LLOYDS BANKING GROUP PLC – 2013 FULL YEAR RESULTS PRESENTATION

THURSDAY 13 FEBRUARY 2014

António Horta-Osório, Group Chief Executive

Good morning everyone, and thank you for joining us for our 2013 full year results presentation. George will shortly present the financial results in detail, and Mark will then provide an update on our simplification programme.

I will start with the key strategic and financial highlights in 2013, and then later I will come back to provide an overview of the trends we are seeing in the general economy, and specifically in the banking sector, together with how we are preparing to grow, taking advantage of our repositioning and of the recovery in the UK.

We continue to make substantial progress on the delivery of our strategy to create a customer focused, low risk, highly efficient UK Retail and Commercial bank, and have now returned core lending to growth in all divisions.

We have delivered many elements significantly ahead of our plan, and this has resulted in a substantial improvement in our financial performance, with our Group underlying profits more than doubling in 2013.

We continued to reduce risk, with our non-core asset portfolio reduced by around £35 billion in the year in a capital accretive way, releasing approximately £2.6 billion of capital. Our total non-core assets now stand at £63.5 billion, £130 billion lower than 3 years ago, having met our strategic review targets, more than eighteen months ahead of plan.

We've continued to intensify our focus on our UK customers; and further reduced our international presence including the sales of our Australian and Spanish retail businesses. We have now exited or announced the exit from 21 countries since June 2011, and this means that we will be in just 9 countries, achieving our target of operating in 10 countries or less, again ahead of plan.

And we further strengthened our funding position with a £32 billion reduction in wholesale funding, and driving the money market funding with maturity of less than a year to a low of £21 billion, around £75 billion lower than three years ago.

This is why I said during the year that the reshaping and strengthening pillars of the June 2011 strategy are basically completed, and we will now focus mainly on the simplification and investing pillars, in order to grow and take advantage of the UK economic recovery.

Our business is highly capital generative, and our fully loaded core tier 1 ratio increased 2.2 percentage points in the year, from 8.1 per cent to 10.3 per cent, a very strong performance given the additional legacy charges we have taken in the year.

I was disappointed that we had to take these additional legacy charges, which were higher than we had anticipated, especially in relation to PPI. But we were also disappointed about the conduct and incentive legacy issues more broadly. I would like to emphasise strongly that we remain totally committed to resolving these issues in the right way for our customers. Of these provisions, £3.1 billion related to PPI, of which £1.8 billion was taken in the fourth quarter, as you will hear from George later.

Nevertheless, the substantial progress we have made in the year allowed the UK Government to begin to return the Group to full private ownership in September.

This strong performance, and the confidence we have in the future of the Group, means that we expect to apply to the PRA in the second half of the year to restart dividend payments, as you saw last week. I'll come back to this later.

Turning now to an overview of our financial performance. We delivered significant improvements in profitability and returns this year, driven by progress on all the key lines of the income statement.

The income performance was supported by core loan growth, and by the substantial expansion in margin to 2.12 per cent. This is slightly ahead of the guidance we gave at the third quarter, mainly thanks to better than expected deposit margin trends in the fourth quarter.

We reduced costs by 5 per cent, driven primarily by the further simplification of the business, with continued investment in our core businesses, and non-core reductions.

Impairments fell by 47 per cent, supported by continued good asset quality in the core, and by the further reduction of non-core assets.

As a result, profits increased both in the Group and in our core business, with Group underlying profit more than doubling to £6.2 billion and core profits increasing 24 per cent to £7.6 billion.

And this improved profitability meant that, despite additional legacy charges, we delivered a statutory profit before tax of £415 million for the year.

And increased profits, together with a reduction in non-core RWAs, meant that the Group return on risk-weighted assets more than doubled to 2.14 per cent, while the core return reached 3.26 per cent.

Turning now to the balance sheet. We continued to strengthen and de-risk the balance sheet, enabling us to return core lending to growth in a falling market, matched by efficient growth in deposits, through our multi-brand strategy.

And we made further progress at the Group level, with the Group loan to deposit ratio reduced by a further 8 percentage points to 113 per cent, reflecting the £35 billion reduction in the non-core asset portfolio.

And as I have already mentioned, we substantially strengthened our capital position, with the fully loaded core tier 1 ratio increasing to 10.3 per cent. This uplift has been driven by capital generation in the core business, including an important contribution from our Insurance business, as well as the management actions we took during the year to reshape our business portfolio and reduce non-core assets in a capital accretive manner.

In acknowledgement of the significant progress we have made in improving the Group's capitalisation and transforming its financial profile, Standard & Poor's upgraded our standalone rating to 'BBB+' in December 2013, and affirmed Lloyds Bank's long-term credit rating at 'A.' And with our credit default swap trading at the lowest of any UK Bank, the market is already presuming further upgrades.

We've continued to focus on our multi-brand strategy with differentiated offerings to our customers, and our progress is evident in the strong growth in our Retail relationship brands, which grew by 6 per cent in 2013, ahead of the UK market which only increased by 4 per cent. The more expensive "non-relationship deposits" decreased and this had a positive effect on our margin.

Within our Commercial Banking division deposits grew strongly in the year with a 13 per cent increase, reflecting growth across all segments. This reflects growth in high quality deposits; a credit to the strength of our customer franchise.

Overall, we saw continued deposit growth despite the low base rate environment, in line with the market, and while maintaining our core loan to deposit ratio at 100 per cent.

Now, let me turn to the broader trends we are seeing in our markets and our business. I have said many times that a strong economy requires a strong banking sector, in the same way as a strong banking sector requires a healthy economy. As a consequence, we have a special responsibility to support sustainable economic recovery. Lloyds is the UK's largest Retail and Commercial bank, therefore our future and the prosperity of the UK economy are inextricably linked. In 2013 we continued to deliver on our pledge to help Britain prosper.

We were the first bank to access the Funding For Lending scheme, and are its largest participant, having committed over £37 billion of gross new lending. We remain committed to passing on the benefits of this programme to our customers and have also continued to support UK manufacturing by committing over £1.3 billion of lending by September 2013, significantly ahead of our target.

The support we are giving to our UK customers and the UK economy is further evidenced by the growth of our core loan book this year. We have grown core loans and advances by £12 billion, or around 3 per cent, against a market that has fallen by 1 per cent.

We expect to continue to grow in 2014, with special emphasis on the SME sector, where we have grown on average by 4 per cent in each of the past three years in a falling market. In 2013, we supported around 120 thousand business start-ups, and have accelerated our net lending growth to SMEs to 6 per cent, compared to a market that has declined by 3 per cent.

For our Retail customers, we returned our core loan book to growth in the year, and we expect to continue to grow our core mortgage book in 2014, consistent with a stronger market.

We have also increased our lending commitment to new-to-market buyers, and helped one in four to buy their first home. During 2013 we advanced around £10 billion, helping more than 80,000 customers get on the property ladder, substantially above our 60,000 target, and our target for 2014 is to help more than 80,000 first time buyers again.

The growth we are seeing is being supported by the increase in investment in our core franchise, to meet the changing needs of our customers.

Our strategic cash investment spend in the year, enabled by our simplification programme, totalled approximately £600 million. Simplification has now delivered run-rate savings totalling around £1.5 billion to date, which will enable the £2 billion investment we targeted in the strategic review for the period through until the end of 2014. This investment is supporting significant improvements in customer products and services and building growth opportunities for the future.

As a consequence, we have seen a further reduction in customer complaints of around 20 per cent compared to last year, and they are down by more than 50 per cent compared to 2010 levels, and less than half those of our major banking peers. With Group complaint levels at 1 per 1,000 accounts, we have the lowest complaint level of any major UK bank, and expect to maintain our industry leading position, with Halifax now being the leader among all major banks and building societies, as Mark will detail later.

Similarly we are seeing strong progress in the customer satisfaction scores across all branded channels, with Net Promoter Scores for the Group increasing 11 per cent over the year, and by more than 40 per cent since 2010.

And with that, let me now hand over to George for a more detailed look at our financial performance.

George Culmer, Group Finance Director

Thank you António and good morning everyone. Beginning with the P&L on slide 9 as you've heard, we've made significant progress on our strategy and this is reflected in the Group's financial performance.

Underlying profitability has more than doubled to £6.2 billion, with profits in our core business improving by £1.5 billion to £7.6 billion, while the loss from the non-core reduced by more than half to £1.4 billion.

Underlying income of £18.8 billion was up 2 per cent, and in line with prior year excluding SJP, with a stronger contribution from net interest income offsetting a reduction in other income.

