LLOYDS BANKING GROUP PLC – 2014 RESULTS PRESENTATION

FRIDAY 27 FEBRUARY 2015

Lord Blackwell, Chairman

Good morning everyone. On behalf of the Board and the Executive Team, I would like to welcome you to our 2014 results presentation. Thank you for coming.

Before I hand over to António to go through the results in the normal way, I would like to say a few words to mark what I think is an important milestone in our recovery.

When we outlined our Strategy Update last October, we noted that we are entering this next phase of our strategic journey from a position of strength, having delivered against the key objectives that were set out in 2011. And I think the financial performance we are reporting today confirms how successfully the Group has been reshaped from the depths of the banking crisis to deliver a low cost low risk, UK focused retail and commercial bank, a strong balance sheet and restored underlying profitability.

And as a consequence of that transformation, I am delighted that the Board has decided we are now able to propose the resumption of dividend payments. We do see this as an important milestone that enables us to start rewarding our loyal shareholders, including of course the taxpayer

However we recognise we still have more to do. Restoring our financial health is only the first step. As we look ahead, continuing to rebuild trust with both our customers and the wider public is also a business imperative. We are therefore committed to invest in our customer propositions, developing simple, transparent and fair products that our customers want and which they can access through the channel of their choice. We will also continue to support the UK economic recovery through the commitments we have made in our Helping Britain Prosper Plan.

And through these initiatives, we will aim to rebuild the strength of our customer and public franchise while at the same time, delivering sustainable growth, thereby helping us to achieve our twin aims of becoming the best bank for customers and for shareholders.

With that, let me hand over to António and George for the results as usual. Thank you.

António Horta-Osório, Group Chief Executive

Good morning everyone, and thank you for joining us. I will start with the key strategic and financial highlights for the year, before outlining how our successes in 2014 mark the culmination of four years of strategic delivery that have transformed the business and created a solid foundation for the next phase of our strategic journey.

George will then present the financial results in detail, after which I will remind you of the strategic priorities for the next three years and the outlook for the business. Then we will do some Q and A.

2014 was a year of continued delivery for the Group, with the achievement of the key objectives set out in our 2011 strategic plan resulting in a significant transformation of the business and improvement in performance for the benefit of our key stakeholders.

We have continued to increase net lending and deposits in our key customer segments across our various businesses and are continuing to support the UK economic recovery.

Strategically, we are now a low risk bank: Since the end of 2010, we have successfully reshaped the business, focusing on the UK and reducing our international presence to only six countries and our non-core portfolio by approximately £150 billion. At the end of 2014, we had a remaining run-off portfolio of less than £17 billion.

We have a strong balance sheet and liquidity position. Pre-dividend, our CET1 ratio and leverage ratio have strengthened to 13.0 per cent and 5.0 per cent respectively, and our ratios are amongst the strongest within the banking sector worldwide. Our funding position is also strong, with a significantly reduced total wholesale funding requirement of £116 billion and a loan to deposit ratio of 107 per cent. As a consequence, our Credit Default Swap spread has tightened significantly, with our current spread of 45 basis points amongst the lowest of the major banks worldwide, which is a source of competitive advantage.

We have become a simple and efficient bank as well, which enables us both to maintain superior levels of investment in the business for future growth and to improve the customer experience, while also generating healthy returns for our shareholders.
In 2014 we achieved our target of reducing the Group's cost base to £9.0 billion excluding TSB, with the cost:income ratio of 51 per cent across the Group providing us with a cost leadership position as an additional source of competitive advantage.

The combination of our low risk business model, balance sheet strength and cost leadership has created a solid foundation for us to compete effectively and serve our customers, with the transformation of the business having been achieved while also delivering a substantial improvement in service quality across all brands.

In 2014, we delivered a 26 per cent increase in underlying profitability to £7.8 billion. This was driven by increased net interest income, reduced costs, and a significant improvement in impairment charges. This increase in profitability, coupled with the reduction in risk weighted assets as we continue to improve the risk profile of the business, has driven a significant increase in the Group's return on risk weighted assets.

We have also delivered a significantly improved statutory profit before tax of £1.8 billion after making provisions for legacy charges, including PPI, which George will cover shortly.

And today, as the Chairman has already indicated, we are also pleased to announce the resumption of dividend payments, with the Board recommending a payment of 0.75 pence per share in respect of 2014, amounting to £535 million

I would now like to show you how our successes in 2014 mark the culmination of four years of strategic delivery built on our four pillars of “Reshape”, “Strengthen”, “Simplify” and “Invest”, and how this delivery has transformed the business for the benefit of our customers and our shareholders.

We have delivered a low risk bank by reshaping and strengthening our balance sheet and funding position. We have significantly reduced risk in our lending portfolio through our careful portfolio management and the implementation of our clear, low risk appetite and tighter controls.

Coupled with the positive impact of the more favourable economic backdrop, this has led to a significant reduction in non-performing loans, which now represent less than 3 per cent of lending balances compared to over 10 per cent in 2010. At the same time, the proportion of our mortgage book with a loan to value in excess of 100 per cent has reduced dramatically, from £45 billion to less than £7 billion, or two per cent of the portfolio. While these trends are encouraging, we have strengthened impairment provisions, with the increase in coverage levels from 46 per cent to 56 per cent over the same timeframe reflecting our prudence as a low risk bank.

Since the end of 2010, we have also successfully reshaped the Group, reducing our international presence from 30 countries to only six, with more than 95 per cent of our activity now in the United Kingdom, and our non-core portfolio reduced by around £150 billion in a capital accretive way. This significant balance sheet reduction, coupled with our ongoing focus on reducing risk in our lending portfolio, have, in turn, led to a 40 per cent reduction in risk weighted assets to less than £240 billion.

We have also significantly improved our funding and liquidity position, reducing our total reliance on wholesale funding by over £180 billion, with our loan to deposit ratio strengthening to 107 per cent from over 150 per cent at the end of 2010. At £116 billion, our total wholesale funding is now broadly matched by our primary liquid asset portfolio of £109 billion.

Being a low cost and efficient bank is central to our strategy as it enables us to continue to strongly invest in our customer propositions for future growth while delivering strong returns for our shareholders.

Since 2010, we have reduced our cost base from over £11 billion to £9 billion, excluding TSB, in line with our latest, upgraded guidance. This significant reduction was, in turn, largely driven by the successful delivery of the first phase of the Simplification programme that we launched in 2011, with our cost: income ratio of 51 per cent now the lowest amongst our major UK banking peers.

This reduction in our cost base, coupled with lower impairments, has driven a major improvement in our profitability and returns, with our underlying result strengthening from a loss in 2010 to a profit of £7.8 billion in 2014, and our statutory pre-tax profit increasing by £1.5 billion, despite significant legacy items. Taken together with the substantial reduction in risk-weighted assets I mentioned a few moments ago, this has driven a major turnaround in the Group’s return on risk-weighted assets, from a negative return in 2010 to a positive return of more than three per cent in 2014.

This improvement in profitability has been a key driver in transforming our balance sheet, with our key capital and leverage ratios having been significantly strengthened through a combination of our strong underlying performance, a reduction in risk-weighted assets, and a number of management actions, including the sale of St James’s Place, the International Private Bank, and Scottish Widows Investment Partnership.

