**LLOYDS BANKING GROUP PLC – 2013 HALF-YEAR RESULTS PRESENTATION**

**THURSDAY 1 AUGUST 2013**

**António Horta-Osório, Group Chief Executive**

Good morning everyone, and thank you for joining us for our 2013 half year results presentation. I will begin with an overview of the further strong progress we have made on our strategy and the support we provide to our customers and the UK economy. I will then hand over to George for a detailed presentation on the financial results, before Mark provides an update on our enhanced operational efficiency and improving levels of service and customer satisfaction.

In the first half of 2013 we further accelerated the delivery of the strategic plan we set out two years ago. Our UK customers are at the heart of our strategy. We have made substantial progress in enhancing the products and services we offer them, through a multi-brand strategy, while reshaping and simplifying the Group and strengthening the balance sheet. We expect this to further enhance the benefits of being a low risk, highly efficient UK-focused retail and commercial bank.

The successful execution of our strategy is reflected in our financial performance, where in the first half of this year we delivered a statutory profit in excess of two billion pounds. This was achieved through a substantial increase in underlying profit as we grew core lending, as well as expanding the core margin, to drive an increase in core income.

Our cost base continues to shrink, as we become increasingly efficient. Impairments continue to fall as we remove risk, especially through non-core asset reductions. Together, our actions are increasing both the level of the Group's returns, and their quality, as we make them increasingly stable and resilient. Our performance this year has already resulted in cost and capital targets being upgraded. Today, given our further substantial progress, we are further improving our guidance in three key areas: on margin, again on capital and on the reduction of non-core assets.

Turning now to an overview of financial performance. Compared to the first half of last year, we delivered a substantial £2 billion increase in underlying profit to almost £3 billion, including a one-off gain of £433 million from the sales of shares in St James's Place.

Similarly, statutory profit increased by over £2.6 billion, turning a £0.5 billion loss in the first half of last year into a profit of £2.1 billion in the first half of this year.

On the net interest margin, we saw further progress ahead of expectations as it rose to 2.01% driven by substantial reductions in deposit costs and a better than expected asset performance. We are now targeting a margin of close to 2.10% for the year as a whole, some 10 basis points above previous guidance for 2013.

We reduced Group costs by 6% as run-rate savings from Simplification increase to over £1.1 billion. Group impairments fell by 43% and non-core impairments fell by 58%. These significant reductions have primarily been driven by our progress in running off the non-core assets ahead of plan. And as a result, Group returns increased substantially, and core returns remain significantly above our cost of equity.

Turning now to the balance sheet. We returned core lending to growth in the first quarter of this year, ahead of plan, and this growth accelerated in the second quarter.

This return to growth represents a key inflection point driven by the support we give to our SME and corporate customers. Core lending to mortgage customers will also begin to grow in the third quarter and I will come back to the support we're providing to all of our customers in a moment.

Together with growth in customer deposits, our Group loan to deposit ratio fell 2 percentage points to 117% in the quarter, below the 2014 target set out at the strategic review. The core ratio has been maintained at our revised target of 100%, as set out last year.

On non-core assets, we made excellent progress in the first half, with a £16 billion capital accretive reduction. As a result, we are today accelerating our guidance by 12 months. We now expect the non-core portfolio to be reduced to less than £70 billion by the end of this year. Within this, we expect there to be less than £30 billion of non-retail assets by the end of the year, and less than £20 billion by the end of 2014.

Following our full year 2013 results, we will cease separate reporting of the non-core portfolio, in line with our previous guidance for a portfolio of this size and mix.

Turning to capital. Our fully loaded core tier 1 ratio improved by 150 basis points in the half to 9.6% and our fully loaded leverage ratio increased to 4.2%. This significant uplift was achieved through a combination of capital generation from our strong core franchise, the capital accretion from our non-core asset reductions, and a number of successfully executed transactions including the sales of shares in St James's Place, and the payment of a dividend from our insurance business. Based on our performance in the first half, coupled with our plans for the second, we are upgrading our outlook for capital as we now expect our fully loaded ratio to be above 10% by the end of this year.

Turning now to core divisional performance where each division is delivering greater underlying profits and higher returns. In Retail, we increased profits by 14% and returns by 73 basis points.

Income remained stable with margin expansion offsetting a reduction in volumes. The improvement in profits was driven by strong cost control while impairments fell by 20% as credit performance improves, thanks to our sustainable approach to risk, prudent lending practices, and the low interest rate environment.

In Commercial Banking, underlying profits grew by 3%. Income grew by 5% driven by margin expansion and increased other income from Capital Markets and LDC as we execute our UK focused strategy. Although credit quality remained strong, impairments were higher due to a number of releases in 2012 not repeated in 2013, while costs were up slightly as we continue to invest in our product capabilities. Returns on risk weighted assets rose as Commercial Banking delivers its capital efficient, customer focused strategy as set out earlier this year.

Excellent progress is also being made in Wealth, Asset Finance, and International. Underlying profits have increased by almost 50% driven by cost reductions across all businesses and a strong net interest income performance in Asset Finance.

Similarly, Insurance has taken great strides forward as profits rose 15% through lower costs from its deeper integration into the Group, and higher income, most notably from corporate pensions.

The consistent performance and strong balance sheet of Insurance allowed it to pay a dividend of £1.6 billion in the first half, whilst maintaining a prudent capital base.

Turning now to the support we are giving to our customers and the UK economy. As highlighted a moment ago, we grew our core loan book in the first half, ahead of expectations. This growth was primarily driven by lending to our business clients, and drove a net increase in FLS eligible lending in the period.

We continue to support the UK economy through a number of Government schemes, including Funding for Lending, and were pleased with the Government's decision to extend that particular scheme by a year to January 2015. The Government see Funding for Lending as a key way to help small and medium sized businesses which are at the heart of the British economy and our strategy is aligned to this.

We continue to focus on areas where we can deliver further growth. One specific example is our support of small and mid-sized clients in the Manufacturing sector where we have committed over £1 billion in the last nine months, hitting this milestone target three months ahead of plan.

In SMEs, over the last 12 months our net lending growth has accelerated to 5% against a market which contracted by 3%, and so far this year we have helped around 65,000 businesses start up and are on track to achieve our commitment of 100,000 by the end of the year.

In Retail, we continue to be the UK's largest lender to first-time buyers, providing one in four with mortgages. We remain committed to helping 60,000 customers buy their first home in 2013, having supported 33,000 in achieving their goal in the first six months of the year.

We are supportive of the UK government's Help to Buy scheme, which aims to increase the availability of mortgages for buyers with small deposits. The scheme will be available from January 2014 on both new build and previously owned properties up to £600,000 in value for first-time buyers and existing home-owners.

We are working closely with government on its detailed implementation and believe this will help to increase the liquidity in the UK housing market while offering support to house prices, and to the wider economy through increased activity in the construction sector, one of the main drivers of employment in this country.

In summary, we remain thoroughly committed to going further to help our customers, and to help Britain prosper. We delivered on this in both 2011 and 2012, and the initiatives I have just outlined show that we are continuing to do so, and more, in 2013.

And now to George for the financial performance in greater detail.

**George Culmer, Group Finance Director**

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

Starting with the P&L. As you heard from António, in the first half of the year, we delivered significantly improved profits on both an underlying and statutory basis, driven by income growth, and further substantial reductions in costs and impairments. Underlying profit improved nearly threefold to £2.9 billion, with Core business profit of £3.7 billion, up 26%, while non-core losses reduced by nearly 60% to £0.8 billion.

Statutory profit before tax was £2.1 billion compared with a loss of £0.5 billion in 2012. Statutory profit includes gains of £780 million from the repositioning of the gilt portfolio in Q1 and £485 million of positive insurance volatility, primarily reflecting the rise in equity markets in the period.

Simplification and Verde costs were £786 million. Within this, Simplification was £409 million, with the programme contributing run-rate cost savings of £1.16 billion. Verde build costs were £377 million and we continue to target an IPO in mid 2014.