Costs reduced 5 per cent to £9.6 billion, in line with our guidance, while impairments fell 47 per cent to £3 billion, with a £2.3 billion reduction in non-core and a £0.4 billion reduction in core.

Overall, the Group made a statutory profit before tax of £415 million compared with a £606 million loss in 2012, mainly driven by the significant improvement in underlying performance.

Looking at the core underlying performance by division. Retail had a strong year with underlying profit up 17 per cent, driven by 5 per cent growth in net interest income and an 11 per cent improvement in impairments.

The growth in Net Interest Income was driven by a 15 basis points improvement in margin due primarily to lower liability pricing, and the return to growth of the core loan book in the third quarter.

The improvement in credit quality reflected a reduction of almost £1 billion in impaired loans and Retail's AQR is now just 33 basis points, compared to 37 in 2012.

Commercial also had a good year with a focus on disciplined pricing, franchise growth and risk selection driving balance sheet growth, improved profitability and RWA reduction, resulting in a 38 basis point increase in returns on RWAs to 1.74 per cent. Core income grew 5 per cent, led by 9 per cent growth in net interest income, with a 31 basis point improvement in margin, a 7 per cent increase in core lending and a 13 per cent growth in deposits. Core impairments were down 40 per cent reflecting improved credit quality with an AQR of 39 basis points compared to 67 last year.

Wealth, Asset Finance and International delivered a strong performance with underlying profit up 38 per cent to £632 million, and returns up 160 basis points to 6.67 per cent.

This performance was driven by income growth of 2 per cent, with core loan growth and a significant improvement in the margin led by the repricing of our online deposit business. Costs reduced by 8 per cent, as a result of Simplification savings, the disposal of St. James's Place and the optimisation of our direct channel customer services in Wealth.

Finally, Insurance has continued to perform well with underlying profit stable at £1.1 billion and an improved Return on Equity, which increased to 13 per cent. Income fell 2 per cent reflecting the run-off of our legacy creditor book and changes in intragroup commission partly offset by an increased contribution from Life and Pensions. This fall in income was offset by a 6 per cent reduction in costs driven by the significant synergies achieved from the closer integration of Insurance within the Group.

And this robust performance enabled Insurance to pay £2.2 billion of dividends to the Group during the year, while remaining very well capitalised.

Looking briefly at net interest income Core Net Interest Income grew by 8 per cent to £10.6 billion and total Net Interest Income by 5 per cent to £10.9 billion driven by an improved margin and core loan growth in all divisions.

The Group net interest margin for the full year was 2.12 per cent, slightly ahead of guidance due to a strong performance in Q4 of 2.29 per cent, with a continued improvement in deposit margins and a resilient trend in asset pricing.

In 2014, excluding the impact of the TSB disposal, we expect the full year net interest margin to be broadly stable at around the Q4 2013 level. And with NIM now in our target range and core lending returned to growth, going forward the focus is very much on growing overall Net Interest Income.

Moving onto other income. With the current economic conditions and regulatory environment, Other Income remains challenging, and core other income excluding SJP was down some 2 per cent on prior year to £6.9 billion.

This reflects reductions across most divisions but includes resilient performances in Insurance and Commercial. In Insurance, income was bolstered by a strong corporate pensions performance offset by reduced bancassurance volumes and changes to intragroup commissions. In Commercial, other income was up two percent, in spite of tough trading conditions, reflecting the successful execution of our strategy, which was led by a strong performance in LDC.

Across the Group, we expect conditions to remain challenging in 2014, and the outlook for Other Income will remain subdued over the short term. 2013's results also included some £1.1 billion of income from disposals announced over the course of the year.

Moving to asset quality. We've once again seen a further substantial reduction in the impairment charge and a significantly improved asset quality ratio, reflecting the benefit of further non-core reductions and robust credit quality in the core book.

Core impairments in the second half were £614 million making £1.5 billion for the year as a whole, a reduction of around £400 million on prior year mainly due to strong performances from Retail and Commercial. Non-core impairments reduced 61 per cent or £2.3 billion, led by reductions in Commercial Banking and Irish businesses.

The Group AQR was 45 basis points for the second half and 57 basis points for the full year, bringing us inside our 2014 target range of 50 – 60 basis points a year ahead of expectations. These ratios reflect the accelerated run down of our non-core and the strong credit quality of our core book, and also benefitted, in the second half, from writebacks and provision releases in Commercial as well as improved Collections in Retail. And for 2014 we now expect the Group's asset quality ratio to be around 50 basis points.

In terms of impaired loans and coverage, the quality of our loan portfolio also continues to improve. Impaired loans now stand at 6.3 per cent of total loans, a reduction of 2.3 percentage points over the course of the year. Our coverage ratio is 50 per cent for the Group up from 48 per cent at the end of 2012, with non-core coverage strengthened by 4 percentage points to 55 per cent.

Looking now at the movement from underlying to statutory profit after tax. Asset sales in 2013 totalled £100 million with the gain on sale of government securities in the early part of the year more than offsetting the losses from the disposal of non-core assets. The prior year comparative of £2.5 billion includes some £3.2 billion of gains on government bond sales, compared to £0.8 billion in 2013.

Volatile items totalled £380 million with positive Insurance volatility more than offset by banking volatility and fair value unwind. The movement on prior year primarily relates to that fair value unwind, which was a £650 million benefit in 2012, compared to a £228 million charge in 2013. I would expect this to continue to be a charge in 2014.

Simplification and Verde costs totalled £1.5 billion. Within this, Simplification was £830 million, bringing costs incurred to date to £1.7 billion, with delivered run-rate savings of £1.5 billion.

I said at Q3 that we expected further Simplification spend of around £600m in 2014.

We have, however, now identified additional opportunities and are increasing our run rate savings at the end of 2014 target from £1.9 billion to £2.0 billion, and the cost of delivering this will increase the 2014 P&L charge to around £0.7 billion.

On Verde, we have made good progress in 2013 with TSB launched in September and now operating as a stand-alone business within the Group. The costs associated with building TSB were £0.7 billion for the year bringing total build costs incurred to date to £1.5 billion. In 2014 we will incur the last tranche of build costs of a couple of hundred million, while the dual running and transaction costs will add around a further £150 million assuming a mid-year IPO and deconsolidation.

Legacy charges totalled £3.5 billion and included £3.1 billion for PPI. In Q4, we also provided £130 million in respect of SME Interest Rate Hedging Products and £200 million relating to a range of ongoing regulatory matters across Retail, Commercial and WAFI.

Finally, the tax charge of £1.2 billion is unusually high due primarily to the write-off of deferred tax assets from the reduction in the UK corporate tax rate and our exit from Australia. We expect the effective tax rate from 2014 onwards, prior to any policyholder tax movements, to be in the range of 20-25 per cent.

Turning briefly to PPI. As mentioned in 2013 we've provided a further £3.1 billion for PPI including £1.8 billion in the fourth quarter.

As announced earlier this month, this Q4 increase was mainly driven by an increase in our expectation of future complaints and administrative costs, changes in our assumptions on uphold and response rates to proactive mailings, and our expectation on remediation costs.

Since the start of the PPI redress programme in 2011 we have now contacted, settled or provided for around 40 per cent of all policies sold since 2000, comprising both customer-initiated complaints and actual and expected proactive mailings undertaken by the Group.

For customer initiated complaints, volumes continued to fall and the monthly average run-rate in Q4 of approximately 37,000 is around 70 per cent below its peak, having declined in each of the last six quarters and Q4 was 24 per cent down on Q3 2013 and 56 per cent lower than Q4 2012.

On our proactive mailings, these mailings target higher risk customers and are expected to be substantially complete by the end of the first half of 2014.

Turning to the balance sheet. As you've already heard from António the shape and strength of the balance sheet continued to improve over the course of the year. Over the last 12 months, we have generated some £57 billion of funds, led by a £35 billion reduction in non-core assets and deposit growth of £16 billion.

These funds supported the £12 billion growth in core lending, and the £32 billion reduction in our Wholesale Funding as well as the repayment of our LTRO funding of £11 billion earlier in the year.

The reduction in non-core assets was also the primary driver in the fall in RWAs, and total RWAs now stand at £264 billion, down 15 per cent or almost £50 billion, in the year.

On non-core, the portfolio now stands at £64 billion and comprises £39 billion of Retail and £25 billion of non-retail assets.

We have continued to reduce the portfolio in a capital accretive way, and the £35 billion reduction in assets during the year has contributed to the release of £2.6 billion of capital. We have also continued to see the reduction in risk outstrip the fall in assets, and the 47 per cent fall in RWAs is well ahead of the 35 per cent fall in assets.