At 12.8 per cent, our fully loaded Core Tier 1 ratio has increased by 5.7 percentage points since 2010, with the strong increases in our total capital and leverage ratios to 22 per cent and 4.9 per cent respectively resulting in all these metrics being amongst the strongest of our major banking peers worldwide and positioning us well against the backdrop of evolving regulatory requirements.

This transformation of our business also includes the great progress we have made towards our strategic aim of being the best bank for our customers, by continuing to invest in our customer propositions and by supporting the UK economic recovery. This will be the major focus of the next phase of our strategy, given the progress made in rebuilding our financial strength.

In March 2014 we launched our Helping Britain Prosper Plan, which contains a number of public commitments in areas where we can make the biggest difference and can create value for our customers across households, businesses and communities. Since its launch, we have exceeded each of our lending commitments within the Plan, while also delivering lending growth in our key customer segments.

Turning firstly to our support for households. As the leading provider of mortgages in the UK, we are committed to helping our customers get onto the housing ladder, and, since the end of 2010, we have supported 275,000 first time buyers, lending over £33 billion over this period. Specifically, in 2014 we supported 89,000 first-time buyers, well in excess of our Helping Britain Prosper Plan target of 80,000.

We believe that small businesses and SMEs are the lifeblood of the economy and have therefore pledged our support for these important customer segments through the Helping Britain Prosper plan, while also continuing to increase net lending in these contracting markets. In 2014 we exceeded our Plan commitments by supporting over 100,000 start-up businesses and increasing net lending to the SME segment by over £1 billion. Over the past four years we have achieved cumulative growth of nearly 20 per cent in net lending to SMEs; in sharp contrast to the corresponding 16 per cent reduction in the market.

Our support for our customers goes beyond lending as we have an important role to play in our communities. We have therefore included a number of key commitments within our Helping Britain Prosper Plan. In 2014, we delivered against these commitments, most notably by providing over 940,000 cumulative paid volunteer hours to support community projects.

To further improve the customer experience and to support sustainable growth, we have continued to invest in our product propositions as well as our branches, digital and telephony channels by reinvesting a third of our Simplification savings into the business.

And, as part of our multi-channel approach, Digital has been and remains a key area of growth and investment, reflecting our customers' evolving preferences in how they wish to interact with us. At the end of 2014, we had 10.5 million active online users and 5.2 million mobile banking customers, the latter a 29 per cent increase compared to the prior year.

Our investment has, in turn, delivered additional tangible benefits to our customers, ranging from reduced processing times, improved ease of access and convenience as well as fewer errors and greater efficiency. This customer-focused approach has resulted in a significant improvement in our key customer service metrics.

Our FCA reportable banking complaints have reduced from 2.4 to 1.5 per 1,000 accounts over the past four years, with the latest figures showing that the Group's complaint levels were approximately half the average of our major banking competitors. Similarly, the number of complaint outcomes overturned by the Financial Ombudsman Service has reduced to 28 per cent: a figure that is industry leading.

In terms of overall customer satisfaction, all of our major banking brands have seen an increase in net promoter scores, with the Group's overall score improving by 50 per cent since 2011.

These results do not make us complacent; rebuilding customer trust remains a key imperative for the business, which we will pursue relentlessly. In support of this, we are continuing to strengthen the control environment, with key improvements including the embedding of product governance as a key control to identify and monitor risk, and changes to the ways we distribute our simpler and more transparent product range.

In addition, we have recently made further changes to our performance and reward framework for customer-facing colleagues in branches, with an overwhelming focus on customer service.

In summary, the successful delivery of the strategic priorities we set out in 2011 has transformed this business for the benefit of our customers and our shareholders. We are now a low risk, low cost, UK focused retail and commercial bank, with market-leading capital ratios. These achievements have, in turn, enabled us to resume dividends as an important element of shareholder returns, while also providing us with a solid foundation to pursue our strategic priorities for the next three years and deliver sustainable growth.

I would now like to hand over to George, who will run you through the key financial highlights for 2014.

George Culmer, Chief Financial Officer

Thank you António and good morning everyone. I will give my usual overview of the financial performance and position of the business.

Starting with a brief summary of the P&L. As you've just heard underlying profit increased 26 per cent to £7.8 billion, with the movement in total income offset by a 2 per cent reduction in costs, and a 60 per cent improvement in impairments. Excluding SJP from last year's numbers, income was up 1 per cent while underlying profit was up 40 per cent, and JAWS a positive 3 per cent.

Statutory profit before tax was £1.8 billion, a fourfold increase over 2013, and includes simplification costs, TSB build and dual-running costs, as well as legacy and ECN exchange charges.

Statutory profit after tax was £1.5 billion, with the effective tax rate of 15 per cent largely reflecting the impact of tax exempt disposals, predominantly SWIP, in the first quarter.

Turning to the P&L in more detail. Net interest income was up 8 per cent to £11.8 billion, driven by better deposit pricing, lower wholesale funding costs, and loan growth in key segments, partly offset by disposals and the expected pressure on asset pricing.

The net interest margin of 2.45 per cent is 33 basis points higher than 2013 and 5 basis points higher than the half year. The Q4 margin was 2.47 per cent and includes a one off charge of 5 basis points as a result of the consolidation of the Savings products range we announced in December.

Looking forward, we expect the NIM in 2015 to be around 2.55 per cent, with continued pressure on asset pricing more than offset by improvements in the liability spread and mix, and reduced funding costs.

In terms of assets and liabilities, total customer assets were down 3 per cent to £478 billion and average interest earning assets by 5 per cent. While customer deposits increased by 2 per cent to £447 billion.

Looking at lending and deposits by segment. For the 12 months we've seen a repeat of the themes we've called out through the year. For lending, excluding TSB, run off and other, loans and advances grew by 1 per cent. Within this we've grown mortgages by 2 per cent, in line with the market, with gross new mortgages of £40 billion, up 14 per cent.

In SMEs, net lending is up 5 per cent, compared with a market contraction of 2 per cent. While in Mid-Markets our 2 per cent growth compares with a market that is down by 3 per cent. As you know, we don't set a growth target for Global Corporates, and for the year, lending was down 10 per cent, reflecting both a small number of large repayments in the first half and our targeted approach in this segment.

Finally, growth in our newly formed Consumer Finance business has accelerated strongly, with UK assets increasing by 17 per cent, driven by a return to growth in our cards business and strong growth in Motor Finance due to the strength of the UK market and the launch of the Jaguar Land Rover partnership in the first quarter.

On deposits, our strategy remains to focus on our retail relationship brands and our Commercial Transaction Banking business. In Retail, our multi brand approach has continued to deliver, with deposits in our relationship brands increasing by 4 per cent. While in Transaction Banking deposits are up by 10 per cent as we've grown both the client base and share of wallet.

Turning next to other income. In other income, as we've said through the year, the environment is challenging, and the underlying performance was down 9 per cent, due mostly to disposals, the tough conditions in Retail and in Financial and Debt Capital Markets in Commercial, and the impact of regulatory changes in Insurance.