On legacy, we have taken a further provision of £575 million, comprising £500 million for PPI and £75 million for our legacy Clerical Medical business in Germany.

Other Items were £304 million, and include a charge of £104 million relating to PPI revisions in pension benefits, and this compares with a £250 million pension curtailment gain in the first half of last year.

Finally, the tax charge was £556 million, marginally higher than the effective UK rate due mostly to the policyholder tax charge and this gives a profit after tax of £1.6 billion.

Looking at income. Core income was £9.1 billion, up 6%, with a 2% increase in net interest income and an 11% increase in other operating income, driven primarily by the gains on sale of SJP. Excluding the SJP effects, Core income was up 1%, mainly due to a 5% increase in Commercial Banking.

Core other operating income was £3.5 billion and in line with last year, with a strong performance in Commercial and reduced weather claims and assumption changes in Insurance, offset by lower bancassurance and protection income in Retail.

The 2% increase in core net interest income to £5 billion, reflects a small reduction in average interest-earning assets which were down 1%, and which was more than offset by the improvement in the core net interest margin, up 7 basis points to 2.39% for the six months, while the overall group margin was up 8 basis points to 2.01%. The 2.01% is obviously significantly ahead of our original guidance for the full year of a Group margin of 1.98%. The outperformance reflects improved deposit margins, and better than expected asset performance.

We have also taken advantage of the recent interest rate rises to reposition our structural hedge, and so eliminate almost all the 6 basis point drag that we highlighted at Q1. Given this strong performance, for the full year, we now expect a Group net interest margin of close to 2.10%.

On impairments, our strong risk management and prudent provisioning has resulted in a further substantial reduction in the impairment charge and a significantly improved AQR, as well as a continued reduction in impaired loans, and prudent increase in the coverage ratio.

The charge for the first half was £1.8 billion, 43% lower than last year and £3.6 billion lower than the first half of 2011. This was mainly driven by substantial reductions in non-core, which are down 58%, driven by Commercial and International, and non-core impairments are, for the first time, lower than core. Within the core, the impairment charge is down 7%, principally driven by improvements in Retail.

The Group AQR was 69 basis points, with improvements in both the core and non-core books, and with the overall Group ratio again benefitting from the decreasing proportion of non-core.

Gross impaired loans are £40 billion, down some £13 billion year-on-year and down £20 billion since 2011, and now represent 7.7% of the book, compared with over 10% in 2011. And net of provisions, we have seen a £12 billion reduction from £32 billion to £20 billion, which represents almost a 40% reduction over the same period.

On coverage, the Group coverage ratio is up to 51.1% from 48.2% at the start of the year. Within non-core, the ratio increased from 50.7 to 54.6% with increases across most portfolios, and including a further strengthening in Ireland. Within the core, the coverage ratio now stands at 42.6 up from 41.2 in December, with increases in Commercial and WAFI.

Looking at the performance by division. In Retail, the impairment charge decreased by 16% to £0.6 billion, driven mainly by continued improvements in our unsecured portfolio, which was down 23%, reflecting an underlying improvement as well as the benefit from debt sale activity, while in the secured portfolio, the impairment charge, is in line with our experience in 2012.

In Commercial, the 48% reduction to £0.7 billion is largely due to lower charges in non-core, while the increase in the core is primarily driven by a collective unimpaired release in the first half of 2012, which was not repeated this year.

In Wealth, Asset Finance and International, impairments fell 55% to £0.5 billion, led primarily by lower charges in the non-core Irish portfolio, which is now 64% impaired and 73% provided for.

For the full year, we expect the trends seen in the first half to continue, leading to a substantial reduction in impairments in 2013 as a whole.

Moving on to legacy. On PPI, the volume of complaints continues to fall in line with expectations. Average monthly complaints received in Q2 are approximately 12% lower than in Q1 and around 40% lower on the second half of 2012.

Costs in the second quarter however continued to be higher than expected, partly due to a number of one-offs such as to the acceleration of FOS cases, and a VAT ruling. We have also seen higher uphold and settlement rates, and revised up our estimate of future administration costs. As a consequence, we have increased the provision by £450 million which comprises of around £250 million for increased redress costs and £200 million for additional administration expenses.

As reported in the RNS, we have also been referred by the Enforcement Team at the FCA for investigation on our complaint handling processes. We have made a provision of £50 million with regards to the likely administration costs of this exercise. This brings the total PPI provision to date to £7.3 billion of which £1.5 billion is for administration costs, although a number of risks and uncertainties remain regarding the ultimate final cost. As at the end of June though, approximately £1.7 billion of the total provision remained unutilised.

On the balance sheet, as already mentioned, we have seen continued growth in core loans and advances in Q2, having returned to growth in the first quarter of this year. This has resulted in £3 billion of core loan growth across the half as a whole, and this is after a £0.7 billion reduction following the disposal of our Core International wealth operations.

Elsewhere, we have continued the progress made over the last 24 months in the de-risking and strengthening of our financial position. In the first half of 2013, we have grown deposits by £8 billion and reduced non-core assets by £16 billion. This has enabled us to repay our LTRO funding of £11 billion, and reduce our wholesale funding by £13 billion in the first half, or by 27% over the last 12 months. These actions have led to a 13% year-on-year reduction in RWAs, which is ahead of the 9% fall in total banking assets, and which also includes a 41% reduction in non-core risk weighted assets.

Looking at non-core, the portfolio now stands at £83 billion, with the reduction since December of £17 billion, or £16 billion after currency effects, significantly ahead of plan, and again driven by non-retail assets which were down by a quarter. We have continued to achieve these reductions in a capital accretive way, releasing £1.6 billion of capital in the half.

The reduction in non-core RWAs was 24% and ahead of the 16% reduction in total non-core assets, and clear evidence of the continued de-risking of the portfolios. In terms of the reduction, £12 billion was in non-retail, with £5 billion in treasury assets including £3 billion of US RMBS, £2 billion in international corporate assets, £1 billion in other corporate portfolios and £4 billion in UK commercial real estate, which is ahead of the run-rate seen over the last two years.

The sale of our Spanish Retail banking operations was the primary contributor to the £3 billion reduction in retail assets. Given this accelerated progress, as António mentioned, we are now targeting non-core assets of less than £70 billion by the end of 2013, a year earlier than previously expected. Within this, we expect non-retail assets to be less than £30 billion by the end of 2013 and less than £20 billion at the end of 2014.

Given the expected size of the non-retail book, it is our intention to cease separate non-core reporting at the end of this year.

Looking finally at capital. We continue to remain confident in our capital position and outlook. As previously announced, we expect to meet the PRA's capital requirements, without issuing equity or additional Cocos. We have already covered £5.1 billion out of the £7 billion requirement, and remain confident in closing the remaining gap. With the actions we've taken in the first half, our fully loaded core tier 1 ratio now stands at 9.6%.

The improvement over the half year was driven by underlying profitability and RWA reduction, which added 130 basis points, while business disposals contributed 80 basis points, and a further 60 came from the payment of the Insurance dividend, all of which more than offset the adverse impact of pensions and other items. Given the progress that we have made in the first half, we now expect a fully loaded core tier 1 ratio of above 10% by the end of 2013, a year ahead of guidance.

On current rules, our core tier 1 ratio improved to 13.7% and our total capital ratio to 20.4%, already well in excess of the ICB's PLAC recommendations. Again, all ratios have benefitted from underlying profitability, RWA reductions and accretive non-core disposals.

In terms of leverage ratio, the Group's fully loaded tier 1 ratio increased to 4.2% from 3.8% at the end of 2012 and, when excluding grandfathered tier 1, to 3.5% from 3.1%. Both of these ratios are obviously in excess of any proposed 3% minimum.

As a result of the significant progress made in strengthening the balance sheet and our substantially improved statutory financial performance, we now expect to commence discussions with our regulators in the second half of this year on the timetable and conditions for dividend payments.

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

**Mark Fisher, Director Group Operations**

Thank you George, good morning. I will give you a brief update now on our progress with Costs and Simplification.