Given the progress we have made, we will now cease core and non-core reporting and report at a total Group level, which will include a small run-off portfolio, which we will continue to show separately.

This run-off portfolio will comprise the £25 billion of non-retail assets as well our Irish and Asian mortgage books, and totalled £33 billion at the 2013 year end. We anticipate that over the course of 2014 this portfolio will reduce by approximately £10 billion to around £23 billion.

As for the remainder of the old non-core, Black Horse which is a strong competitor in motor loan finance, with a good brand and improved profitability will become a part of the new Consumer Finance division. Also within Consumer Finance will be our Dutch mortgage book which continues to perform resiliently.

And our closed UK Specialist mortgage book will return to Retail as while Self-Cert mortgages remain outside risk appetite the customer relationships remain core.

Finally on the Group's capital position. As you know, we've made significant progress in 2013. Our core tier 1 ratio under prevailing rules now stands at 14 per cent, while our fully loaded CET1 ratio is now 10.3 per cent, up 2.2 percentage points in the year. This progress has been achieved in spite of additional legacy costs and adverse pension fund movements. These negatives were more than offset by strong capital generation in the core business, management actions including the sale of SJP and SWIP, the up streaming of £2.2 billion of capital from Insurance, and £2.6 billion from our capital accretive non-core reductions.

Going forward we will continue to be strongly capital generative and, prior to any dividends, we expect to generate fully loaded CET1 capital of around 2.5 percentage points over the next two years, and thereafter 1.5 - 2 percentage points per annum..

That concludes my review and I would now like to hand over to Mark.

Mark Fisher, Director Group Operations

Thank you George. Good morning. I would like to give you a brief update on the progress with Simplification and our costs. At year-end, our total costs were £9.6 billion, in line with guidance, a 5 per cent reduction on 2012.

Overall, total Group costs in 2013 reduced by £489 million, mainly driven by in-year Simplification savings of £599 million. In addition, the effect of disposals, such as St James's Place, further reduced costs by £164 million. These savings were offset partially by pay and inflation increases of £155 million. Within the £119m 'Other' category is the net of reduced non-core costs, increased regulatory costs including Bank Levy and Anti-Money Laundering, higher Defined Benefit Pension costs, some core business growth and some smaller one off items.

Looking at the Simplification savings, at the end of 2013 we were slightly ahead of target, with annual run-rate of £1.45 billion – an increase of £610 million in 2013, which followed an increase of £605 million in the previous year.

As we enter the final year of the programme, we now expect to achieve run-rate savings at the end of 2014 of £2 billion. This higher exit run-rate comes from initiatives that deliver relatively late in the year, so the 2014 in-year benefit is marginal.

Moving to the chart at the bottom of the slide you can see that total Group costs are now 13 per cent lower than at the start of the programme. We have beaten the £10 billion Group costs target, set out in 2011 a full year ahead of the original plan. We continue to forecast total costs of £9 billion in 2014, excluding TSB. This will give us a full £2 billion real reduction in the cost base by the end of the programme.

The Simplification programme is the major driver of this outcome but it is also down to strong cost management and, more recently, the impact of disposals. This is a real reduction after we have covered inflationary and regulatory cost increases and with continuing reinvestment in our core business of up to a third of our Simplification savings. Behind the headline numbers we continue to make strong progress in Simplifying the Group.

Through our Sourcing initiatives, since the start of Simplification we have delivered £464 million of run-rate savings, which is about 14 per cent of the non-labour cost base.

We have also further reduced our supplier base to just below 9,100, and that represents approximately a 50 per cent reduction since the start of the programme, and as you may recall from the Half Year Results, we are now targeting a figure of 8,500 suppliers by the end of 2014.

During 2013 we also made significant progress in reducing the number of legal entities, which are now down to less than 1,000, a reduction of over 40 per cent since the beginning of the programme, including 37 from the sale of St James's Place, but achieving our Strategic Review target of under 1,000 a year ahead of schedule.

As I have previously highlighted, Simplification is about improving service as well as reducing costs. It is central to our strategy of becoming the 'Best Bank for Customers' by making a wide range of improvements to the customer experience. As we enter the final year of the programme we have now delivered over 300 improvements with a mix of heavy lifting IT initiatives and a range of smaller, but equally important, enhancements.

In the Digital world, our strong online growth continues with an increase in net new internet banking users of over 750,000 in the last 12 months. We have over 4 million mobile banking users and at the end of last year, we started to see mobile banking log-ons exceed those from desktops for the first time. It is worth remembering that we had no mobile offering at the start of Simplification.

In addition to day-to-day transactions, online purchases are also increasing. The 24/7 digital availability is a significant advantage for our customers and this was highlighted in 2013 where 6,000 ISAs were taken up online by customers in the four hours leading up to midnight at the end of the tax year.

We have continued to automate and simplify our key customer processes, for example, reducing the time taken for Fixed Term Deposit Maturities by 85 per cent; improving ISA transfer times; and reducing the time taken to settle insurance claims. Obviously particularly relevant at present.

In the branch network in 2013, Simplification has removed over one million hours of work, giving colleagues more time to spend with customers on value-adding activity. The effectiveness of our operations grows further as we deploy e-based solutions allowing us to move work within and between multi-skilled sites more easily, increasing the ability to load-balance and flex our resource volumes.

As you heard from Antonio earlier, customer experience improvements are being reflected in falling complaint levels and increasing customer advocacy. Our FCA reportable banking complaints, excluding PPI, are now down to one per thousand accounts, eighteen months ahead of our original target. And that target has now revised to 0.9 per thousand accounts by the end of 2014.

At the brand level, at the end of 2013, Halifax stood at 0.8 complaints per 1,000, Lloyds is at 1.1 and Bank of Scotland at 0.9 – all very significantly below the other mainstream banks by their most recent scores. As a Group, we have the lowest complaint level of any major UK Bank, and expect to maintain our industry leading position.

The Net Promoter customer advocacy scores continue their upwards trend across all three brands, now up a third since the start of Simplification.

To summarise, the programme continues to deliver on all of its objectives. We are now in the final year but course much still to do, but we have already achieved a number of the targets we set ourselves at the outset. We are increasing again some of the targets and we will keep going – delivering the programme, maintaining cost control and improving service to our customers.
Thank you. I'll now hand back to Antonio.

<u>António Horta-Osório, Group Chief Executive</u>

Thank you Mark. Now, let me provide you with an update of our business model and how we're investing for growth in the business going forward.

Our strengthening performance is supported by a simple and focused business model, which gives us clear competitive advantages.

Our focus on the UK, where we now have more than 95 per cent of our assets, means we are concentrated in a triple-A rated country and also don't have the complexities, the "capital trapping", or the costs and risks of multiple jurisdictions.

Similarly our Retail and Commercial specialisation means we don't have the exposure to, or increased risk weightings from, volatile investment banking activities. At the same time, we have significantly reduced risk by lowering financial leverage, successfully reducing non-core assets and building capital strength.

And we are targeting to improve further our leading cost position through the delivery of our Simplification programme, which significantly improves our operating leverage.

This results in a much lower-risk business model with a unique competitive position, which in turn delivers a low cost of equity and, as we saw in 2013, a much lower cost of debt. In a world where higher capital requirements are the norm, having a lower cost of equity is fundamental in helping deliver competitive advantage and strong and sustainable economic returns for our shareholders.

And this puts us in a very strong position as the UK economic recovery gathers momentum.

We are seeing clear signs of UK economic recovery. The headwinds of household de-leveraging, extreme downside risks associated with the Eurozone and the Government's fiscal consolidation all lessened in 2013, and this has helped to boost consumer and business confidence. Bank of England and Government policies like Funding for Lending and Help to Buy were also key to this, in my opinion.

And this momentum is being reflected in UK economic growth forecasts, which are moving upwards, with the latest consensus now on GDP growth in 2014 at 2.7 per cent, and you will have seen yesterday the Bank of England are now expecting 3.4 per cent growth in 2014.

However, risks remain, and we continue to prudently assume that it will take some time for the economy to fully normalise, and therefore we expect base rates to remain low longer than the market anticipates, despite the recent faster than expected reduction in unemployment levels.

As regards the housing market, UK house prices are increasing, and this is no longer confined to the London area. We are seeing recovery across the country, with the Help to Buy scheme supporting better trends in the regions, which have been depressed for some time.

As a result, we have seen the number of mortgages approved each month increase. Halifax has been the largest participant in this scheme to date and 80 per cent of our mortgages have been approved outside London and the South East. Also, the average loan value is less than £150 thousand, which confirms the data showing that the majority of mortgage lending through "Help to Buy" is being allocated throughout the country.