In the second half we have seen income levels stabilise, with Q4 volumes in line with Q3 at around £1.6 billion for the quarter with stronger performances in Commercial and Insurance offset by lower fee income in Retail.

Moving forward, with the reshaping of the Group complete, we would expect other income to remain broadly stable in 2015.

On costs we have hit our target for the year of £9 billion excluding TSB. Total costs including TSB were £9.4 billion and 2 per cent lower than prior year with disposals and run-off accounting for £392 million of the reduction, and Simplification a further £449 million, both offset by reinvestment in the business. Costs in the fourth quarter were £2.5 billion, up 12 per cent on Q3, largely due to the bank levy charge of £254 million and an increase in operating lease depreciation from the growth in Lex Autolease.

In Q4 we also completed the final phase of our Simplification programme, delivering annual run-rate savings of £2 billion, well ahead of the original target of £1.7 billion. And as we said in October, we are now targeting an additional £1 billion of run rate savings by 2017 in the next phase of this programme.

In terms of cost to income, our market-leading ratio now stands at 51.2 per cent or 49.8, excluding TSB and adjusting for operating lease depreciation. And, as we said in October, we are targeting a ratio of 45 per cent as we exit 2017, with reductions in every year.

Moving on now to asset quality. On impairments, we've seen a 60 per cent reduction in the charge for the year to £1.2 billion, with the AQR improving to 24 basis points compared with 57 in 2013. Impairments reduced in every Division, and continued to benefit from better credit quality, improving economic conditions, provision releases and write backs and reductions in the run-off portfolio.

In terms of impaired loans and coverage, the quality of the Group's loan portfolio continues to improve. Impaired loans now stand at 2.9 per cent of total advances, compared with 5 per cent at the half year and over 6 per cent at the end of last year.

At the same time, we have also seen an improvement in coverage, with the coverage ratio increasing to 56 per cent from 54 per cent at 30th June, and from 50 at the end of 2013.

Given our focus on low risk retail and commercial banking, together with improved credit analysis and risk management, we expect the AQR for 2015 to be around 30 basis points.

Looking briefly at underlying performance by Division, we've delivered strong increases in Retail, Commercial Banking and Consumer Finance.

In Retail, we continue to deliver strong profits and returns, with the 7 per cent increase to £3.2 billion, reflecting improved net interest income, which was up 9 per cent, as well as a 21 per cent reduction in impairments.

In Commercial, the 17 per cent improvement to £2.2 billion is a very strong performance in tough market conditions. Income was up 1 per cent and underlying profit again benefited from a significant reduction in impairments. Returns in Commercial Banking also continued to improve. Return on Risk Weighted Assets was 1.92 per cent and close to our 2015 target of 2 per cent, and well on the way to our new target of 2.40 per cent. This improvement was driven by the improved profitability, and a targeted change in asset mix including exiting lower margin business in Global Corporate.

In Insurance underlying profit was down by 15 per cent, impacted by the regulatory changes and tough market conditions that we talked about at the half year and at Q3. Going forward the environment will remain tough, however we expect a stable result in 2015, with adverse economics offset by growth from investment in our digital offering, as well as Bulk Annuities and Corporate Pensions.

Consumer Finance again benefited from reduced impairment charges, as well as higher income from Asset Finance, and these more than offset the increased investment in the business and were the key drivers of the 5 per cent increase in underlying profit, to just over £1 billion.

Finally the improvement in the run off portfolio is primarily due to lower impairments; the improvement in TSB mainly reflects a reallocation of support costs to Retail, and the increase in other income is mainly due to the change in the treatment of interest payable on the AT1s following the ECN exchange.

Looking at the usual reconciliation from underlying to statutory profit. As a reminder, the £1.7 billion charge in asset sales and volatile items includes £1.1 billion relating to the ECNs while the charge of £280 million in 2013 included £787 million of gains on the sale of government bonds. And there were no such sales in 2014.

Simplification costs were £966 million. This comprises around £800 million to complete the original programme and deliver the targeted £2 billion of savings, and £160 million of redundancy costs which forms part of the £400 million we called out at the recent strategy day to deliver the next phase of the Simplification programme and our target of a further £1 billion of savings.

TSB costs were £558 million, representing build costs of £232 million and dual-running costs of £326 million.

While PPI totalled £2.2 billion, down from £3.1 billion in 2013. Other legacy charges is up from the £500 million we reported at Q3 to £925 million, which is higher than in previous years, and includes a number of one off items such as the settlement for LIBOR and Repo.

The Q4 provision increase of £425 million includes a further £100m for interest rate hedging, £120 million for German insurance and around £200 million for other conduct related matters and associated costs.

And finally, other statutory items of £374 million include a credit of £710 million from the changes to our DB benefits pension arrangements that we announced in the first half.

As previously mentioned, we expect the gap between underlying and statutory profits to close. In 2015 we will see the last of the material costs for TSB and liability management, and while conduct remains uncertain, I am confident that going forward underlying profit will flow through into statutory profit and so drive capital growth.

On PPI, we increased our provision in Q4 by £700 million due to an upward revision in expected reactive complaint volumes, additional remediation costs, and upward pressure on uphold rates and average redress. Re-active complaint volumes have continued to fall, down by 12 per cent in Q4 over Q3, and down 22 per cent year on year. Volumes however have remained slightly above expectations, due mainly to CMC activity, and reactive volumes and associated expenses account for around £400 million of the Q4 provision increase.

On the Past Business Review, we have largely completed the proactive mailings. Remediation of previously defended cases is also now well advanced, and we expect to complete the vast majority of this activity in H1.

In terms of cash spend, this was around £200 million per month in Q4. In 2015, the costs will rise slightly in Q1 due to Remediation work, before falling in the second half, to a substantially lower level as Past Business Review and Remediation run off.

Turning then, to the balance sheet. Our strong balance sheet and key ratios continue to improve. During 2014, we generated around £34 billion of funds, led by deposit growth of £10 billion, lower Global Corporate lending of £8 billion and a £16 billion reduction in the run-off portfolio.

And that Run-off portfolio now stands at just under £17 billion and well below both the original and improved guidance for the year.

We've used the funds we've generated in the year to reduce wholesale funding from £138 billion to £116 billion, build primary liquid assets and to fund a further £8 billion of net lending to key clients and customers.

In terms of net assets, tangible net assets increased over the year from £34.6 billion to £39.2 billion and the TNAV per share from 48.5 to 54.9 pence. This substantial increase was driven by our strong underlying earnings and positive movements in pensions and other reserves.

On pensions, we have significantly de-risked our pension schemes over the last two years, and in 2014 we have benefitted from changes in the asset mix and our interest rate hedging programme, which we completed in the first half of the year.

Other reserves include the cash-flow hedge reserve, which has benefited from falling swap rates, and the Available for Sale reserve, which has benefited from a reduction in gilt swap rates.

Turning next to Risk weighted assets. On RWAs, these now stand at £240 billion, down £32 billion or 12 per cent in the year and clear evidence of our continued de-risking of the balance sheet. This reduction has been led by Run off where RWAs are down by £14 billion, due mostly to disposals, and Commercial Banking where RWAs are down £18 billion, or 14 per cent, thanks to the active management of this portfolio.

