and 14, you just go through the impairment trends. I am just interested in the movements on the Wholesale book because your new to impaired is down a hell of a lot over the year and versus the average in the quarter. And yet your Wholesale impairment charge is kind of in line with what the average was pretty much last year. Implying that the coverage has gone up very sharply, which actually stands at odds I think with what you were saying at the full year. So was there something funny in the first quarter in terms of the new to impaired assets which meant the coverage was a lot higher than you would expect going forward? Or is that a new run-rate?

And then secondly, your other income pre-claims was flat quarter on quarter. Based on history I would have expected some positive seasonality, particularly from your Wholesale. You mentioned the improvements in your cross-sell and your Insurance businesses. So I was wondering if you could just talk about the outlook for OOI for the rest of the year using the first quarter as a base please? Thanks.

Answer: António Horta-Osório

Okay, Michael thank you very much for your questions. And relating to the first one I am going to ask Juan Colombas to give you some colour on it. It is just Wholesale is more lumpy in terms of the nature of the provisions, but Juan will elaborate on that, Juan please.

Answer: Juan Colombas

Yes. The impairment provisioning in Wholesale and Retail is a combination of the new to impaired assets on one side and on the other side is how much we have to provision in the back book that we already have. So we are showing the positive trends in the new to impaired assets because our provision has always been that our good book is good, so we have done all the cleaning up of the balance sheet from previous years. And I think it is important to show that new impaired assets and the flows in the bad book are reducing as we would expect.

With regard to the why the Wholesale impairment has grown, As Antonio has said, there have been some assets that we have impaired more than they were in the past and some of them are in the UK book, but are related with the European CRE prices, so we have seen some deterioration there. As I said the quarter is always particularly seasonal so you should not extrapolate across it here.

Answer: António Horta-Osório

And Michael on your second question, the outlook. I think just to make a broad comment, and then Antonio Lorenzo, our Head of Strategy will tell you about more colour about it. As we said on the growth initiatives, most of the growth initiatives would start the investments and projects as we would see the visibility of the cost savings of the simplification initiatives. Of course we would have to frontload some of those investments which have NPVs of 3-4 years, and you would start seeing results in OOI mostly backloaded, so in 2013 and 2014. And we have for the year in terms of the growth initiatives that we have at the moment, more than 75 per cent visibility of our revenue growth initiatives. So we are absolutely on plan. And Antonio will give you some more colour and also on the behaviour versus last year.

Answer: Antonio Lorenzo

Thank you Antonio. In terms of the performance in the first quarter, we have some seasonality. But I could say in terms of negative terms that we have some accounting impacts that we are not expecting to have the rest of the year, and at the same time we are seeing some early signs of improvement as you can see in IMS; that the relationship with the customers in Corporate are improving, and we are seeing that we are improving in the league tables in things such as Debt Capital Markets, in rates, FX and in transactional banking. At the same time I would like to consider that all initiatives are based on the relationship with our customers. And I would like to say as well, what we are doing in terms of savings campaigns, in terms of switchers in bank accounts that you can see in our presentations, that we are doing a good job in this as well in terms of Halifax as a challenger in the market. All of this stuff in terms of improvement I am seeing as a springboard for our other operating initiatives, and in the future we are expecting to see good progress in this OOI. So this quarter in terms of the core underlying other operating income I am seeing as lower than we were expecting for the rest of the quarters.

Further question

Can I just have a quick follow-on on your mortgages? Because I think you pulled out that you did a lot lower market share on gross lending and for the first time I think you said that that was intentional to get your stock down towards the 25 per cent which is in line with your ex-Verde position? Does that mean when you get to 25 per cent that you will look to increase your share of gross flow back to 25 per cent to maintain it there? And if I am thinking that is right, how are you going to do that?

Answer: António Horta-Osório

Well what you say is correct and I said that, but what I meant was not exactly what you said. What I meant is the following. When we decided some strategic action we want to see, whether it is holistically coherent with the rest of our strategy. And we felt that the best trade-off at the moment in terms of our mortgage product would be to increase margin in line with the market. And therefore to have some less market share of gross lending targets. And last year we had 20 per cent in Quarter 1 and this year we have 16-17 per cent depending on the final numbers for the market. So it is not a lot less, it is like 3-4 per cent less. And what I said is, looking more broadly at the bank as a whole and our strategy, we think this is absolutely coherent with the rest of the strategy because we have, if you want, an over-market share in mortgages. Therefore if we decrease slightly our stock market share, given that we have a 25 per cent market share post-Verde in current accounts, we will still have room to grow. And on the savings side for example, we had 23 per cent and so we have room to increase as we are increasing. Number one. Number two, we think that given we have higher wholesale funding costs and higher repricing of deposits, we should offset therefore on the asset side by the repricing of the assets which we have been doing last year. And we are continuing to do. So what we said is that these are holistically coherent with our strategy. Whether we will go exactly to 25 per cent or we stop at 27.5 per cent or 26.5 per cent will depend on the dynamics of the market and on the competitive dynamic and that is the trade off we do every day and every month in terms of doing what we think is best for both the customers and the shareholders. So the trends are clear and I think they are coherent with the overall strategy. The precise number is not a strategic aim, I mean we can be very well with 27 per cent. If for example the mortgage market starts to increase a lot and therefore margins go up and volume also goes up, we may decide we want to have and to keep the market shares, it all depends.

Michael Helsby

That's very clear thank you.

Closing remarks
António Horta-Osório

Thank-you very much all of you for dialling into the call and giving us the opportunity to update you on the strong progress we are making against our strategic plan. I think it was a very interesting Q&A session.

If you have any further questions which have not been covered, please feel free to contact us during the day.

End of Q&A