We are therefore seeing the scheme as increasing confidence in the economy and liquidity in the housing market as well as increasing the volume of mortgages available. Moreover, it is supporting the wider UK economy through increased activity in the construction sector, one of the main drivers of employment in the United Kingdom.

The next phase of our journey, now that we have substantially finished the reshaping and strengthening of the Bank, is to grow, taking advantage of the economic recovery and of the reorganisation of the business achieved over the past two and a half years. Going forward digital technologies will increasingly be a key development area across all our brands, and that's why I have reorganised the Bank, making Digital a Group wide function reporting directly to me.

In September, we have relaunched the Lloyds Bank brand, building on its 250 year heritage of serving the British public, and also brought TSB back to the high street as a new challenger brand.

Our multi-brand strategy is supporting efficient and segmented growth in both loans and deposits, as I have already mentioned, and looking ahead I expect that we will continue to deliver positive mortgage lending growth consistent with a stronger market, and grow in areas where we are under-represented, such as consumer lending, both through the Retail and the Consumer Finance divisions.

In Commercial Banking we are continuing to focus on the SME and Mid Markets businesses, part of our core positioning. We expect to continue to grow lending in this sector capitalising on our momentum in SMEs over the last three years. We have followed this with growth in the mid-corporate sector in 2013, and increasing our share of wallet of Global Corporates, driving a significant increase in the core return on RWAs in the division, to 1.74 per cent, in line with our target of reaching more than 2 per cent in 2015.

Within Insurance we are supporting our customers to protect for today and to secure for the future, and will continue to grow in annuities and general insurance going forward.

We have some 17 per cent of the FTSE 350 companies using Scottish Widows for their corporate pension arrangements, and we have been active with many of them over the past year, helping them and their employees make the transition to auto-enrolment.

Last month, we relaunched our Scottish Widows brand, bringing protection and retirement planning to the forefront of our customers' minds, and demonstrating our continued commitment to be a leader in the life planning and retirement market.

Following the reduction of our international footprint, the Wealth, Asset Finance and International division will change its scope and responsibility. The Wealth business will transfer to Retail, to sharpen our focus on delivering value-added Wealth services to eligible Retail customers, while the Asset Finance business will be the foundation of a newly created Consumer Finance division, which will also include our consumer and corporate credit card businesses.

Bringing Asset Finance and cards together will increase our focus on growth opportunities in Consumer Finance, continuing our good momentum in asset-backed lending and with the aim of growing our market presence in credit cards.

The substantial progress we have made to date, our improved financial performance and capital position, and the confidence we have in our prospects, supports the dividend policy we announced last week.

Following completion of our discussions with the PRA, they have now confirmed that they will treat our applications to make dividend payments in line with their normal procedures for other banks.

We therefore expect to apply to the PRA in the second half of the year to recommence dividend payments, starting at a modest level. Thereafter, our aim is to have a progressive dividend policy, with the aim of moving over the medium term to a dividend payout ratio of at least 50 per cent of sustainable earnings.

In summary, we have continued to execute strongly on our strategy and to beat our announced targets. The reorganisation and investments we are making in our franchise are increasingly benefiting our customers, while supporting the UK economic recovery.

At the same time, we have substantially achieved our reshaping and strengthening strategic targets, and will now focus even more strongly on simplifying and investing for the future, building a UK Retail and Commercial bank with unique competitive advantages; a strongly capitalised, low cost, low risk business, which will increasingly take advantage of the UK's economic recovery.

I believe this differentiated business model is well positioned to deliver strong and sustainable returns, above the cost of equity, which is already a reality in our core business.

Thank you, this concludes our presentation, and we would now like to take any questions you may have.

End of Presentations

Question & Answer Session

<u>Question 1: Chintan Joshi, Nomura</u>

Good morning. Chintan Joshi from Nomura. I have two questions, one on capital and one on NII. On capital, you indicate 2.5 per cent capital generation over the next two years. I'm just trying to understand this. If I look at your current pace… I mean let's pick the mid-point between 1.5 and 2 which is quite close to the 2013 number, you get to about 3.5 per cent and you've got Verde coming up for sale, you've got some more non-core to run down…. So I'm just trying to reconcile the 2.5 per cent with the run-rate that I can see coming over the next two years

The second one is on slide 12, where you give the breakdown of the margin mix. If I look at your Q3 slide versus the Q4 disclosures, the deposit margin mix momentum has fallen quite a bit. But you've seen no asset repricing effects… but the problem I have there is I can't see what contribution [there is] from wholesale funding reductions in those two buckets… so if you just break it out for us, where is deposit re-pricing, where is asset re-pricing and where is wholesale funding within that chart. Thank you.

Answer: George Culmer

At the moment the way we do it… we blend the movements in wholesale funding into those numbers as you say… into the assets, into the deposits and you're right… I think the deposit uptick year-on-year was something like 28 basis points in Q3… it's up to 32 now. You are seeing a slowing and that plays into what we're seeing in terms of the overall guidance and now what we are saying about in terms of direction of that NIM moving forward. Wholesale funding is coming down. How that bleeds through into those numbers is relatively slow because obviously it depends on the churn of that wholesale book and as you say we've not been overly active in terms of 2013. We'll not be overly active in terms of 2014. Thereafter that pace will pick up but seeing that… that wholesale, that reduced cost of funds come through is a massive positive to us, but it will just take time for that to bleed through into the numbers. But we can separate out and give you separately in terms of how that factors through into that walk.

In terms of the first part, in terms of capital progressions…. What you'll see over the next few years is a change in blend in terms of what is contributing to that capital generation over the period as we move from balance sheet driven reduction events, as we move forward to a much richer mix in terms of underlying profits dropping through into statutory profits driving capital forward. So it's quite hard to look through the rear window and look at historic capital build and try and project that forwards. So we will continue to run down the non-core, but you've got a slower pace of delivery. So for example, 2013, we talked about reducing non-core by about £3.5 billion. In the slides I gave today I talked about a £10 billion. So you'll get a smaller contribution from that non-core. There has also been a big contribution from some of the business disposals, the Australias, the SWIPs, etc. We obviously did the RMBS earlier in the year as well. So some of the things, those that have happened, they will drop away as factors in terms of driving capital forward. What they will be replaced by is earnings that will come through although unfortunately in 2014, that will remain slightly messy because as again I was just going through my presentation, in 2014 you have got the last hurrah from the Simplification, you have got, as you mentioned, Verde, that's both the build and obviously whatever gain or loss in terms of disposal. I will have a smaller amount from asset losses, given that slower run-down of the non-core. I will have a pick-up in the fair value unwind. So the earnings contribution will stay relatively messy in '14 before becoming much clearer in '15. But some of the things that have driven that capital generation previously, in terms of things like, as I said, business disposals, much greater levels of non-core will fall away.

So that was probably a relatively long answer and didn't give you much help, but we are seeing a changing mix is the big message I want to give to you.

Further question: Chintan Joshi, Nomura

Your underlying performance contributes about 1.7 per cent to core tier 1 based on 2013 numbers. So if I just add that up I get to a lot ahead. And even if I back out the £350 million of one-offs you have guided, Verde sales should hopefully lead to a profit not loss. So like it still doesn't get me to 2.5 so that is what I was trying to reconcile.

Answer: António Horta-Osório

Let me add one thing on your NIM question and wholesale funding, which is quite important just to call your attention. As George was saying, the fact that our wholesale funding costs went substantially down, will progressively have an impact as we are going to renew those wholesale issues as they mature. Because our credit default swap, as I mentioned, is now at 75 basis points, the lowest of any UK bank. So the significant benefits we'll have in the future by renewing our wholesale funding needs, which will be less and less, will be very significant.

Chintan Joshi
Thank you.

<u>Question 2: Arturo de Frias, Santander</u>
Hello. Good morning, it is Arturo de Frias from Santander. Two or three questions, please. One on this new Consumer Finance unit which is going to be one of the growth engines, as you say. Can we have an idea of what is the profitability of that unit today? You have given us the RoRWA of Retail and the RoRWA of Corporate or Commercial… can we know what is the RoRWA of Consumer Finance just to have an idea of how accretive to ROE and not only to growth is going to be this unit. That's the first question.