At the mid-year, our total costs were £4.75 billion, a 6% reduction on the first half of 2012. Once again, the key driver is our Simplification savings which are £321 million higher at £619 million.

Costs are also £41 million lower in this half year following the sale of our stake in St James Place in March. All this is offset partially by inflation and other cost movements of £56 million, and increased investment in our strategic initiatives up £23 million to £158 million in the half year.

As you can see from the chart at the bottom of the slide, we are maintaining our strong downward trajectory on costs. If you do the sums, you will see that this suggests costs will be higher in the second half than the first which is our normal pattern because of certain costs that occur in the second half, like the UK Bank Levy. We remain, however, on track for a full year cost figure of around £9.6 billion. Looking further forward, and as we guided in first quarter results, we now believe that we will reduce costs to around £9.15 billion in 2014, assuming a half year of costs from Verde in 2014.

Now, looking at Simplification in a bit more depth. As I have highlighted before, Simplification is not just about cost savings, it is also central to our strategy of becoming the 'Best Bank for Customers' by making improvements to the customer experience. have previously spoken about some of the significant changes we have made to key customer processes and on screen you will see further examples that demonstrate further progress over the last 6 months.

Our new automated ISA transfer system is making a real difference for customers. At the beginning of the year, in addition to the industry-wide interbank ISA switching process, we also implemented a fully automated ISA set up process. 80% of requests are now completed at first point of contact in our branches or on the telephone without the need to complete a paper application. This brings obvious savings in time both for our customers and ourselves.

For fixed term deposits, where we have over 500,000 maturities each year, we have rolled out a fully automated process that reduces set up times by 85% from 20 minutes to just three, and this includes capturing our customer's maturity instructions at the outset thereby helping save time at the end of the deposit term. This has successfully launched into Halifax and Bank of Scotland, which have the majority of our Fixed Term Deposits, with Lloyds TSB to follow shortly.

In the Digital space, we deliver improved functionality to our customers on a 4 weekly cycle. As a result, our strong online growth continues with an increase in net new active internet banking customers of over 1.1 million in the last 12 months to now more than 10 million, including 3.7 million mobile banking users. On 28 March we hit a new peak of 4.97 million logons in a single day and on average so far this year 2,302 customers have logged onto our internet banking service every minute, and that's a 15% increase on the same figure last year.

We are also seeing 37% of internet logons now coming from mobiles and tablets, with over 7 million mobile transactions completed per month, and that has more than doubled compared to this time last year. This growth in digital, and the fact we now have nearly 14 million paperless current accounts and savings accounts, has also helped contribute to further reductions in our paper and distribution costs.

In Telephone Banking, we have made further improvements to our automated call routing and speech recognition software which we call 'Say Anything'. Nearly two-thirds of all calls are now being fulfilled in the automated service and if customers do need to talk to someone, our enhanced call routing capability directs them more quickly to the right person.

The improvements we are making are perhaps best evidenced by the response from our customers. On the left you can see the data published by the FCA on banking complaints which all the banks report to the regulator. In each reporting period we have demonstrated very clear progress and at Annual Results, I announced we were bringing forward our target of 1.0 complaint per 1000 accounts from the end of 2014 to the end of 2013.

As you can see from the slide, we have achieved this new target early. Lloyds Banking Group achieved an overall figure of 1.0 reportable complaint per 1000 at the half year, and at a brand level both Lloyds TSB and Bank of Scotland achieved 1.0 complaint per 1,000. Halifax actually achieved 0.9 complaints per 1,000.

Similarly, we are making strong progress on improving the satisfaction scores across all our brand channels, with Net Promoter Scores for the Group up by over 10% in the last 6 months.

Looking now at how we are Simplifying the Group. We continue to make strong progress in the way we source third party goods and services. The Group's total supplier base has reduced further, to fewer than 9,600 suppliers at the mid-year point. This is a 47% reduction since the start of the programme and over 80% of our spend is now concentrated with the top 100 suppliers.

Given the success we have seen in reducing supplier numbers, we have now tightened our target from an original figure of 10,000 by end of 2014 to just 8,500. We have also continued to streamline the organisation. In March, we further consolidated our mortgage systems, so that we now process mortgage accounts totalling £236 billion for all our core brands on a single platform.

We have also delivered a new, integrated learning and development system with over 7,500 training options available to all our colleagues all in a single place.

If we look at how all of this activity is flowing through into Simplification savings, we continue to make excellent progress. As at the end of June, as Antonio and George have mentioned, we had realised annual run-rate savings of £1.16 billion. This is an increase of £313 million since the end of 2012 and nearly £650 million since this time last year. This is slightly ahead of our plan at this stage of the programme and we remain well on track to meet our target of £1.9 billion annual run rate savings by the end of 2014.

So, to summarise, the strong downward momentum on costs continues. The Simplification programme, which is the major contributor to this, is going well and is on track to deliver against all its targets.

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

**António Horta-Osório, Group Chief Executive**

Thank you Mark.

Before we move to Q&A, I would like to close this morning's presentation with three slides to summarise our performance, to draw together our guidance and outlook, and to end with a reminder of our strategic focus.

Underlying profitability in the first 6 months improved substantially across all divisions and all lines of the underlying P&L, as did the Group's statutory performance, and we continue to deliver well ahead of plan in many key areas. Two years ago we presented our strategy to you, structuring the plan around the four key pillars of Strengthen, Reshape, Simplify and Invest.

Our delivery of this plan gained momentum early on and has been accelerated despite economic and regulatory headwinds, legacy issues, and the challenges posed by the turbulent funding markets of recent years. We present our half year results to you today as a company that has been substantially transformed, whilst retaining and harnessing the great strengths of our strategic assets, our brands and our people.

The progress we have made in reducing the non-core in this and previous periods has meant that our Group results increasingly reflect the strong profitability of our core franchise, where returns have grown and remain significantly above the Group's cost of equity.

We continue to simplify the business to the benefit of customers, colleagues, and shareholders, reducing costs and enhancing the franchise. I expect the momentum behind the delivery of our strategy to continue to accelerate. We are on track to meet our existing targets for 2013, and are pleased to be able to upgrade guidance in three key areas.

The momentum of the Group is strong with the growth of core lending set to continue while the Group margin is expected to improve to close to 2.10% for the year. As you have heard, we have today accelerated guidance for the reduction of non-core assets in a capital accretive way. Simultaneously, the ongoing prudent management of risk will deliver a substantially lower impairment charge in 2013.

This combination of accelerated de-risking and the Group's improved financial performance means that we are now targeting a fully loaded core tier 1 ratio of above 10% by the end of the year and will now seek discussions with our regulator regarding the timetable and conditions for dividend payments.

And finally, I would like to close this presentation with a brief reminder of our strategic focus in becoming the best bank for customers, as set out two years ago.

We are a UK-focused retail and commercial bank which places customer needs at its heart in order to help Britain prosper. The lending and other financial services this Group provides to the UK form an inextricable link between the success of our business and the health of the UK economy. We undertake this responsibility prudently, primarily funding this flow of credit to the economy through the savings and deposits the Group safe-guards for its customers.

We strive for greater efficiency and simplicity, creating an organisation that is lean, agile and responsive to the needs of our customers. Through this low risk, high efficiency model we expect to achieve a substantially lower cost of equity, delivering strong, stable, sustainable returns for our shareholders, and allow the UK taxpayers' investment in the Group to be repaid at a profit, which is now a reality.

Thank you, this concludes our presentation, and I would now like to invite you to pose any questions you may have.

**END OF PRESENTATION**

**QUESTION AND ANSWER SESSION**

**Question 1: Tom Rayner, Exane BNP Paribas**

Yes thank you very much, it's Tom Rayner from Exane BNP Paribas. Two questions if I may please. The first on the discussions you will be having in the second half with the regulator on dividends. Clearly you have passed the recent PRA stress test, both on leverage and on sort of Basel metrics. You are going to be fully loaded Basel 3, above 10% by the end of this year. So I am just interested to know what you think the points of discussion will be around and what sort of constraints there might be? And I have a second question please on margin.