In Retail, RWAs reduced by around 7 per cent year on year, reflecting the improved risk profile of the mortgage portfolio, while the increase in Consumer Finance reflects the growth in that business.

Finally, looking at capital, as you've heard our fully-loaded CET1 ratio increased to 12.8 per cent, from 10.3 per cent at the start of the year, and well ahead of our targeted growth for the 12 months. This increase is after the charges for the ECNs, PPI and other legacy, and has been driven by underlying profits, the dividends received from Insurance, and, as just mentioned, the reduction in risk-weighted assets.

As you know, the capital framework continues to evolve and I now expect the steady state CET1 requirement for the Group to be around 12 per cent, compared with our previous estimates of around 11. Despite this increase, the return on required equity target we announced in October, of between 13.5 and 15 per cent by the end of 2017, remains unchanged.

Going forward, given our strong levels of underlying profitability and the anticipated reduction in below the line items, I would expect the business to generate between 1.5 to 2 per cent of additional CET1 each year, before dividends, starting in 2015. On total capital, our ratio improved to 22 per cent, positioning us well compared to peers, and for later in 2015, when we expect to receive greater clarity on TLAC and MREL requirements.

Finally on leverage, we also remain in a strong position and have increased our ratio on a Basel III basis to 4.9 per cent, from 3.8 at the start of the year. This includes a 0.5 per cent benefit from our AT1 issuance adding to the positive effect of strong underlying profits.

So to sum up, 2014 was another year of achievement. Underlying profitability is strong, statutory profit saw a four fold improvement and capital and leverage ratios continued to improve. And as you have heard, the Board has recommended a dividend of 0.75 pence per share in respect of 2014, representing a payment of £535 million.

The Group's aim is to have a progressive dividend policy, with dividends starting at a modest level and increasing over the medium term to a dividend pay-out ratio of at least 50 per cent of sustainable earnings. And the intention is to pay an interim and final dividend for 2015, subject to performance.

That concludes my review and I would now like to hand back to António.

António Horta-Osório, Group Chief Executive

Thank you George. The successful delivery of the strategic commitments we set out in 2011 has resulted in a significant transformation of our business, in turn supporting our aim of being the best bank for our customers and our shareholders, while providing us with a strong foundation to deliver the next phase of the strategy.

Last October, we set out a clear and simple strategy for the next three years, which builds on the strategic plan announced in June 2011. Our priorities are to continue to create the best customer experience, to become simpler and more efficient, and to deliver sustainable growth.

We will deliver sustainable growth by capturing significant growth opportunities within our prudent risk appetite and, over the next three years, we expect to grow net lending in our key customer segments by £30 billion. To achieve this, we target to maintain our market leadership position in the competitive and key markets of mortgages and current accounts, and to outgrow the market in areas where we are currently underrepresented.

We expect to outperform the market in our SME and Mid-Market segments, increasing net lending to each of these business customer segments by over £3 billion.

In our Consumer Finance division we also expect to outperform the market by growing UK customer assets by £6 billion, with our auto finance business achieving double digit growth and increasing customer assets by £4 billion, and our credit cards business delivering a £2 billion increase in customer balances.

Over the next three years, we also expect to grow customer assets in our Insurance division by £10 billion through the enhancements we are making to our retirement planning proposition and by leveraging the Group's operational scale, customer reach and insight.

In conclusion, the successful delivery of our strategy has transformed the business, enabling us to drive a significant improvement in profitability, giving taxpayers the opportunity to get their money back at a profit and allowing us to resume dividend payments. This is a big tribute to the hard work and commitment of everyone at Lloyds during the past four years.

This makes me confident in the future prospects for the Group as we enter the next phase of our strategic journey, with our clear set of strategic commitments building on the firm foundations that have been established through our successful transformation of the business. As I just mentioned, we have significant opportunities for growth within our prudent risk appetite.

Through the strategic initiatives we announced in October, we confirm we expect to deliver a sustainable return on equity of between 13.5 per cent and 15 per cent at the end of the strategic plan period and through the economic cycle.

Dividends, which are a key element of shareholder returns, have been resumed and we will build on this symbolic resumption announced today, by targeting a medium term dividend payout ratio of at least 50 per cent of sustainable earnings.

In the shorter term, we expect the Group to continue to perform strongly. In 2015, we expect our net interest margin to increase further, other income to remain broadly stable, and our low risk business model to be reflected in a low AQR. We also expect the business to remain strongly capital generative. While we recognise that we still have a lot more to do and despite uncertainties relating to the political, regulatory, economic and competitive environment, we believe that the Group is extremely well positioned.

In fact, the combination of our strategic priorities for the next three years, underpinned by our increased investment in Digital, our differentiated business model and unique brands, make me very confident that we will deliver our dual aims of being best bank for our customers and achieving strong and sustainable returns for our shareholders, while also Helping Britain Prosper.

Thank you. We are now available for questions.

Question and Answer Session

Question 1: Chris Manners, Morgan Stanley
Good morning everyone, it's Chris Manners from Morgan Stanley here. So I guess three questions if I may. The first one was on the net lending growth target of £30 billion. Obviously returning to net lending growth on a Group basis is something we'd all love to see. Just trying to understand, is that the total loan book? Is that the franchise loan book? How should we think about that growth and where do you see it coming and in which segments?

And the second point was on the NIM guidance. Obviously NIM dropped in the fourth quarter. I think everyone was really encouraged to see it is going to rise in 2015 given asset spread compression as you mentioned. So just maybe a bit more colour on where that uplift is going to come from? Presumably deposit pricing is going to be part of it?

And the last one was on your capital stack, saying 12 per cent now. How do you think about the DSIB buffer? We kind of thought you might have a 3 per cent DSIB buffer going forward and just the components there? Thanks.

Answer: António Horta-Osório
Thank you Chris so I will answer you the first question and then George will take two and three. So the £30 billion refers to the increase in our key customer segments as we have been describing them every quarter, which is basically £6 billion on both SMEs and mid-corporates, £3 billion each, which means according to present expectations, to grow around 5 per cent in SMEs as we have been growing and to increase our growth in Mid Markets from 2 per cent. So the target is £3 billion in SMEs, £1 billion per year and £3 billion in mid-corporates, £1 billion per year, £6 billion for those two segments over the next three years. Then you have another £6 billion in Consumer Finance, our high growth area division where I said £4 billion would be in the car financing business and double digit growth we expect for the next three years and £2 billion on current car balances, so another £6 billion. The remaining £18 billion is what we foresee to grow on the mortgage markets where we are assuming after last year's growth of close to 2 per cent, we think this year will again be around 2 per cent and therefore assuming market growth for the next three years. And we will grow with the market. We will grow £18 billion in terms of mortgages over the next three years.