The second one is also on RoRWA, it's on the RoRWA of Commercial. You made some remarks at the end saying that you expect RoRWA to improve to 2 per cent, I think you said, by 2015, but still if I touch that and I use 12 or 13 per cent core capital ratio, we are talking about a unit that is generating around 15 per cent ROE which obviously is good, well above the cost of equity, but it's substantially below the Retail ROE and probably also the Consumer Finance ROE. Are you satisfied with this Commercial ROE? Do you think it can still improve and how can it improve while it's relatively low versus others is probably one question from several angles. That is it. Thank you.

Answer: George Culmer
Arturo, as you said, as we move into 2014, obviously we've got the reorganisations in terms of, as Antonio talked about, obviously we'll cease the non-core reporting, we'll do it as a run-off. Our intent is to get out pretty quickly proformas so you do, precisely as you say, so you can see actually the new organisation in that structure. And I am not sure what the precise timing is, but we will endeavour to get out those speedily. But we will get out the cut of 2013 in that new structure… you'll be able to see precisely what you said. But yes and your instinct is right at the end… Consumer Finance is a very healthily returning business.

Answer: António Horta-Osório
And relating to your more strategic question about the Consumer Finance division, that will go to the commercial as well. I am very positive on this newly created Consumer Finance division, because if you look at Lloyds as a whole and our concentration in the UK, we have a 25 per cent market share in current accounts ex-TSB, but we only have a market share of around 16 per cent in consumer lending, both through car financing and through personal loans. And in credit cards we are also around half the market share that we have in current accounts. So we have the contact with the customer, but we have a very strong opportunity of growing our relationship with the customers, as we have for example, and I mentioned that before, in the insurance area.

Number two, the Asset Finance division, which is the core part now of the Consumer Finance division, performed, as you saw from George's presentation, very well last year. We have completely revamped what we were doing in terms of keeping the focus on Lex Autolease which is now in great shape in terms of car fleet financing and we are now bringing back Black Horse which was on the non-core side and was also completely restructured, now has return on equity substantially above the cost of equity and the growing market share back to that division in terms of serving the retail sector. And we have growing projects, for example, of co-ordinating the knowledge we have in the Retail division about the current accounts behaviour of the customer, with our point of sale approach when a customer goes to a dealer and asks, for example, for a loan for a car, which we are in a unique position to be able to do, given we have 25 per cent of the current accounts. So we are very positive about this division. We have market shares which are like half our market share in current accounts. So the growth prospects and economic dynamics are very positive here.

On the Commercial division. I think the progress of having increase around 40 basis points the return on RWAs to 1.76 is very positive. I think the division behaves very well during the year because you have to have in mind that the markets were quite difficult in terms of debt capital markets, in terms of foreign exchange margins just to give you two examples. And the target of at least 2.0 of return on RWAs for '15 is now quite close to the 1.76 per cent. So I think the Commercial division with the new focus on a customer approach and serving the customer needs, whatever they are, but focus on the customer, not on products, is being very well implemented in the division. And I think the economic track record is absolutely in line with what the division promised to investors in the Investor Day in the beginning of the year. It will meet the cost of capital as you say, if it reaches the 2.0 per cent, and I think the underlyings and the trends are clearly positive.

Question 3: Chris Manners, Morgan Stanley

Good morning everyone, it's Chris Manners from Morgan Stanley here. So three questions if I may. Firstly would you maybe be able to give us a bit more colour on the loan growth by division and how much core loan growth we might expect? I know that's what you have done in the past…. Obviously a strong GDP projection and potential quite positive impact from Help to Buy….

Secondly, on the net interest margin, obviously you printed 2.64 per cent in the core NIM in the quarter, and what's the reason that the Group NIM can't trend towards the exit rate on the core net interest margin at the time?

And thirdly, core tier 1, ex-dividends you're saying you are going to build to 12.5 and then build further past then. What do you think a steady core tier 1 ratio for Lloyds should be and where would you be comfortable? Thanks.

Answer: António Horta-Osório

Chris… I will take the first question… and George will take the second and third. In terms of loan growth per division… so what you have seen throughout the year in quarter 4 was very much in line with what we said a year ago, i.e. we said we would grow Mid Corporates and Large Corporates starting on Q2, which we start in Q1, and then has grown sustainably. We said we would start growing retail mortgages in Q3 in line with the market which we did in Q3 and Q4. And we said we would grow SMEs at at least the same pace as previous year. We were growing 5 per cent on a net basis until quarter 3 and we have accelerated this, as I said, to 6 per cent in quarter 4, year-on-year. So 6 per cent year-on-year.

What can you expect for 2014? I think with the increase in the UK economic recovery… I think you can expect our good track record on SMEs to continue for the fourth year running. You can expect Mid Corporates to also have positive net lending during the year. On Large Corporates it will depend, because as I was just saying, we serve them as a customer and Large Corporates, as you know, have access to the capital markets. So we will do whatever they want, depends on the dept capital markets prices versus loan prices. We don't target loan growth on Large Corporates. What we target is a share of wallet of the customer to serve them as best as possible. And in the retail market, you should expect our mortgage market share to continue evolving in line with the markets so continue being the same. And I would expect the market growth which according to the latest Bank of England numbers was around 0.7 per cent. I think it will increase to be 2 per cent by the end of this year. We will continue to focus specially on first time buyers as we have been doing.

And finally, you should expect our other consumer finance activities. So car financing, credit cards and UPLs as a whole, to start also turning positive and increasing as the economic recovery improves and as we have this refocused approach through the Consumer Finance division as well. So I hope this gives you a good base for the segments and growth.

Answer: George Culmer

And on the second questions… the first, on NIM. Obviously we have guided to this, a relatively flat, stable in 2014, and a number of the factors that have driven the improvement in the NIM over the course of this year will persist. So I have got things like the main benefits, or the main drivers, have been things like liability pricing, the structural shift. What you'll see though is those significantly reduced levels of support from those positives. So on the liability pricing, we have been through the… most of the instant access book. I have got some of the term, which I may still get a benefit from. So that will be a benefit, but a reduced level. In terms of the structural shift within the Group, that morph to the core book. as I have already just answered that, the move to or reduction in non-core will be less in 2014 than it has in 2013. So you'll see whilst there will be a benefit, it will be less marked than it has been… in 2013. Going the other way, and I know there hasn't been much shift in terms of the asset pricing going to an earlier question, but we are seeing… it's tougher in terms of new business pricing, whether it is on a mortgage, credit card, UPL type front. So you are seeing asset headwinds coming towards you. There's also our stance… and linking back to what we said earlier, what António has been talking about, we want to be looking to increase volumes to grow the book, to target areas where we are under market share. So there is a sort of management action on this as well in terms of the volume/margin type trade-offs. So that's the first bit.

And your second question, obviously a big question in terms of capital and capital ratios and expectations. Obviously it's still a bit of a movable feast. I mean we've had PS 7/13 or whatever out there, which describes how the PRA are going to approach things. We still have a whole variety swathe of stress tests that still lie ahead of us, all those sorts of… to be gotten through. I would have said though, in terms of steady state when I look at our bank and I look at our risk profile, and I look at the other banks, I would have thought… on a steady state basis, I would've hoped somewhere around 11 per cent is a not unreasonable target.

Answer: António Horta-Osório

Just one thing, Chris, which I didn't tell you, just to complement, in terms of markets, you know the numbers for the market this year, so SMEs -3, Mid Corporates and Large Corporates -4. I would… I would expect corporate loan markets in SMEs and mid corporates to go from -3 and -4 towards a positive number throughout the year in line with the UK economic recovery… so the market…. So we will continue to gain market share and grow above the market but I am expecting the UK economic recovery… and I think credit is normally, as we discussed many times, a lagging indicator, I expect it to turn positive throughout the year, progressively. And our story, as George says, will be more an NII story of growing volumes times NIM, than just a NIM story.

Question 4: Manus Costello, Autonomous

Thank you. I have a couple of questions, please. Firstly on NII, I noticed in the release that you talked about the repositioning of the hedge, meaning you were protected against moves in interest rates. Should we interpret that as meaning you don't have as much sensitivity to a rise in interest rates? And I wondered if you could give us a new quantification of that?

My second question is on the ECNs. Following the PRA's release in December, I wondered if you thought the ECNs still provide useful stress test capital for you?

Answer: António Horta-Osório

Let me just say one introduction and then George will take you to the sensitivity and ECNs. Just to be very clear. I mean what we… our position, as I said, is we are a low risk bank, focused in the UK, retail and corporates. And so we are normally hedged in terms of our asset/liability risk. That is our base position as we were two years ago. As I explained and sometimes we have discussed, you and I, in detail, what we thought as a team, was that given that implausible low level of interest rates at a certain point in time as you know, during 2012 and in the first quarter of 2013, we thought we should unwind that hedge and therefore become much more exposed to a rising interest rate environment than we would have been otherwise. Given that interest rates moved in line with what we thought, we have put back the hedge in place during 2013. So just to let you know that we went back to the position we had one and a half years ago. And that is why, as George will tell you, the sensitivity is similar to what we said two years ago.