**Answer: António Horta-Osório**

Right I will start with the first and then George can elaborate and also tell you about margin. I mean this is not new, I mean we have been repeating to you for a year and a half now that we would wait the CRDIV Paper to be published in order to see European Law relating to capital. And second, after that we would wait to see what the PRA interpretation, especially in terms of the insurance deduction would be at local, national level. The CRD4 paper trailed a lot, as we all know, it was finally published in the first quarter of this year and then in June consequently the PRA also clarified their policy in terms of the insurance deduction. And therefore we are moving to stage 3 of what I have been repeating which is we now together as you say, with the finishing of the stress test measures towards the end of the year, we will now start engaging with the regulator to have a timetable defined for dividends which we will then share with you as promised since some time ago. Because the two first stages are done, we are going to start on stage 3.

**Further question**

Okay, just on the margin. Obviously the structural hedge is quite large for a bank like yourselves and it has moved quite significantly in the last sort of few periods. And I just wondered if you could say something about your margin guidance to give us comfort that it is not just about calling the directions of bond markets, that this is just part and parcel of your overall management? I would just like to understand a little bit more about that please?

**Answer: George Culmer**

Right Tom. Obviously as you know, original guidance for this year was 1.98 which we have now basically come out and said we expect to be close to 2.10. Now that pick up, there are a number of things going on. It broadly falls into a couple of buckets. One basically I think is our outperformance in terms of the management of the liability asset spread. And put simply, I think in terms as we have moved through the year liability pricing has got lower than we were anticipating and I think on the asset side there has been more resilience than we have anticipated. So that is about half the differential. The balance comes predominantly from what we have done with the structural hedge. We have a structural hedge for the non interest bearing liabilities. As you will recall, last year we were a big seller of gilts into sort of Q1 of this year. Basically these have been uninvested in terms of our structural hedge. So we came into the year basically in about a 50% uninvested position with regards that structural hedge. So we have just basically, we took action on the gilts and we have been letting that roll off. What that obviously gave us was the flexibility to respond and to restore and replace that hedge when we thought the market was attractive and we were sellers at the sort of 1.70, 1.80s when the market got up to the 2.20s basically we redeployed that excess liquidity and put that to work. As you would expect, we have very strict guidelines around term, around amount etc. That very strictly controlled the amount we use and the durations we extend to and we are obviously significantly still inside of those and we still have some headroom on the hedge. But that was the sort of background and the pick-up you have seen come through.

**Answer: António Horta-Osório**

And we are still, as George has said, we are still positively exposed to interest rates increasing. So if they increase further, we will do more of the hedge. If they decrease on the other hand, we will have locked in what we have at much higher yields basically.

**Tom Rayner**

Thank you very much.

**Question 2: Mike Trippitt, Numis**

Thanks, it's Mike Trippett at Numis. Can I just on the margin question, just ask you about your liquidity portfolio and how you see that develop, obviously it has come down and that is part of it I guess, part and parcel of the gilt sales earlier in the year. But as growth restores, what sort of size do you think that gilt portfolio, sorry the liquidity portfolio should be? And whether you see a sort of tail wind effect as you switch into high yielding assets going into next year?

**Answer: George Culmer**

There is a sort of tail wind effect in terms of eligibility for that liquidity portfolio so as you go into the sort of tier 2 type securities which we have not been a big player in and that is something we would be looking to develop. So we would expect to see a slight yield pick-up from that. But with regards quantum, I would not expect to see material reductions in the size of the liquidity portfolio that we currently hold.

**Mike Trippitt**

Thank you.

**Question 3: Chintan Joshi, Nomura**

Thank you. Chintan Joshi from Nomura. Can I check with you how your discussions are going with the Treasury on the Help to Buy Scheme? There are a number of unknowns in the mortgage guarantee scheme, particularly around capital charge and what kind of fee they will choose to charge for the guarantee. If you could give us some sense of how that is going? And I have another.

**Answer: António Horta-Osório**

Well let me start by saying we were the first bank to publically endorse the scheme because as I have said already, we think it is very positive for the UK economy. House prices until three months ago were going down across the country and there was a real difficulty for customers with deposits of less than 25% to be able to buy their first home. I do believe that that difficulty is very much tied up with the uncertainty created on capital with all the discussion post FPC. And therefore it makes a lot of sense in my opinion to support temporarily the housing market to address that market failure in a way which I believe will probably drive house prices next year up back in line with inflation, 2-3%. Mortgage stocks are growing only 0.7% according to Bank of England numbers which is extremely low, the lowest of the last 15 years. And this should stimulate first time buyer demands, increasing stock mortgages probably by 2-3 percentage points next year. And more importantly, given this is targeting new first time buyers, this will drive new builds, and new builds and the construction sector are the largest drivers of employment in this country. So I strongly believe this is the right thing to do on a temporary basis on an also optional basis to sustain a market to recover its normal position. And this exists in many other countries for example such as Canada, where it is even compulsory. So the discussion now is exactly how much the Government is going to charge for this and the view that we are discussing with the Government, is the Government should charge the capital costs of the credit risk between 75% and 95% which we estimate on average to be around 30 basis points, plus the administrative costs of running the scheme. Given that two months ago when the scheme has been announced the difference in price between a 75% LTV mortgage and the 95% one was more than 150 basis points. You can see there is a lot of leeway to be able to pay the capital costs plus the administration costs and still lower prices in order to make these mortgages more affordable to customers. So I really think this will be set out around the Government's recovering the cost of this scheme and there will be room for prices to be lower and for customers to be able to jointly have a deposit, lower cost of mortgage and this will stimulate as I told you, employment, new build etc.

**Further question**

And you did indicate that 150bps could come down. How should we think about that coming down below SVR and the risk of remortgaging picking up because of that? It has been very resilient so far.

**Answer: António Horta-Osório**

The interesting thing is you are replacing theoretically lower prices but with zero volumes by much bigger volumes at still very attractive margins. So you have to bear in mind that is almost, there is no market above 75% LTV mortgages. Of course as those prices come down, people in SVRs will have more chance to switch, but that has to be coupled with increases in house prices which will take a long time. So you are right, there will be some additional attrition which is normal. We consider ourselves neutral in that position because there are people with very big books in the market and much higher SVRs than us. So you should see us in a relative position. Yet I believe that the additional volumes at healthy margins of adjusted 75% LTV would be beneficial for the banking sector given that we don't do almost anything. There is a repressed demand above the 75% LTV level.

**Further question**

Thank you and the second question was on the structural hedge again. Any chance you could give us a sense of how much of your NII comes from the hedge so we can think about how much is business NII and how much is hedge NII?

**Answer: George Culmer**

We will consider it!

**Question 4: Peter Toeman, HSBC**

Peter Toeman from HSBC. Going back two years, when you did your initial presentation, you presented a slide where you said that the Group margin could be between 215 and 230 basis points by 2014, I suspect people rather ignored that slide, but with the upgrade today I want to ask you if you still feel that is a realistic expectation and to what extent does it depend on maybe short-term upward movements in base rate?

**Answer: António Horta-Osório**

Yes that is a good point, because as you know we make a strong point in going back to what we announced two years ago because we like to say what we think and then be measured against what we said. We have upgraded guidance slightly to 220bps to 235bps in the way, not as an upgrade, but as a technical point in the way we measured it. So that is 215bps to 230bps is now 220bps to 235bps. And as you saw our core margin is now above that level. And given that part of the non core assets will return to the core and I am referring to the self certified mortgages which are really not bad assets, they are our customers using our current accounts, our credit cards and those are £30 billion. I think that that guidance is absolutely compatible to where we will be and we do not need significant increases in interest rates as you see from the combination of the two at the moment to reach those levels. I would agree with that.