So I am leaving out, just to clarify earlier model, as always I am leaving out the £17 billion of the run-down, I am leaving out the closed book that we have in terms of Dutch mortgages, and I have not mentioned our overdrafts in the Retail area and large corporates. Large corporates as you saw in the 2014 results was the reason why the target segments, the core book did not grow at 2-3 per cent because large corporates came down. I have mentioned repeatedly in our quarterly meetings and presentations that large corporates we don't target credit growth because of debt capital markets, market conditions. On the previous year we had grown a lot of large corporates, last year we reduced because of lower margins and more risk in the market that we did not want to join. I expect during 2015 large corporates to grow in line with the average of the other segments. So I do expect the core of the bank to grow between 2-3 per cent, the average of everything I just told you. Was that clear?

Chris Manners
Very.

António Horta-Osório
George could you please go on NIM and capital stack?

Answer: George Culmer
Yes on NIM Chris, as you have seen the current NIM for 2014 is 2.45 per cent which was up from the 2.12 per cent and the main driver to that which we set out in the waterfall, I had over 20 basis points from the liability side, I had accounting benefits from the ECNs. Going the other way I think it was about 7 basis points for basically mortgage pricing and I also get a benefit from wholesale funding. As you say, the Q4 bit was a sort of one-off, it was the 5 basis points in the consolidation savings, but it was all those features as well, those other elements featured in that as well. So we did a see a further benefit from wholesale funding Q4 versus Q3. We did see a further benefit from deposits Q4/Q3 and a bit of asset.

As we move forward, the story will sort of remain the same. I think there is still a bit of headroom in terms of liability pricing. I do expect to see a bit of asset pressures as we move forward, although it is interesting in terms of as expectations of rates move out and what that does on things like SVR. What I do also expect to see is further benefit from lower wholesale funding and I would see that in terms of as a lot of crisis funding continues to roll-off and is replaced by something that is much more reflective of where the Bank currently sits in terms of cost and money and I see that benefit coming through. So as I said, we have given our guidance and I think it is pretty robust guidance and I think quite a positive outlook.

On capital, yes we said at the round level, now saying around 12 per cent. What has happened since? I think as we talked through last year we said there were risks as the sort of involving regulatory conversations sort of continued, that the risk were that it would increase and we have pushed it up. That reflects us passing through a couple of stress tests, ICG conversations etc and just factoring all those in. I think the capital rate has moved forward, it is interesting to see what everyone has come out with over the last week in terms of expectations and the sort of coalescing around numbers. We are not a GSIB. So we don't have that specifically applying for us. There are still some uncertainties about what is coming out of Basel and whether it is standardised operational risk, we still have to work through those. But for now we certainly think about 12 per cent is reflective of where we see ourselves and how we see ourselves in comparison with our peers I suppose and compared with our low risk business model that we operate. But that is where we sit.

António Horta-Osório
And we are keeping the target return of equity of 13.5 per cent to 15 per cent to the new capital target of around 12 per cent.

Further question
Thanks. Just to clarify. I was talking about DSIB rather than GSIB, so obviously I guess you put up a slide showing how strong your market share is and how important you are to the UK economy, I thought you might have a high DSIB buffer?

Answer: George Culmer
The reality is actually whilst I say we are not a GSIB, I would expect we will probably get treated like a GSIB.

Question 2: Tom Rayner, Exane BNP Paribas
Thank you. Good morning, it's Tom Rayner from Exane BNP Paribas. Yesterday one of your peers talked about its capital targets as well, 13 per cent for them above which they felt they would be happy to start distributing all their free cash flow effectively. Irrespective of the debate whether it is 12 per cent or 13 per cent, you are pretty much at 13 per cent yourselves anyway, eligible Tier 1 is above 2 per cent which I think is more than you need and your eligible Tier 2 is nearly 4 per cent. So on a fully factored in CRD4 basis I think you are 19 per cent total capital. So a long way ahead of your peers. So when I look at your guidance for 150 to 200 basis points of capital generation, I guess my question is, pretty soon is there any reason why you shouldn't be able to start distributing if not all of it, pretty much all of it?

My supplementary to that would be, if you are not allowed to and you are building up bigger pots of surplus as will some of your peers be, is there then a risk that we will see more margin pressure coming into the industry because the other thing that will start happening is you will start competing for more volume in an environment where loan rates might still be on the slow side? So that is my question thank you.

Answer: António Horta-Osório
I will just offer a few comments because we are not going to give any more guidance on future dividends than the ones that we have said. Look, it's a nice problem to have, number one. Number two, we will take it step by step until we are really proud of getting dividends back to shareholders and to our three million individual shareholders and taxpayers after 2008 for the first time. We said we would start at a token level. As you very well said, we have finished the year better than we thought with a 13.0 fully loaded capital ratio pre dividend and we will take it semester by semester. So we will see at the interim, we will see at year end and we will discuss at the Board then and we will set the specific dividend at each moment. It is clear that we intend to move to a payout ratio of at least 50 per cent of sustainable earnings over time. And it is clear, as George told you, that we believe we will create 1.5 per cent-2 per cent of capital per year because, and this is very important, because we have a business model which is both low risk and low cost. This is critical. That is two key competitive advantages; the low risk drives not only impairments down, but should drive the cost of equity and the capital requirements down. That is why as George said to Chris, if others are now mentioning 13 per cent or 12-13 per cent, we as a low risk bank, we believe we are very comfortable on the low end of around 12 per cent.

And second, having a cost to income of 51 per cent when all of our major peers are between 58 per cent and 67 per cent, gives us a major competitive advantage in terms of providing better products to clients at the same time as we have superior returns to shareholders. So all of it results from the fact that not only we have a simple business model focusing UK retail and commercial banking, but we have two critical competitive advantages of the lowest credit default swap or risk if you want and the lowest cost to income in the UK.

Further question:
And on the margin bit of the question, if somebody stops you distributing the dividends, what do you do instead? Do you start competing more aggressively for faster volume?

Further answer: António Horta-Osório
It's a nice problem to have Tom. We will take it then if it happens.

Question 3: Chintan Joshi, Nomura
Good morning, Chintan Joshi from Nomura. Can you give us some update about the SVR book? Constantly it is pointed out as something that is a risk factor. Just want to get an update. From what I can see from industry trends it shouldn't have picked up in January, but wanted to see what you are seeing? That is the first thing, and then I have another one on margins.

Just if you can elaborate on your hedge assumptions within your NIM guidance for 2015?

António Horta-Osório
George will address both those questions

Answer: George Culmer
Yes on the SVR book, we have seen pretty stable trends actually and one that people focus on particularly in terms of the Halifax book. This is the sort of 3.99 per cent, we came in at about £61 billion at the start of the year. The movement in the balance I think is a reduction of about 7 per cent which will be consistent with actually our totality of SVR books, it is not out of line with the movements of books with lower rates on. So it has come down to about 7 per cent, so sort of £58 billion or £59 billion in terms of closing. But we have seen a pretty stable trend and obviously one of the sort of, one of the earlier questions, one of the benefits of base rate rises being put back is that has made things pretty sticky and I think would expect to stay with us for some considerable time. But that is what we are seeing.

In terms of hedge assumptions, we continue to be sort of well over 90 per cent invested. We have put a premium by stable, predictable earnings and that reflects our policy on our hedge. We don't see material shifts in terms of reinvestment rates and differentials between earned and reinvestment in terms of roll-offs etc.