Answer: George Culmer

You've answered it! Manus, as António said, it is an interaction between the level of hedge and also assumptions about how much gets passed through to, sort of, retail deposit holders. Our presumption at the moment is for the first couple of increases you won't see a material impact upon our numbers, less than £50 million. Once you get after that for every 25 basis points… as it stands today will be around about the £100 million type level which I think is relatively consistent to where it has been.

In terms of ECNs, yes, as you say, currently, yes, they do count. So they count within our stress tests that we currently carry out for the PRA. In terms of go forward, the go forward is much less certain. As you know as well as I, the EBA with things like their 5.5 per cent floor. Obviously we have the AT1s and the PRA's 7 per cent conversion level. With CRD IV implemented and with capital rules… as we move forward, I think it is fair to say the continued regulatory compliance of those ECNs for stress test purposes is much less certain. I think that's all I would like to say on the matter.

Question 5: Sandy Chen, Cenkos Securities

Yes… it's Sandy Chen from Cenkos. Actually I'd just like to carry on with Manus's question on the structural hedge if I may and see…. Looking at page 107 on the reserves note, 23, I was just wondering, is there a link between the £909 million negative movement in change in fair value hedging derivatives and the movement in the caterpillar hedge as relates to NIM? And could you talk us through that relationship? For example as the swap curve steepens, does the reserve loss increase as a sort of counterpart to supporting the NIM?

Answer: George Culmer

It does relate to that. So it's basically the cashflow hedging. So you're right. On that page there's a £909 million negative on that particular reserve which does move around. And what that essentially represents is the mark-to-market on the structural hedge. Now that hedge has a… five year life to that… that is the weighted average life. But what it does reflect is the 30 basis points or so pick up in yields towards the end of last year. But that's what that relates to.

Further question

Right so if that long end for example of the gilt curve and swap curve begins to steepen unexpectedly, would we expect to see the sort of combination of a relatively healthy NIM, but the reserves taking a hit again?

Answer: George Culmer

Well it is around the shape of the structural hedge and as I said the way that we govern it internally. We have very strict adherence in terms of what are the applicable funds in terms of the non interest bearing liabilities. But also in terms of the duration of that hedge. And as I say we stick avidly to our five years. So that is where the predominant amount of that hedge. So it is actually much more susceptible to those shorter ends.

Question 6: Jonathan Pierce, Exane

I have got three questions on capital and dividends. The first coming back to the target equity tier 1 ratio which you just said is 11 per cent. Could you tell us what your Pillar 2A requirement is please, like other banks are starting to do?

George Culmer

Do you want to give all three questions, Jonathan or…?

Further question

I can do if you like…. So Pillar 2A is the first question. The second question, in terms of your capital generation numbers in the short and medium term, I am assuming they are net of any RWA growth that you would expect. So can I just confirm that… and you give us an idea of what RWA growth you are thinking about both in the short term and then post 2015?

And then the third question is, in terms of this up to 2 per cent capital generation number post 2015… I mean if I simply assume an RWA figure of approaching £300 billion, that's suggesting a £6 billion surplus capital generation per year, which in the context of your earnings, suggests a payout ratio of much higher than 50 per cent. Can I just confirm that and get your thinking on that please?

Answer: António Horta-Osório

Very simple questions so I'll ask George to answer…!

Answer: George Culmer

Right, on the first one… on Pillar 2 disclosures…. as you are probably aware, the PRA is currently carrying out consultation on Pillar 2 framework including the disclosure of Pillar 2 and so no, we haven't disclosed today things like our ICG. We haven't disclosed things like our headwinds, etc. and a raft of things that are currently privy to us and our regulator. And I think that is our preferred position and we are going to follow what the developments with the PRA actually are and will let that lead our disclosures. So that's our stance in terms of things like Pillar 2, ICG, capital planning buffer, etc. So that's what we've decided we are going to do as a bank.

To your second bit. Yes, it is net of RWA growth. I am not going to give you a precise percentage in terms of what our RWA growth is, but I think if you link what António has said in terms of, what we are looking for in terms of growth across the book, you can factor in what your own RWA growth assumptions might be.

Then to your last bit…. Look I am not going to comment specifically on numbers. What I would give you a generic comment around how this franchise works. And we can do the right thing by our customers, we can do the right thing by our stakeholders and make very good returns for our shareholders. You know that is the benefit of the unique focus we have got on the UK and that retail and commercial franchise. And as I have talked about in different places, what you get as my below the line items drop away, as I finish the restructuring of the bank, that underlying profit flows through into statutory profit, drives the capital and drives the options and the opportunities for this bank. And that's the unique advantage, the new competitive position that we've got.

Answer: Juan Colómbas

Just the impact of CRD IV that we have seen in our competitors in our case is going to be very small and so the number is around £8 billion… is our estimate of the impact of CRD IV on RWAs. And £3 billion is in the Corporate business and the rest is in the centre so… very small.

António Horta-Osório

Thank you Jonathan for your questions.

Question 7: Rohith Chandra-Rajan, Barclays

Thanks, it is Rohith Chandra-Rajan from Barclays. A couple if I could, please. First one on provisions and particularly on the guidance for next year. So the 50 basis points bottom end of the sort of normalised range that you historically talked about looks cautious relative to where you are at in the second half of this year, so 45 basis points at the Group level and less than

30 in the core business. Just wondering sort of… about the reason for that caution, particularly given… given the point we are at in a strengthening cycle and why you wouldn't expect the low normalised levels to continue. That's the first one.

Second briefly on OOI, just to clarify George's guidance there. So start point of continuing business £6.6 billion. I think you said subdued over the next few years. Should we read that as a continuation of the divisional performance that we have seen in 2013? Thanks.

Answer: António Horta-Osório
We are a prudent bank, so Juan will answer to you in terms of provision guidance.

Answer: Juan Colómbas
Cautious, I take it as a compliment. Yes we are being cautious but the underlying trend of the portfolio is positive as you can see quarter by quarter in 2013. We expect these positive trends to continue. We have been cautious simply because you should not take the Q4 probably as the reference for 2014 because, as George has said in his presentation, there have been some one-offs both in the Commercial with some write-backs and some releases of provisions. And in the Retail book more related with improvements in the collections activities. So… but all in all I would say that the positive, the trends of all the portfolios are very positive. The core book is performing very well, as we have been telling you in every presentation. We are very confident that the cost of credit in the coming year will be within the range that we have been telling you from 2010/2011 and then I would be, I mean 50 basis points is a reference. It could be taken as a through the cycle kind of cost of credit for Lloyds Banking Group, so it will be above or below depending on the economic conditions… of the economy.

Further question
Can I just ask on the 4Qs, so write-backs as you are saying in Commercial and improved collections in Retail. Why given that the economy is improving, would you not expect to see some of that continue?

Answer: Juan Colómbas
Well… it could happen, but the write-backs happen when they happen. So in any case some of the write-backs that have been in the core book as well. We don't expect so many next year because they were in some cases that have been with us for some time. And the entries into BSU of the core book in the last quarter have been very low. And so we don't think that write-backs activities in the core book commercial will be recurrent.

Answer: António Horta-Osório
What we want to tell you is, I mean, 28 basis points quarter 4 in the core book. We don't want you to extrapolate as a trend, because the trends are positive, but going from 42 which I think was in quarter 3 to 28 was a big drop. The trend is downwards, but it is not a straight line, is what we want to tell you. But we see all the portfolios performing better, also on the Commercial Bank and the others as you saw, coverage has increased, which is also a good sign and we are a prudent bank and that is the way we will continue to be in terms of DNA… in terms of risk management.

Further question
So OOI…?