**Question 5: Chirantan Barua, Bernstein**

The two questions that I have, so one is on leverage ratio. The thing is with leverage ratio implying different kind of return profiles on the EBITDA, do you see a significant change in your portfolio business mix in the next three years? That is question number one and the second is, could you just give us a little more colour on what exactly you are doing in credit cards and personal loans, the two areas where you kind of underballed in the last three years? That would be great, thank you.

**Answer: António Horta-Osório**

Well on leverage ratio, given that we are balanced, well balanced if you want, retail and commercial bank. As you saw on George's numbers, we don't have any, it is not an operational restriction for us. We are at 4.2% now up around 50 basis points since the start of the year. The trends continue to be upwards. So that will not be an effective restriction for us going forward. And therefore I don't see any business mix change as a consequence. What I think is which is interesting, is that given it will be an operating restriction for others, especially the building society type bank, that will probably have an impact on their business mix or their prices in mortgages which might be beneficial. Second, on credit cards and UPLs, you are absolutely right, we are not happy about our position in UPLs and credit cards because while we have 25% of the UK retail market in savings, current accounts and mortgages broadly speaking, we are at half that level in personal loans, credit cards, insurance, asset management and OOI of companies related products which as interest rate protections, FX, transaction banking and capital markets. So we have a lot of room to grow those eight areas just to give you eight. We have therefore set specifically internal growth initiatives around these areas and we expect these portfolios to start to grow next year and then to accelerate its trajectory.

**Question 6: Rohith Chandra-Rajan, Barclays**

Thank you, good morning, it's Rohith Chandra-Rajan from Barclays. I wonder if I could ask two as well actually. The first one a follow-up on the dividend question and I do very much appreciate that your comments on dividend are subject to discussions with the regulator. I was wondering if you could share your views on what you think are the right sustainable payout ratio would be given the returns and growth you expect? And also whether you would expect to move there immediately on dividend resumption or whether it would be a phased approach?

**Answer: António Horta-Osório**

Well I don't want, as I said, to give any more specific indications on timing in the short term. But speaking of the long-term, sorry the first part of your question. I think it is rather obvious that given our increased returns substantially above the cost of equity already on the core and with the non-core disappearing quickly in a capital accretive way, Lloyds will likely be a high dividend paying stock in the future, because a small portion of our earnings will be necessary to sustain loan growth and all the rest which basically derives from being a more efficient bank than the peers with a lower cost of income and a lower risk bank, therefore with lower provisions than the peers, that would be able to flow into shareholders with a high dividend paying stock for sure. We will see how much in due time. Okay.

**Further question**

I am sure that was all I could expect from that question! The second one hopefully maybe a little bit more. Just on the non-core, very helpful disclosure in terms of the asset mix of the residual non-core and the RWA mix, just looking at the performance in the half year, the retail business is virtually break-even, non-core and the AQR generally in non-core is coming down. I was just wondering if you could give some indication of what particularly the retail part of non-core, you mentioned moving that back into core and the impact that would have on the margin, just if you could give some indication of the profitability of the retail element of non-core that you expect from next year on?

**Answer: António Horta-Osório**
I can tell you that the movement of the self-certified mortgage into core will not affect the margin by more than less than 10 basis points. It is not very relevant. So the £30 billion coming back into the core would not affect the core margin by more than 8, slightly less than 10 basis points, okay.

**Question 7: Manus Costello, Autonomous**
Thank you. It's Manus Costello from Autonomous. You mentioned that you have got a total capital ratio of over 20% which is well in excess of the PLAC requirements you might have. Should we assume that going forwards you will be retiring a significant amount of your sub debt therefore to bring you back down to 17%? And what kind of NIM support could that provide? Because presumably that is going to be NIM accretive as you go through that process as well?

**Answer: António Horta-Osório**
It is a difficult question. And therefore I will leave it to George!

**Answer: George Culmer**
And I will duck it! Look we start in a good position at 20.4% and as we said, that is over and above the requirement. We also will get a slight benefit in terms of in a sense we suffer paying from what is now the prescribed treatment for insurance businesses. We are actually going to get a benefit in terms of the tier 2 treatment. So we actually think there is scope as you say, to retire and come in a slightly leaner position in terms of the total capital, but I am not going to give you a specific amount or tell you which particular issuances we will be targeting. But you are absolutely right.

**Further question**
Presumably for the Group overall, that will be NIM accretive over the next few years as you do that?

**Answer: George Culmer**
That is correct.

**Question 8: Andrew Coombs, Citi**
It's Andrew Coombs from Citi, I have a couple of questions on the margin and then one on PPI please. Firstly on the interest margin. Obviously your 2.10% guidance for the full year points to an exit run-rate for the second half of 2.2%. So just intrigued to know if that is entirely driven by the backbook savings rates rolling onto the front book rate as well as the lower drag from the structural hedge? Or does it also assume a further decline in new savings rates?

**Answer: George Culmer**
It doesn't assume any further decline in new savings rates no. It is a kind of where we are rolling forward, the points that you raised as well as some of the other factors such as the ongoing switch between core and non-core. It is not making if you like dynamic pulls on where rates go.

**Further question**
And then on the asset margin, you have seen a 9 basis points decline to 0.96% and that is after a 5 basis points decline in the second half of last year, so better than expected, but is it accelerating. So just intrigued to know your thoughts there going forward?

**Answer: António Horta-Osório**
On that point, and at the risk of being boring in my response to you, you have to understand that what we manage is the difference between the two. Because I strongly believe that in a country where the loan to deposit ratio is above one, every unit you fund you have to go and get deposits for it. So what makes sense is to consider the difference of the two margins. And then you have to consider that we have a multi-brand strategy which enables us to be much more responsive in my opinion to changing customer needs and patterns in a segmented way. And we will continue to do so, i.e., the fact that we have a multi-brand strategy gives us much more levers than others in the markets in order to adjust our pricing difference of the two to the customer preferences through a differentiating strategy. And therefore the trends that you saw in H1 in our opinion are likely to continue over the next quarter, two quarters. So I don't like to give guidance on intensity and I am not to. But as George has said, what we saw in H1 is what we are extrapolating for the next one to two quarters and we are not seeing any different trends in the market. On the contrary as I just said when I answered a previous question, I think the leverage ratio would be a natural restriction to many players on the mortgage market which might have implications on their pricing.

**Further question**
On PPI, one of your peers earlier in the week happened to flag they had achieved two-thirds of their active mailing and that the response rate on that to date was 24%. I don't know if you have the comparable figures for yourself please?

**Answer: George Culmer**
We do, I think buried in the back we have some sensitivities on the back, which talks about in terms of where we are through mailings and response rate. We are about half way through and if I am quick enough at being able to turn pages, I could tell you what the response rate would be, I think it is around 27%, so I think it is buried away on page 132 which I appreciate you may not have flicked through to yet.

**Further question**
And the proportion of active mailing completed, is that there as well?

**Answer: George Culmer**
I will get back to you, what was the proportion of proactive mailing complete – 53%.

**<u>Question 9: Claire Kane, RBC</u>**
Hi, its Claire Kane from RBC, I have got two questions. The first is a follow-up on margin. The big delta this quarter was clearly the repricing of deposits. Could you give us an idea of the duration of those savings, clearly they were built up at the most expensive time. How quickly they are pricing lower and how much more we have to come through on this? And my second question then is on the asset quality, the Group loan loss ratio is 57 basis points this quarter. You have guided 2014 50-60 basis points. Can you tell us if there is any reason we should see the core losses trend higher from here or if potentially you see that come down?

**Answer: António Horta-Osório**
George will answer you on NIM and Juan on AQR

**Answer: George Culmer**
Claire I am not going to give you the sort of detail in terms of the duration and the particular tranches in terms of where the deposit prices are coming through. We do, as I say, expect it to continue to come through for the remainder of this year and as we look into next year some upper momentum, but on a muted level, would be our expectation.