There is not a huge proportion of the hedge that is expected to roll next year so I am not looking at a big differential in terms of 2015 plays 2014 in terms of structural hedge contribution to earnings. As you know we have got a target weighted average life of about 5 years. We are currently inside of that, but shorter than that at the moment. So the strategy remains pretty unchanged as I say and we see earnings year-on-year it doesn't have a material impact in terms of overall shape.

Further question
On the hedge I agree 2015 versus 2014 not much impact. Assuming the current yield curve would you see some impact in 2016 or 2015? That is on the hedge. And on the SVR can you talk about trends also on your Buy to Let Book, if you are seeing any increase in churn there or is it similar to kind of SVR churn rate?

Answer: George Culmer
I am not aware of any different trends on the Buy to Let book, I have not seen any different trends there. And I am not going, you know 2016, 2017, all those sorts of things, it is a way out and it depends upon what rates do and obviously there has been movement over the last months, so in terms of how hedges roll-off and reinvestment rates when you move out 24-36 months, let's see what is in the market and what rates are available then.

Question 4: Arturo de Frias Marques, Santander
Arturo de Frias Marques from Santander. First of all, congratulations to you and the team for a truly remarkable turnaround. And then a couple of questions; on one on dividends and one on long-term strategy. I was going to ask the same question that Tom asked about you not being allowed to pay nearly all of it. So I will rephrase slightly the question and focus more on the short-term and ask, the 0.75p that you are announcing today corresponds to 44 per cent payout ratio. I am sure you would not like to start with a 44 and then come down. So should we assume that at the very least for 2015 onwards we are going to see that 44? That is the question on dividends.

And then the question on strategy, it is true you have a remarkable advantage on costs and on funding to grow, but it is also true as you show us in this chart on market sales which I found really interesting, that you have already very high market shares in some of the key markets, current accounts, mortgages, SMEs. You also said you did not want to grow in large corporates. Of course you can grow a lot in home insurance, in credit cards, in Consumer Finance etc. But the biggest books you already have 20 per cent plus market share. So there is a limit to the growth you can achieve there. Knowing that the transformation is pretty much done, could you share with us your thoughts in terms of non UK growth, inorganic growth, international expansion in the medium term?

Answer: António Horta-Osório
So three comments on what you said. The first in terms of dividends, we are not going to anticipate anything else. I understand your problem, we will leave it to each one of you to make your own assessments and we will discuss it for sure though in the next few quarters.

Strategically speaking Arturo I think you are right, but we see significant growth possibilities and I think that is demonstrated by what we started doing as we said we would do, because I think the interesting thing about, in terms of our strategic plan is not only what we did but we did what we said we would do, because sometimes it is not exactly the same thing. And we said to you two or three years ago we would start growing aggressively in Consumer Finance, this has been done. The car financing portfolio grew at more than 25 per cent where the market grew around 11 per cent and we believe we also grew around 11 per cent on if you want a footfall basis, but given that we won the Jaguar Land Rover representation, it more than doubles our growth in car financing which is very important, one of the main brands in the UK. We told you we would start increasing the credit card portfolio and we did it annually over three years last year as targeted, where it grew by 2 per cent. And you have growth targets which are much bigger for credit cards going forward. On credit cards, to give you an idea, we only have 15 per cent market share. We never did the non franchise business so have a huge opportunity on the non franchise business as we do and have been executing well on the franchise business.

In SMEs, where we have grown 20 per cent net over the last four years, in a market that shrank 16 per cent, we still only have around 18 per cent market share and we believe that we can grow clearly towards the 25 per cent. The same thing in Mid-Markets where we have an 18 per cent market share as well. So you should not, to be very fair, you should not expect huge market share increases, first because we are a prudent bank and have a low risk appetite and second, because market share gains to be then well, take a long time to execute for example in credit cards our ambition is to go from 15 -16.5 per cent in three years, which is a 10 per cent increase from 15 -16.5 per cent but this will enable us in our opinion to grow above nominal GDP progressively. And because you have to see it in the whole, if we execute as we have been doing, and we have a clear commitment to you of increasing costs by less than the revenues, we will continue to increase our competitive advantage and go towards cost:income of 45 per cent which will increase further our competitive advantage I believe, because I see others going up not down. And therefore we will be able to grow as we offer better products for customers and superior returns for shareholders. So we are very comfortable about our UK focus strategy of households, SMEs, Mid Markets UK and we have great possibilities of growing over time, more than the costs in creating value.

The third point of our strategy is very simple. We have no plans of expanding internationally, we have no plans of doing anything besides where we are which is basically a small presence as you know in Holland of mortgages which is a closed book. And where we have a good presence in Germany of online deposits in a small asset finance business. We have a business in Ireland which is going to zero. We have a branch in Singapore to support UK companies in Asia, a branch in New York to support UK companies in New York. Very simple, 95 per cent in UK for the next three years. We are going to continue and deepen because I think when you do well you should deepen instead of diversifying and continue to do well in what we have been doing well in and we are not complacent at all. We will continue relentlessly to pursue these goals.

Arturo
Very clear, thank you.

Question 5: Rohith Chandra-Rajan, Barclays
Thanks, good morning, it's Rohith Chandra-Rajan. If I could come back to the margin expectations for next year please and you have given us a lot of detail on the asset side. Just on the deposit side of the margin, maths for next year. Certainly some of your peers are talking about relatively flat deposit margins so I was wondering if your expectation of the liability side is more to do, certainly on the deposits is more to do with mixed shift in your own book either between brands as you have talked about before or from timed to site deposits ?

Answer: George Culmer
Yeah I mean the explanation I gave earlier, yes the components we have seen will continue to play a part I would have thought in terms of different weightings, wholesale funding is going to play a bigger part as we move through next year, it is going to be a larger part of that. You have seen this year and will continue to see next year our ability to flex between brands is an advantage and you have seen that this year. You will see more of that next year. But also you know in terms of shaving a few basis points etc, I still see that possibility within the core Retail and Commercial Banking core deposits as well. So I see that possibility.

Further question
Thank you, that is very clear. And just very briefly, just on your other income comment which clearly has been an area that has been more challenging I guess over the last few years. I was just wondering about your confidence of stability of that line for next year and what are the headwinds so things like interchange fees etc?

Answer: George Culmer
Yes good question and you are right, it has been area where it has been hard for factors and reasons that we all know. And as you allude to one there, as we move forward there continue to be challenges. So our comment of broadly stable, was fully appreciative of what is happening on interchange and that is factored in for 2015. So that is already in there. But you know across the book, some encouraging signs. I talked about in the presentation in terms of commercial for example, which had very strong Q4 and came back strongly. We are also making investments across the business, I talked to things in insurance regards our aspirations and hopes around things like corporate pensions, bulk annuities which we are investing money in as well as the digital offering. And we would hope to see a rebound in the insurance contribution. But the environment stays tough. And in terms of retail I think it will continue to be a tough environment, just given product mix and the environment that we are in. But I think broadly stable is a fair assessment. I would hope for growth thereafter in sort of 2016 and onwards, but my expectation is it is going to stay a pretty tough market for fee generating products.