Answer: George Culmer
We obviously quite deliberately showed the slide which showed the impact of those businesses which we have disposed of during the course of the year. They tended to be OOI heavy, so I think we came down to about £6.8 billion as opposed to the 6.6. You mentioned and I talked about subdued outlook for the short term, that was more a sort of orientated around the sort of 2014. You said over the next few years. I wouldn't actually put that time scale on it. In 2014 you will see a continuation of some of the factors that have impacted us in 2013. You know there has been a consumer preference for NII, the evolving conduct agenda is something I think has impacted things like productivity. You have seen product withdrawals either on a permanent basis such as investment products or on a temporary basis. Things like packaged accounts, etc. So it has had an impact on that. Going the other way, you know the Commercial Bank in tough trading conditions put in a great performance. We continue to invest behind that business and there are still great opportunities in terms of franchised growth… share of wallet in terms of trying to drive that forward. Although the environment will still… is still staying pretty tough there at the moment. Within things like the Insurance business, again António talked about our plans for things like the annuity type business, etc., which will offset some of the negatives which we have seen on bancassurance for example. So the comment that I gave was more orientated around 2014 than the time period that you have given it. And things will stay tough, but there are certainly initiatives and actions that are undertaken within the business that I think thereafter would drive that OOI growth forward.

Answer: António Horta-Osório
It is quite important, the part in terms of the Commercial division and you know how the other banks have performed in terms of some of those product areas. The Commercial division has had, as George said, very good performance in terms of market shares, customer share of wallet development and preparation for the future. But as you saw, the markets move against in terms of margins and in terms of some of the processing of volumes. So the good work being done in terms of client share of wallet on the one hand and in terms of market shares like in debt capital markets you don't see it in OOI this year, probably the same in '14 because of the adverse trends you are seeing in terms of margins in the market. But the underlying work is increasing market share and share of wallet in the Commercial Bank as I had said previously and I am very confident about the trajectory going forward of the Commercial Bank.

Question 8: Claire Kane, RBC
Hi there, it's Claire Kane from Royal Bank of Canada. I have two questions on capital and one on asset quality. Firstly the 11 per cent core tier 1 target. I know you don't want to give the Pillar 2 requirements, but can we deduce that the 100 basis points buffer over the 10 per cent minimum for retail ring fence banks covers your Pillar 2?

My second question is on the capital generation. Can you tell us what you are assuming for the DTA absorption? I think you have 1.9 percentage points coming through from that.

And then finally on asset quality. In Ireland you saw net write-backs in their retail book and your commercial real estate provisions went down 80 per cent H2 over H1. Can you talk us through the outlook for Ireland please?

António Horta-Osório
George will take the first two and Juan will speak to you about Ireland.

Answer: George Culmer
As I said, it is not unreasonable, on a steady state basis, 11 per cent would be the number and that would cover Pillar 1, Pillar 2, that would be my expectations of the type of number you would have to carry. And that would be sufficient to cover capital planning buffers, ICGs, etc., etc. So that would be our expectation.

In terms of DTA usage again, I won't give a precise number, but again as the bank returns to profitability, you know we do get quite a big kicker in terms of utilisation of those DTAs. So the best way to give it, at the moment, you know, £500 million of profit on current rules gives me about a… 12-13 basis points pick-up. But on the fully loaded core tier 1, because of that DTA utilisation that converts into about 18-19 basis points. And as the bank moves into that sustained profitability, which we will do this year and will do with a vengeance the years thereafter, you do get a very rich mix in terms of utilising those DTAs.

António Horta-Osório
You have to bear in mind, Claire, that the capital guidance we are giving is on our fully loaded core tier 1 ratio which is not affected by the DTAs in terms of equity. So the guidance we are giving on capital generation is relating to our fully loaded capital ratio which I think you were also asking on the DTA question. Is that clear?

Further question
Yes… sorry I thought the DTA unwind would benefit your fully loaded ratio?

Answer: George Culmer
Yes it does. It helps… it makes those profits more valuable as we generate those, yes.

Answer: Juan Colómbas
So in Ireland you are right, so we have had some write-backs in the retail portfolio because you know that we sold a portfolio of nonperforming loans in Ireland. And that has produced some write-backs… which is a good indication of a good level of provisions that we have in this retail portfolio. What we are seeing in retail, if you discount the sale of nonperforming loans, the levels who have been flat in the year. So at 23 per cent and after the sale we are going to be below 17. And what we are seeing in Ireland is a positive trend in terms of house prices. So the market has been 6 per cent up in '13. In Dublin it has been more than 15. And the rest of Ireland is kind of zero, is flat. So but you can see clearly house prices going up in Ireland which is positive on our nonperforming loans flat if you discount the sale.

In the commercial book we continue with running down this portfolio. You know we are closed in Ireland for any type of business. And the good news in Ireland is that in 2013 we have reduced the commercial book from 5.5 billion sterling to 3.5. And so at this pace we hope to continue with actions in the coming years. And the level of the impaired loans in the commercial book today is 88 per cent. And we have increased the coverage into 2013 up to 72 I think it is at the moment…. So I think we are in, most of what we had to do in terms of impairments we did it in the previous years.

Question 9: Joe Dickerson, Jefferies

Hi there, it's Joe Dickerson from Jefferies. I just have two quick questions. Firstly if I look at your primary liquidity portfolio, the government bond component has gone up to about £43 billion from £29 billion. Could you just give us a sense of the duration of the bond portfolio?

My second question is, if I look at the ECNs, I mean you said going forward the regulatory compliance was less certain. I mean what would be, if that was to be called, what would be the impact to NAV? I think there is about a £1.5 billion derivative asset associated with that. And would you look to replace the ECN with other types of securities to potentially mitigate a TNAV hit? Thank you.

Answer: George Culmer

The ECNs…. Well it all depends on pricing and all those sorts of things, so I am afraid I can't answer the particulars of your questions in terms of what might happen at certain places. It would depend on circumstance. So I am sorry, but I can't give you the particulars on that.

On the gilts, the average duration of the gilts is round about the ten year type level.

Answer: António Horta-Osório

The average duration of our hedge is five years, okay. On the primary liquidity portfolio you also have to see that is depending on base rates versus gilts levels and the asset swaps. We may change the mix between gilts and Bank of England deposits. Right… so the number you quoted may be to the change of mix in terms of the relative yields of Bank of England deposits and then gilts which we then do the asset swap. But our hedge has a five year average duration.

Question 10: Ian Gordon, Investec

Morning, it's Ian Gordon from Investec. One issue, two questions, please. You referenced the half per cent drag to capital from pensions in 2013. Looking to 2014, obviously four months ago you initiated consultation on curtailing final salary pension scheme benefits. Firstly, can you give me some help in understanding the incremental capital benefit either within Pillar 2A or more generally?

And then secondly, just to fill in the spreadsheet… when you initiated consultation, I conservatively estimated your one-off gain at £400 million. Am I my ball park correct or too low? Thanks.

Answer: George Culmer

Pensions per se stays relatively volatile number actually within the capital number. So a lot of the questions we have had around capital and trying to project, you know pensions volatility is as much a pain for us internally. So for example, something like every 20 basis points in discount rates gives you about a billion pound swing factor. Now what we are doing within the pension scheme, you know, totality basis is derisking and that is derisking in terms of asset composition. That's derisking in terms of our exposure to things like interest rate movements. We had a huge exercise going on which will reduce some of that volatility I just talked about and give us benefits from the capital positions as well.

To the capital and, sort of, P&L consequences of the actions being proposed, that action is still underway and there are still consultation processes that are taking place within the company with regards that. It is the right thing to do, it is the right thing to do from a risk management perspective in terms of managing the risks, the liabilities… the pensions liability, the £30 billion or so that sits on our balance sheet. So it is undoubtedly the right thing for the company to be doing. The precise capital impact and the precise P&L impact is dependent upon what the members of that scheme decide to do and where those pension schemes are at any particular point. So whilst it will produce a benefit in terms of the scheme position, it will only count towards capital to the extent to which a capital scheme is currently in deficit and it reduces that deficit. If I have got a scheme that is currently in surplus, and it adds to that surplus, that does not count for capital add-on. So I can't give you a precise number.

Similarly, actually I am going to frustrate you hugely here. Similarly on the P&L side, it depends on the presumption of a successful vote… how many people actually stay within the scheme and how many people opt out of the scheme. And that has an impact in terms of the P&L consequence.

What I will say, you are right, to give you some idea, it is a successful consultation period and successful execution of what we think is the right thing to do in terms of the risk management within this business would result in… certainly a significant P&L plus and there would be some form of capital benefit, although it is very hard to quantify that at this moment in time.

Question 11: Andrew Coombs, Citi

Good morning, it's Andrew Coombs from Citi. I think all my number questions have been answered, but perhaps a couple of strategy questions. Just firstly with regards to the Consumer Finance business. You mentioned that your market share in credit cards was half that of current accounts. If I could firstly ask why do you think that is so low and how do you go about rectifying that going forward?