**Answer: Juan Colombás**
On AQR in the first half been 69, in Q2 57, we said 50 to 60. The core book is moving into the 40 to 45 range and our forecast is stability in all the portfolios, whether they are little portfolios or the commercial ones. So we don't see any risk to suspect changes in the core book, but what we expect is the non core to keep on reducing both in size and AQR which is what is combining the improvement. The combination of both is improving the total AQR of the bank.

**Answer: António Horta-Osório**
So you are correct, that the guidance we gave two years ago is likely to be exceeded.

**<u>Question 10: Jason Napier, Deutsche Bank</u>**
Good morning, it's Jason Napier from Deutsche. Two questions if I may. Somewhat predictably coming back on net interest margin. I appreciate the guidance that half on half improvement around half of it will come from structural hedge improvements and the like. Just looking at first half performance by division, retail NIM was up 3, commercial was up 30 and wealth was up 30. And I just wondered, given that if half of the benefit is from structural hedge and that is driven by where you have got interest free deposits or behaviourally sticky deposits, should we expect most of the momentum in the second half to show up in retail? And I have a second question.

**Answer: George Culmer**
You will definitely see more of it coming through retail, that is correct. Yes.

**Further question**
And then perhaps a question for Mark, in terms of cost saves and so on. You have obviously as a firm made huge progress in taking down costs and a lot of that is very impressive. But I wonder to what extent you are limited by the capacity of an organisation to be changed? And I am thinking in particular about the nearly 13,000 people that are still booked as central in the Group. How much of that is due to things like Verde and whether you really do have as you say, a multi-year process that stretches well beyond the end of next year from a restructuring standpoint? Thank you.

**Answer: Mark Fisher**

I don't see a limiting factor in terms of the organisation's ability to change. We have been at this for quite a long time and you know overall if you look at the longer sweep of time, we have reduced by 25% the size of the cost base, the size of the employee base over the last five years. It is a very structured process. You shouldn't misread central for Head Office. For example a lot of my businesses are partly classed as central. There is a lot of high functioning activity in there at the centre, it is not all strategy and investor relations! The organisation genuinely does feel tighter and more efficient these days than it did. It is noticeable I think in the organisation. We have a clear line of sight for the next 18 months. I think beyond there of course it is really about jaws between income and costs and as we start to see income growth, clearly we are seeing activity growth, you know the mortgage story which we talk about balances, but the actual number of mortgage applications is much higher now than it has been for the last two or three years and we have got more people doing mortgages. But in our view that is good cost.

**Answer: António Horta-Osório**

Jason, I think on costs, I think it is interesting to just make a more strategic comment which is we are decreasing nominal costs of this bank very quickly as you say, but we are the only bank in the UK which is not closing branches in net terms. So we are not in our cost programme decreasing our future capacity of generating revenues. Because in the branches is where you have the sticky deposits when interest rates finally start to rise. And at the same time, all of our NPS scores in all three brands are going up. Lloyds being classified the best high street brand last quarter. And the complaints per customer, the banking complaints per customer halved in two years and are now a third of three out of the four of our main competitors. So I think this is the really important combination for you to assess. Because to cut costs is very easy, the problems when you cut costs and then you have an impact on revenues or when you cut costs at the expense of service. And that is why we are very comfortable that we will continue to drive costs down because the results on quality, on complaints and without closing branches, gives us a lot of confidence that the programme we are doing as Mark explained, is absolutely to benefit customer experience and therefore we can go even deeper in this direction.

**Question 11: Raul Sinha, JP Morgan**

Hi good morning, it's Raul Sinha from JP Morgan Cazenove here. If I can just invite you to comment a little bit on the outlook for core loan growth? Obviously it is up very nicely in the last two quarters. And I notice your comments on funding every unit of loan growth with a unit of deposit growth. Should we expect the LDR to be the main driver of core loan growth going forward, so remaining around the 100%.So deposit growth is what will drive your core loan growth? Or do you actually expect given that retail is going to go from negative to positive in the second half, we could actually see the LDR starting to move into positive territory again?

**Answer: António Horta-Osório**

Well that is a very interesting question and has lots of questions within it. But the answer is not exactly that. The order is, we want to increase net lending in several segments of the country as we always did for the last two and a half years in SMEs which now accelerated to 5%. Given that we put SMEs together with mid-corps last year, in order to put the best practices then in SMEs to mid-corps. Both mid-corporates and large corporates increased in net terms in quarter one, one quarter ahead of what we thought, given that best practice from SMEs. And second, the usage of the FLS especially on the larger corporate segment where we had a funding cost disadvantage and with FLS we did not have it any more. Therefore we used FLS to get back those customers with low risk and have more of the share of wallet of them in terms of OOI, right. So that happened one quarter ahead of targets. We increased £1 billion net quarter one, but that has been a mix of higher growth in corporates and negative growth in mortgages. Because our commitment was to increase mortgages in quarter three after we achieved the 100% core loan to deposit ratio. In quarter two, the growth doubled to £2 billion, still including some negative, but mild impact of mortgages. We already have now the applications of the mortgages which will drive quarter three positive in terms of net mortgage lending. And therefore from quarter three onwards, you will see all of our segments, so retail, SMEs, mid corporates and large corporates increasing.

In mortgages we don't want to grow more than the market because we are already around 25% so we will grow with the markets. On SMEs and mid-corps it is a different story. We have 21% in SMEs and around 20% in mid-corporates, other banks have 30 plus. And therefore we want to grow our presence in SMEs and mid-corps above the market, like we are, because the market is following 3 and we are increasing 5 in SMEs and around 2 in mid-corporates. So you can expect on the corporate sector for us to grow more than the markets and then we will grow deposits in order to keep 100% loan to deposit ratio which is a restriction we think is prudent and wise to maintain.

**<u>Question 12: Vivek Raja, Oriel Securities</u>**

I have the first question was back to the margin. And second question on other operating income. So in terms of the margin and help to buy scheme. I sort of got the implication from your presentations that asset margins have held up better than you would have expected up until now. And I am just wondering when you think about the help to buy scheme which parts of your mortgage stock you think would be most at risk and what the implication for asset margins there would be? And how much you will defend your market share basically assuming there is a real uptick in competitive pressures?

And the second question on other operating income. I note from St James's Place's results yesterday, that they have picked up a lot of high net worth bank advisors recently, a lot more than they would do in the past. I am assuming that some of those have come from you. And I am just wondering how will you protect the revenue opportunity there or the revenue that you generate from those clients when you have lost those bank advisors?

**Answer: António Horta-Osório**

Right, well that is quite interesting in terms of conceptualisation. You are right in everything you say by the way. What is interesting is again you have to consider the asset margin minus the deposit margin because we don't think of them separately. I mean other banks do asset pricing and deposit pricing separately and we don't, we do it together and we do it every week. So we don't do it on a monthly basis because we think it is one of the most critical decisions that we should do on the retail space given the proliferation of products and the different channels through which customers can access products. It is critical to do it together on a monthly basis, at the top of the organisation. And therefore I do expect as you said, assets margins to come under pressure, more pressure because the FLS is driving interest rates lower which is macro economically the right thing to do when you want to stimulate an economy. You lower interest rates in order for people to have a lower opportunity cost of consuming or investing now versus saving for the future. But given, as we discussed, that deposit margins have been going down even further because people are still saving a lot and therefore deposits are growing and increasing their growth rate and with the FLS also available deposit prices have been coming down, what is critical for the bank's profitability is to properly manage the difference of the two, right, when some other players may tell you, I am increasing deposits substantially. But then if you pay substantially you have an impact on profitability. The important thing is to manage both volumes and the difference of the two margins. And I believe as George also told you, that we do not see a different pattern for the next three to six months than the pattern we saw in the past. And on top of it, which I already said twice, I think that the leverage ratio may impact some players pricing policy positively in terms of the industry.

**Further question**

So market share is more important than the margin?

**Answer: António Horta-Osório**

Yes but I already told you that we are going to rise mortgages from quarter three onwards in line with the market which means that I am going to keep market share constant. So of course this puts a lot of restrictions on our management and that is what management is about, to manage many restrictions in a holistically, coherent way. So we will keep market share constant. We will manage the difference of the margins as well as we can and we will do a multi-brand strategy appropriately to maximise that combination.