Question 6: Andrew Coombs, Citi
Andrew Coombs from Citi. First if I could possibly just follow-up from the previous question. I mean on the other income point. We talked about the interchange fee cap there, you have also got TSB dropping out at some point during the year. You have also got the run-off contribution presumably declining. So there are a number of headwinds, so I guess you talked about a tough environment for retail products, but there must be an offsetting positive somewhere. So perhaps you could just elaborate on where you see that coming through from? Is it the Commercial bank?

Answer: George Culmer
Sorry the previous explanations. It is Commercial and Insurance. I mean Insurance, as I said there are some adverse economics that they have to deal with which is just the wonders of insurance accounting in terms of how we sort of discount some of the free assets. But there are some initiatives in Insurance and as I said, yes Commercial Banking had a very strong Q4, bucked the trend, particularly in the financial and capital markets, put in a good performance. And you know we have hopes, but again it will stay tough

Further question
And just a broader question on mortgage pricing. When you look at a number of competitors, there have been some quite substantial rate cuts made over the past three to four months. If we look at Halifax, there has been some adjustments, but they have not been of the same magnitude. And that has been a consistent point that Lloyds have made. So I guess I was wondering, when you think about the pricing differential, I mean how much does your scale and your service proposition, how much of a differential does that allow you to maintain whilst remaining competitive?

Answer: António Horta-Osório
That is a very good question and of course we look into all of what you have just said. And the fact is that we grew broadly with the market last year as was our objective and we continue to believe we will grow in line with the market this year and we don't necessarily have to have the lowest prices for that. That is one comment.

The second one, as you know, we have a multi-brand strategy which I continue to believe is a competitive advantage especially in a low interest rate environment.

And the third one is we manage the margin, not separately, but as the difference of the two between loans and deposits, we do it on a weekly basis and we do it at the highest level of the organisation which is another competitive advantage. So I would expect as George said before, that the environment in terms of margins of assets, minus margins of liabilities, to continue to evolve broadly in the same way over the next few quarters.

Question 7: Fahed Kunwar, Redburn
It's Fahed Kunwar speaking from Redburn. I had a couple of questions. The first is on your statutory RoE target 13.5-15 per cent. So your adjusted RoE in 2014 was 13.6 per cent. I know your statutory was only 3 per cent, but I am assuming you don't have legacy costs going forward in the medium term or at least they kind of drop out. I was just wondering why the target is so low I guess? You move from 11 per cent to 12 per cent right now in your Core Tier 1, are you potentially factoring in the fact that that might actually keep increasing and you would like to hit that target even if you have to hold 13 per cent or 14 per cent Core Tier 1, or is there something else going on in that number?

I can give you my second question as well now.

António Horta-Osório
So you can give us time to think about it.

Further question
The second question is actually on other income, but it is actually on another, in another manner. A lot of the European Retail Banks are talking about a move from retail customers and some small corporate customers, moving from deposits into AUM and other types of saving products. Now you are probably kind of pre-eminent bancassurance model definitely in the UK and I know there are near term headwinds to OOI, but going forward, is that happening in the UK and if not, why do you think it won't happen in the UK going forward? Thanks.

António Horta-Osório
George will do the first one. He wants to give me time to think about the second one!

Answer: George Culmer
Right I will make it long. Look the 13.5-15 per cent I think is an entirely appropriate target and I think stands good comparison with the previous target the bank had when we put out the first Strategy Review in 2011. So we have improved it. And I think it stands very good comparison with the targets of our peers. So I think it is entirely appropriate and a good target.

In terms of just some elements around calculation, you are right, the expectation is as we move forward and those below the line items drop away, you should see a convergence between the 3 per cent and the 13 per cent just taking those as static numbers. There will though always be some element of drag. You will have things like sort of fair value unwinds, you will have amortisation of costs etc. So you are never going to have a complete one for one, but there will as you say, and I have said, there will be a significantly lower level of dilution as we move forward.

What we have also seen is that assumptions change and when we introduced that in October, that was based around a capital climate of around 11 per cent, and we had base rate assumptions for 2017 and I forget whether it was 2.5 per cent or 3 per cent etc. And what we said at the time was that you know we would if we saw movement in those assumptions and we have now seen something on capital, base rates continue to move around, we would look to absorb those and stick by those RoE targets. And we have seen a movement on capital as I say, base rates continue to move, but we are sticking with our target and will continue to do so, if we see further wiggle room I think, in terms of some of the key elements of that.

So it was an appropriate target, we would stick by that target and what you will see as I say, is those RoEs, the statutory and the underlying come together.

Answer: António Horta-Osório
Thank you George. On your second question, that is quite an interesting question strategically. I mean I would make two or three comments.

The first is we have, as you said, a major opportunity in that area because we have the largest presence in retail in the UK and we are under weight in terms of assets under management as you said. And we both have Scottish Widows in terms of insurance products. But we also have the partnership that we recently initiated with Aberdeen which we really value and so we have both products if you want asset management and insurance products available. That is the first one.

The second one is, we will develop that of course and it is a major opportunity. But relating to the European context and the move to direct our customers towards those products, I think we are going to be careful. And we are going to be careful for two reasons. First we want absolutely to be the Best Bank for Customers, so we have to think what is the best interest of the customers. And I personally have some doubts that in the lowest interest rate environment of the last century, it is a good idea to move clients into fixed income products that will be exposed to rising interest rates which I think are inevitable, the question is when. And second, we have to do this in a conduct appropriate way and we have been working very seriously with the FCA in terms of execution only products versus advice, how to do it in internet, mobile and this will take some time to develop. So I would say, versus Europe you have a totally different approach in terms of conduct which I think is leading in the UK and Europe should start thinking about. Second again, in the interests of our customers, I would be very careful in trying to push our customers to fixed income products in this point of the cycle.

Further question
Can I just follow-up quickly on a couple of points. Sorry, on your 13.5-15 per cent, you probably won't answer this question, but how high does the Core Tier 1 have to go before you potentially bring that target down, i.e. how much is built into it?

George Culmer
You are right, I won't answer that!

Fahed Kunwar
Thank you.

Question 8: Ian Gordon, Investec
Hi, it's Ian Gordon from Investec. I have got three pretty dull questions actually. The first one, can you just update me on your expectations and intentions on the residual ECNs? In December when you updated the market you seemed to be only talking about a portion of the residual ECNs, whereas the Daily Mail may disagree with me, I don't understand why you don't get rid of the whole lot or at least convert them?

Secondly, just coming back to conduct, sorry to be boring, but with regard to the £200 million of other, other legacy charges in Q4, can you just provide a bit of colour as to what that is?

And then finally, Irish provisioning, I know you don't give us real quarterly disclosures, but I think in Q4 there was for the first time a release of about £50 or £60 million which probably just reflected where certain disposals fell rather than a proactive write-back. I appreciate there is less granularity of future trends for you because of your residual, £2.6 billion odd Irish provisions, it is mainly corporate and not retail, but you are now starting to look rather more conservative and rather more fully provided than some of your peers. Is that eggs of eggs or is there real conservatism baked in? Thanks.