Second question with regards to slide 26, you highlighted the benefit during your presentation, of being entirely focused in a triple-A region, without multiple jurisdictions. Osborne was on the record this morning as saying if Scotland walks away from Britain, it walks away from the pound. So in the event of a 'yes' vote for Scottish independence, what would that mean for the Bank of Scotland? And then more broadly for Lloyds as well? Thanks.

Answer: António Horta-Osório

In terms of the credit card market share, the precise number that we have in terms of market share is 15 per cent while our current account market share is 25. And that is only 60 per cent of our client market share if you want, so around half, as I told you. The reason why I think it is so low, which is absolutely connected with the reason why we are setting up the Consumer Finance division is because, as you know, credit cards are both sold through the relationship channels as they are sold as a product on a category alone strategy. And we were only participating on the first leg and we now through the Consumer Finance division, are going to participate as well in the second leg, like through co-branded, white labels, different channels. And that's where the opportunity lies. The fact that we have the contact through the customer, we know the behaviour of the customer enough in order to offer them differentiated offerings according to their needs. And the fact that we were only participating through our Retail division on a relationship based approach, we can also now explore the other channel which is also very important, which is the non relationship branded channel.

In terms of our business model, I strongly believe that with the increased regulatory uncertainty and the non convergence yet of standards globally, the fact that you are in multiple jurisdictions increases your regulatory risk. So I think that is one of the key advantages of the strategy we chose in June 2011 of simplifying the Bank not only in terms of reshaping, but in terms of legal entities. We had more than 1,700 legal entities. We had an internal target, as Mark mentioned, of going to less than a thousand by the end of 2014 which we reached at the end of last year. We have less than a thousand legal entities which is still a lot, by the way. But almost half of what we had three years ago. We sold for example, as you saw, our international private banking division. We exited 21 countries. So I think that decreases significantly our regulatory risk apart from the fact those units were small and therefore did not have the critical mass to have strong competitive positions to attract the proper talent, etc. And so that is an integral part of our low risk business model which I am completely convinced will bring our cost of equity lower and lower as we go through the five points I mentioned to you in our presentation.

And relating to Scotland which is obviously a different point. We have a multi brand strategy, as you know. So we are at present in Scotland… through the Bank of Scotland brand. And that's our differentiated approach. Lloyds is present in England and Wales, Bank of Scotland in Scotland and Halifax is a challenger brand across the UK… until now was not present in Scotland and as we have announced in the summer, we are now expanding Halifax into Scotland where we have several customers that are using the brand through telephone and internet.

Relating to the Scottish vote. Our position is very clear on that. We absolutely believe as a Board that it is up to the Scottish people to decide about their future. And so if in September there is a 'yes' vote and given that there will be 18 months between the vote and in case it is positive, the implementation of separation, we believe we have enough time to then address the consequences and the actions we will have to take should the vote be 'yes'.

If… is there anybody who hasn't asked a question yet? No… so Arturo second question then please. Second… no fourth! The third one you had forgotten.

Question 12: Arturo de Frias, Santander

It's Arturo de Frias from Santander again.... I thought somebody else would ask this question. I would like to ask about competition. Obviously the economy is picking up and every bank is also enjoying a lower funding cost. So I guess that means inevitably that we are going to have more pressure particularly on asset prices. And you have already shown in one of your slides that there is a six basis points, I think, negative impact on the asset side on your margin. So the question is, would you expect this to continue, would you expect this probably to get worse? And in which products do you think you are going to see more pressure from your competitors? Thank you.

Answer: António Horta-Osório
I think there are two main strategic points here relating to your question. The first one is our wholesale funding costs, which as we discussed, we are now at a 75 [basis points] approximate CDS level, the lowest of any UK bank.   So the market is anticipating further upgrades in terms of our position… because we are now the lowest of any bank in the UK. That will be quite positive as old maturities like the ones we issued in '10/'11 as they mature over time. And that is a point we covered before. And the second one is in terms of our customers' attitudes in terms of loans and in terms of deposits. I think we have also a big competitive advantage here because of two reasons. The first one is that we have a multi-brand strategy and a multi-brand strategy is very appropriate in the case of Lloyds because our client bases are very different. So the client base of Bank of Scotland in Scotland and Lloyds in England and Wales are very different from the Halifax customer base in terms of segmentation, attitudes, attributes that they value. And therefore the fact that we are able to offer them segmented offerings integrating, as Mark explains every time we come here, everything the client doesn't see, enables us to have both a segmented approach and lower costs from the integration of all the back offices, systems and single areas. I think that is a big advantage, especially in a low interest rate environment, as I showed you for example, on what we did last year. All our tactical brands like Birmingham Midshires, Scottish Widows Bank, that we use tactically, we have decreased their prices and have improved margins as a consequence. On the relationship brands, Halifax, Bank of Scotland, Lloyds, we have increased above the market and the overall was lower deposit costs because of the segmented preferences versus our strategy. So I think that is a big differentiated advantage. Nobody has it in the UK. And I think that will continue and is especially relevant, as I just said, in a low interest rate environment.

The second competitive advantage we have is that we manage internally in terms of culture within the Retail division, within the Commercial division, but especially in Retail where prices change, as you know, every week. What matters for us is not asset prices and deposit prices. What matters for us is the difference between the two. So we manage this combined. We manage all the prices combined, in terms of assets and liabilities. We manage them on a weekly basis, which I don't think anybody else does. And we do this at the highest levels of the organisation. So this capability of doing this, together, with all brands, which makes I believe our competitor reaction a bit difficult because they don't see the whole picture. We manage this on a combined basis, on a weekly time in terms of decision and at the highest levels of the organisation, [and this] has produced sustainably good results as the ones I showed you.

And my expectations just to finish your point for the next two or three quarters, because we will always react to competitor behaviours if they change, is that the competitor behaviour will be very similar to what we have been seeing over the last three or four quarters. And therefore I foresee our margins to have a similar evolution to what has happened in the last quarter and that is why we gave the guidance that we gave, in terms of NIM.

Okay, a final question. Please….

Question 13: Mike Trippitt, Numis
Hi, it's Mike Trippitt at Numis. I just wanted to ask you about capital and dividends. We were under the impression I think towards the end of last year that there were discussions with the PRA about restarting dividends. Clearly you have stated now that that is, you will have… you will be able to re-apply in the second half of this year. Macro feels better, regulation feels a bit better, you have highlighted capital generation coming through, so… is it right to conclude it's really PPI and the uncertainty around that, that has delayed a restart of the dividend or are there other factors? And what do you see as the risks in those discussions in the second half 2014?

Answer: António Horta-Osório
I will ask George as well to comment. But I just want to clarify that we don't see any delay. I mean, every time I spoke to you here or that I have had investor meetings, both George and I, we have always guided investors to the fact that we were very hopeful that we would be able to pay a dividend for the results of '14. And we have had discussions with the PRA because since the FPC 18 months ago there was a series of capital changes which we wanted to be sure that we had well understood and clear, before we applied for dividends. So now that we are considered a normal bank like any other bank, what the PRA told us and that was both constructive and positive discussions was, okay, you are clear, now you can apply for dividends like any other bank, after you show the results and we will obviously respond to whatever you apply. But the conversations with the PRA went in line with what we were expecting and we have never given the impression that we were thinking of paying dividends before the results of 2014… and the investors we spoke to also know, I don't know if you want to add anything?

Answer: George Culmer

The discussions with PRA which took place December, January… they were about the earnings direction of this business and what we could achieve. They were about clarifying things like PS 7/13 etc, what the requirements were. That formed the basis of the discussions. They weren't about PPI and '13 or whatever, it was where the franchise is going and what the evolving regulatory requirements for the UK were. That was the… that was the basis of the discussions, I mean.

Answer: António Horta-Osório

And I think it would be fair to argue, because I understand where your question comes from perfectly. But you have to bear in mind that as we started discussions in quarter 3, we did not have the full profitability of 2013. And in the same way, in which we had an additional provision, much bigger than we could expect in terms of PPI, as I said, in that same way as you know, in quarter 4 we have beaten consensus on the underlying profits by more than £500 million which in quarter 3 we were completely unaware of. And at the same time, we finalise the year with £35 billion of non-core reductions. Again much bigger than what we thought. Releasing £2.6 billion of capital which we have committed to, as you know, just to be capital accretive. And as the year progressed, we had no idea how we would finish the year. So you have to see the whole thing combined. So we are exactly on the stage where we thought we were. And we are very confident that we will apply for dividends in the second half of the year and I am very confident about the capital generation prospects of the bank and it will be a high dividend paying stock in the future, as per our stated dividend policy.

Thank you very much to everybody. Thank you for coming and we are available to speak more with you if you want on a one to one basis.

End of Q&A