On the OOI, which you are also absolutely right on, I think it is fair to say that given our absolute focus on our conduct strategy and treating customers fairly where, as you know, the industry suffered a huge shift in the last two or three years and we were the first in announcing our strategy of being best bank for customers, not only in words, based on the lower cost to income. Because the lower cost to income is the key weapon in order for us to be able to offer better value for money for customers which is absolutely coherent with the conduct strategy and in implementing this conduct strategy there were like in the extreme case of PPI, there were behaviours which we changed and there were products which we no longer do and one of the examples which you mentioned, is the advice below £100,000 which we don't do any more in line with what the FCA regulated. And of course that translates into less OOI for the bank. But we are absolutely determined to follow the right conduct strategy and the fact that will translate into less OOI in the future versus what otherwise would be is something which you should include into your expectations as well. But it is absolutely, we will follow what is right to do for customers. So you have those examples which you mentioned which are right. But our response is not to protect for example the advisory sub £100,000, we will not do, that will be execution only and we will focus on providing the lowest cost execution for our customers to be able to transact with us at the lowest possible cost and serve them through that approach.

**<u>Question 13: Joe Dickerson, Jefferies</u>**

Thank you it is Joe Dickerson from Jefferies and I don't have a question on the margin! Basically if I look at your commercial segment you are at least £1.6 billion from the stock of provisions, it looks like it was on the back of UKCRE. Do you see scope for further releases going into 2014? And could you discuss some of the underlying dynamics of that industry? And I suppose second question is to the lag in the Irish business and when that business may cross an inflection point of what you have reserved for versus potentially releasing reserves from the Irish business?

**Answer: António Horta-Osório**

Maybe Juan can start with the Irish business.

**Answer: Juan Colombás**

Well you know we are closed to the Irish business so we are not lending there any more and all the Irish book is in the non core and we are managing for exiting this portfolio. The evolution of the Irish assets in the last quarter have been in the retail space positive. Q2 have been, we have had price indexes in the positive territory for the first time. And the real estate is more difficult because the overhead is bigger, hence you are seeing the P&L has still provisions in the retail, sorry in the Irish books. Our expectation is that we think that the economy is flattening or bottoming so for the coming quarter we expect this more normalised trends for the quarters, that is basically what we are seeing there.

**António Horta-Osório**

And George UKCRE

**Answer: George Culmer**

Yes the first bit was about if I understood it correctly, commercial disposals and gains thereon which I assume remains something we have done a number of things in the year particularly in the non core book and the rundown of that in terms of, we are down about £4 billion on the CRE, we also as you know, things you refer to, like disposal of the US RMBS which did produce a significant gain. I am not going to speculate on individual transactions and what we might or might not do. What I would say is collectively across that non core book as a whole as we sort of bored you in the past, we will continue to do that on a capital accretive fashion. That doesn't mean that every single disposal will be capital accretive in any quarter or whatever, but over the course of the year we will basically do that run down, do those disposals in a way that adds to that capital base. But I am not going to sit here and tell you what additional gains might be locked up in some of those disposals going forward. But I would reiterate our commitment and as you will have heard all the targets today, accelerating that run down and do it in a way that is good for our capital base.

**Answer: Juan Colombás**

We have seen positive trends in the UKCRE market in the last month and then you can see the reductions we are doing in the UKCRE books have been bigger than the previous halves and so this is helping to do more transactions. So we are confident that we will be beating.

**<u>Question 14: Fahed Kunwar, Redburn</u>**

I have another question about the non retail or sorry the retail portion of the non core book that will eventually go in after FY13. Obviously you are not making much of a loss right now, but the non core charge as a whole is coming down and I was wondering how much of the non core reduction is in that retail portion and where does the impairment charge go? And I guess the ultimate question is without asking for a full P&L of the retail business, that zero ROTE on that business at the moment, is that increasing as the impairment charge reduces in that business? And what kind of drag do you see on the total ROTE from that as that seams with the core business? Thanks.

**Answer: António Horta-Osório**

Let me just tell you what we have there and then George will tell you about the impacts. So that portfolio the non core retail assets, basically includes five portfolios. They include the self certified, so the biggest one I referred to, the £30 billion which we will come back to retail core for the reasons discussed. Then you have Black Horse £4 billion, which is a great business, we totally revamped the business, lowered the costs, better risk approach. It is very profitable now and it will go into the asset finance business like we already have there and that will make part of our core asset finance book. So those two will go into core. And then you have three portfolios which are non core and which we will exit ourselves. One of them is Australia where we have some asset finance activities in retail which perform very well, but they are non core. Second and these are around £4 billion. Second you have Netherlands which is about £6 billion which is basically a mortgage origination business which performs well, no issues there, although that economy is getting worse, the mortgages behaves well. It is non core so we have to decide in due time what we can do with that. And thirdly which is our worst portfolio as I have always said, we have the retail Irish mortgages which Juan referred to.

And the two first ones will come back to the core, the three last ones we will sell them or we will see what we do with them, but we will continue to report them to you as a closed book so you can see the impact, the trends, everything will be transparent. We will just not report the whole as the non core book because the non core assets will be less than 5% of the book and therefore they are not meaningful enough for you to have a non core book as a whole. But we'll report the different portfolios, those on retail and non core retail so that you can follow the trends of the performance as we continue to report.

**Answer: George Culmer**
And those trends, again without giving P&Ls, that would be a cautious yes in the positive earning trends, given the level of impairments previously taken and the expected coming through, but it would be a cautious yes.

**Answer: António Horta-Osório**
For example when you look at the worst book which is the Irish mortgages you should bear in mind two things. We are the only bank in Ireland that has an impaired ratio, a declared impaired ratio in mortgages which is bigger than the 90 day NPL ratio which means that we are conservative in the way that we consider a mortgage as impaired. All the other banks have a higher ratio in 90 days overdue loans than the impaired ratio they declare. And second, on that conservatively declared impaired ratio, we have 72% coverage. When you put the two combined, that is double the coverage of any of our peers and that is why if you look quarter by quarter they have been catching up and doing increasing provisions and we have been doing less and less provisions.

**Further question**
So to clarify then, your total FY14, you said less than £20 billion are the non retail portion?

**Answer: António Horta-Osório**
No the less than 20 will be the non-retail portion, yes sorry.

**Further question**
So your retail portion will be about £40 billion non core in FY14?

**Answer: António Horta-Osório**
No because 34, so the self certified mortgages plus Black Horse will become core. We want to keep them and grow them. We don't want to exit them anymore. The only reason why the self certified mortgages have been classified as non core is because we don't allow people to self certify their income any more as you would agree, but after five years those cohorts have been behaving okay. They are our customers, they have our credit cards, they use our current accounts, they are part of the retail portfolio. So they will come back to the core, but as I said it is less than 10 basis points on the margin. And Black Horse we totally revamped and restructured the company and it will be part of the core asset finance business and we will want to grow Black Horse. So you have to take those 35 away, you will only get the Dutch mortgages, the Australian asset finance and the Irish mortgages.

**Further question**
Perfect, one quick follow-up. That £27 billion RWAs then how is that split between the £34 billion you are going to keep and the other bits you are not going to keep?

**Answer: António Horta-Osório**
We will have to come back to you on that if that is okay.

**Answer: Juan Colombás**
Just to clarify one point, we are not going to reopen the business in self-certified.

**Answer: António Horta-Osório**
The one we are going to grow is the Black Horse, the other one we will continue to run down but we will treat the customers as a core customer because they have more products with us as I just said. We will come back to you.

**Answer: George Culmer**
It is about 8.

**António Horta-Osório**
George knows everything.

**<u>Question 15: Chris Manners, Morgan Stanley</u>**

Two questions if I may. Firstly on loan demand on the corporate side. Obviously that had been weak, if you could give a commentary on how you see business confidence? If you are seeing demand picking up in that area which may again give a tail wind? And secondly, and apologies if it is in the release, but under the PRA capital exercise, the 7% fully loaded, prudently adjusted hurdle by the end of the year, can you give us an update on where you are on that ratio and on the leverage ratio on that prudently adjusted basis at the moment just so that we can see the progress? Thanks.

**Answer: António Horta-Osório**

I will answer you on the business confidence and George will detail to you the PRA question. On business confidence, that is quite interesting, I have said here repeatedly last year that I was not seeing the UK economy going down as you remember, I was not seeing the double dip, I was seeing the economy stable. From the beginning of the year that I told you, it is recovering. And I can now tell you I think the signs are even stronger. So I do not expect a very quick or strong recovery, but the signs are much stronger in terms of breadth of recovery and the direction of the recovery. So I would say that in the beginning of the year we thought GDP would grow between half and one percent. Now we see the growth at high ends, around 1% into 2% next year. So much more certainty of direction and much wider signs in the economy. To give you an example, in SME net lending we are growing 5% accelerating from 4%, and within all regions of the UK except one, so everything is spread across the country. And business confidence according to the studies that Lloyds has been publishing lately, confidence is increasing. I think the FLS was a game changer, not only in terms of the scheme itself, but about the confidence that the publicity of the scheme being available transmitted. And I do believe as I just told you, that the help to buy will be another game changer in terms of new buy housing market, construction sector and employment. So the signs are good, but again it will be a long and difficult recovery because when you have to deleverage the recoveries are always weaker than otherwise.

**Answer: George Culmer**

And on the capital leverage ratios versus PRA which is a slightly trickier area, in terms of the capital ratio, because the 7% type stress target they put out it won't surprise you to know given that we expect our core tier one to be north of 10 by the end of the year, we expect to meet that 7% stress ratio. Leverage ratio, if you go back to the start of the year and try and work out what the PRA adjusted and apply headwinds or whatever you can to come up with a number, it is a bit of a movable feast. Since then as you have seen over the first half of the year we have grown our leverage ratios by about 4 or 5 basis points. You then also have the amortisation of those headwinds that the PRA applies to those. So it is all a number we discuss with the PRA, but we expect to comply with all the requirements placed upon us.

**Chris Manners**

Super.

**<u>Question 16: Chintan Joshi, Nomura</u>**

Two follow-ups, one on DTAs. Clearly a big DTA component the deduction in your Basel 3 core tier 1, how should we think about that going away? If I read your annual reports, you said 2019 is when you expect to utilise, but that 2019 has been constant for the past two years, clearly things are improving now so where is your judgement in terms of utilising that DTA and how long will it take? Second, follow-up unfortunately on NIM. You said…

**António Horta-Osório**

I am not going to allow you any further questions!

**Chintan Joshi**

You said in NIM guidance, technically the 215 to 230 becomes 220 to 235?

**Answer: António Horta-Osório**

Well that is correct, we have made already like one and a half years ago, it was a technical correction, it was not guidance. It was a technical correction. If you remember in the summer of 2012 we changed internal pricing and that was just a technical adjustment, not new guidance.

**Answer: George Culmer**

The DTAs we would still expect 2018/2019 and as you have seen we have started utilising them. We have utilised part of those assets this half year in the return to profitability which we expect to be sustained. It gets a bit more complicated than that because you get things like pension deficits, you get movements in AFS reserves which adds to the deferred tax asset as well. But 2018/2019

**António Horta-Osório**
Any more questions? No, yes.

**Question 17: Sandy Chen, Cenkos Securities**
And it is not a question on net interest margins actually, a question on insurance. You know every two years I guess you get a question like this. The PVNBP seems to be going down, I was interested in guidance on both revenues and costs because the income looks like it is flatter, slightly down year on year. And given that a lot of the growth is in corporate pensions, it might be thin on margin, is there, what is the outlook in terms of insurance.

**António Horta-Osório**
It is good we have an insurance expert here.

**Answer: George Culmer**
Look, I mean the insurance remains a great business and you know we have seen that from I think results we have delivered over the last few months. When you look at the dividend flows coming out of that insurance business, we have paid up a dividend of about £0.7 billion. So we obviously had that £1.6 billion which was essentially if you like excess profits which were sitting within the insurance business and didn't reflect 2013 earnings, so it continues to be a huge and important part of this Group. And of course of capital and source of cashflow. Within things like earnings powers and PVNBP you are right, in terms of the way those ratios are going you will see the increased proportion of the corporate pensions as a part of that. And that has a sort of slightly diluted impact on that ratio. But the business remains very profitable. One of the great assets of that insurance business is it picks the fields it wants to play in, corporate pensions, protection, general insurance, annuities and unlike a lot of its brethren, it has stuck to them. And we have a great profit stream, we have a business that is throwing out a billion pounds a year or so and will continue to do so. If you look at their half year results, year on year, yes as we said in the presentation, there has been some benefits from assumption changes, but we have used quite a lot of that to offset things like a persistency amendment as well, which has gone against that. The profits are up, general insurance business remains a great business. Corporate pensions in terms of profitability is actually moving ahead of our internal plans and we have actually got internally some great initiatives in terms of where we take the protection businesses and where we take the annuity business and develop that through the intermediary channel. So it has been a great profit stream and will continue to do so.

**António Horta-Osório**
On top of being a great business as George said, we are also creating additional synergies from the fact that it is integrated in the Group, which are basically three. Given the customer behaviour is changing with RDR and you don't know in which direction exactly yet, the fact that we are the only integrated bank and insurance company in the UK, I think gives us an advantage in terms of being able to react quicker in an integrated way to customer behaviour changes, number one. Number two, we now have fully integrated the operations people within the bank and Mark joined the Board of the Insurance Company. So 3,600 people in operations in the company out of a total of 6000, are now integrated into the bank, in order to serve the insurance company through a TSA with lower costs that are already showing as we showed to you with the performance of the insurance business. And thirdly we are also creating financial synergies through the purchases of the insurance company last year and in the first quarter of this year of portfolios in the bank with high maturities, long maturities and higher yields like social housing, students loans, project financing and replacing that by the sale of gilts at very low yields as George has mentioned to you on the top of the gilts we sold at the bank last year, where we made a £4 billion profit. The Insurance company sold £4 billion of gilts and replacing those by assets we had in the bank which are no longer appropriate in the bank, given the new liquidity rules, but are absolutely appropriate for the insurance company, that has long dated liabilities and matches those with long dated assets. So those three synergies as well as being a great business even creating additional advantages for us having an integrated insurance company within the group which we are very pleased about.

**Further question**
And just one unrelated question on Verde. The language at the back of the big book, is there any change in that regarding the EUs potential decision making regarding the timetable for disposals?

**Answer: António Horta-Osório**
No the existing timetable is until November. We have said in anticipation given what happened with the co-op, that we would number one, open the bank because we have built the bank, the bank is now ready. And on 9th September you will see the TSB bank on the high street, with a massive advertising campaign, you will see all the branches changing. The TSB bank will split from the Lloyds TSB. You will see Lloyds bank and TSB bank on the high street on the 9th September with a separate board and independent Chairman. And we will then until November have to have authorisation from the EC to do an IPO next year which we have as a tentative target around the middle of next year. But the bank will be operating on the high street independently although owned by us from 9th September onwards.

**<u>Question 18: Mike Trippitt, Numis</u>**

Just one final question, Mike Trippitt, NUMIS. In your 10% or more guidance fully loaded, can you say what the assumption is on risk weighting on the mortgage book? That was obviously part of the PRA stress test, was risk weight floors, so we should assume there is some absorption of capital for additional risk weighting?

**Answer: António Horta-Osório**

The impact of that for us was minimal because our mortgages are at 18% and although at is on our portfolio, and although that is on a portfolio basis, the impact was minimum so that has minimal impact on us. The big hit was Nationwide as you know.

So okay if there are no more questions, thank you very much for joining us and have a good summer. Thank you.

**END OF Q&A**