Answer: George Culmer
On ECNs, our position is clear. I mean we announced that a capital disqualification event had occurred in the non treatment of these as Core Tier 1 capital in the stress test. We made that determination and we have applied to the PRA, we made that application on 18 December and the PRA know they have three months to make their determination. They actually determine not around has the CDE occurred but simply around capital positions etc, but we made that on 18 December and we await that response.

In terms of where we go, as I said we have been very clear in terms of a portion, but those prioritised bonds that have been touched are where we will be exercising the regulatory par call, but that will not be the end of the story in terms of where we go with that overall residual holding. So your point is valid that there is more action that we will take there.

In terms of the other of other, there is a number of items none of which is material unto itself, it relates to things like in terms of incentive schemes, things like bancassurance, there is a portion in for that, a portion in for things like forbearance, we have associated legal costs. So there is a list of things, none of which is material unto themselves that go into that.

Further answer: Juan Colombás
In Ireland, good morning, in Ireland you are right, so we have sold two big portfolios in Q4. We did the first one in 2013, we sold a number of loans of the mortgage book in Ireland. We have done the same in 2014 and then you can see the level of arrears in the mortgage book of Ireland is very low now. And we have sold also a big portfolio of commercial loans in Ireland in Q4. The three transactions have had write-backs and I think you are right that we have a conservative approach to our Irish book. The only thing I would say it is not new, it has been since the beginning.

Question 9: Raul Sinha, JP Morgan
Hi good morning, thanks for taking my question. It is Raul Sinha from JP Morgan Cazenove. Can I have two please. Firstly on capital. I was wondering if you could tell us if you would be disclosing your capital stack going forward? And the reason for asking the question, I wanted to check if you have assumed a buffer within your capital requirements for potential counter cyclical increases? I know it might be a very long way away, but it does give us some clarity about how well capitalised you are even relative to the 12 per cent and how that can move. And obviously the latest consultation allows you to disclose Pillar 2A. So that is the first question.

The second one is on your 2.55 per cent NIM guidance. Pretty straightforward. Have you assumed any interest rate hikes for that or within that? And if you could comment on, if base rates were to go up in the second half of the year how that would impact your margin going forward? Thanks.

Answer: George Culmer
On the capital stack, yeah the around 12 per cent, would allow us to have a small management buffer in there. In terms of disclosures, I may take a pause on that. I mean yes as I said we got the 2A out for the first time along with everybody else, but I don't know about additional disclosures so I may have a pause for thought in terms of where we go. I know what people would like to see, there is an issue of what we are allowed to show and what would be useful to show. So I hear what you say, but it is something that we will ponder.

NIM, the house view is you are the sort of back end of the year, you know if it is going to happen will be our earliest, so our 2.55 per cent is not dependent on a base rate increase. And I think as we have previously said, given the position of structural hedge and the questions of how much you would pass through, but certainly in the early base rate movements, don't expect us to be particularly sensitive in terms of earnings to those base rate changes.

Question 10: Leigh Goodwin, Royal Bank of Canada
A couple of questions please. One, just on the run-off portfolio. That has obviously come down more than was previously guided last year and I wondered whether you could update us on your thinking for the run-off of that portfolio this year and when we might finally see the end of that?

And then secondly just back to Insurance because I always feel this division is a bit of a sleeping giant really and I know you have got some ambitions which you have set out for us today. And I just wondered when we might really expect insurance to start returning to profitability growth? It seems to be going the other way over the last few years, so when might we actually see profits in the Insurance division turn positive again.

Answer: António Horta-Osório
Okay, starting on second one and Juan will give you colour on the first one. Because for the first time we are not targeting run-off decreases because we consider basically then, but Juan will give you some colour on that.

On the Insurance company, like George mentioned, the Insurance company decreased profitability because they had quite an adverse environment last year. On one hand we had the floods which affected our GI business very significantly and there were floods in several moments of the year, much more than the average. And secondly, because the legislative changes that changed the plans we had for annuities and that also impacted the corporate pensions.

So that is why, as George mentioned, there were abnormal circumstances and apart from that the three year plan that we have for insurance is of growth from a stable base. So those are the plans that we have and Insurance is an integral part of our business and I think we have established significant competitive advantages from having Insurance within the bank. On one hand we are able to much better respond to changing customer needs because we have it in-house and the teams can work together before changing customer needs. Like you have for example for upcoming changes in pensions in April that we don't know how the customers are going to react, but we are fully prepared.

Secondly, by the fact that we have the operations centralised, we have lower unit costs and third, we were also able to swap portfolios that were mutually beneficial between the bank and the insurance company in terms of long duration portfolios being bought by the insurance company that has long-dated liabilities and that were no longer appropriate for the bank, given the changing liquidity rules.

So this is just an example of the three major synergies we have created as we have been explaining through the years. So we are absolutely convinced that the plan is upwards and what you mentioned, which is correct, was with a view mostly to very adverse trading conditions last year in several of the products.

Further question
Just to clarify that, leaving weather related events aside, which obviously are unpredictable, should we expect there to be some profit growth within the division this year?

Answer: George Culmer
As I said in my presentation, we are looking for a stable result but what that reflects is management initiative, real initiatives in terms of as I said corporate pensions, bulk annuities, GI etc being offset by quirk of accounting from an accounting perspective. What one does is you discount the free assets basically using Swap rates and when swap rates are moved. So from an accounting perspective of the underlying profit level, I start with that headwind but actually those initiatives will take me back. When swap rates return to more normal levels, you will get the benefit of that coming through. So what matters is from a management action underlying basis, that division is moving forward, accounting is holding it back.

Further answer: Juan Colombás
On the run-off you can see in the appendices where we have more detail, we have £17 billion, it is £6 billion retail international and £11 billion is the commercial bit. The idea is continue with a study of decreasing it. So we have to complete it because run-off has to be run-off. And that is the idea so we will continue with it. But we are not disclosing any targets because we think it is not material anymore

Further answer: António Horta-Osório
I think we will probably emphasise even a bit more value versus volume when we change the volume. So at the end of last year we were able to do the transactions already with pre-capital impact positives. We had capital gains on many transactions as you know, apart from the capital accretion and I think we will give even more focus to the value versus the volumes given that it is basically achieved and there is no significant risk in the portfolio any more.

<u>Question 11: Sandy Chen, Cenkos Securities</u>
Good morning, it's Sandy Chen from Cenkos Securities and actually probably a second question to follow-up on Insurance. Two insurance questions in a decade is probably quite good. Looking at your, I would just like to look more closely at your insurance volatility assumptions underneath it. Because on page 31 just looking at the yields on UK government bonds, it has gone up from assumed yields of 2.6 per cent in 2013 to 3.5 per cent. Corporate bond yields have gone up from 3.2 to 4.1. And I am just trying to tail that with what you were saying about falling swap rates and how what the underlying assumptions are in the insurance business. Because when I look at the expected investment returns versus the actual, I notice that there was a gap of £219 million on the Insurance business. Should we take that out of the underlying Insurance PBT as an actual?

Answer: George Culmer
You will get a very volatile result if you do. Obviously statement over time, my positives and negatives in terms of investment fluctuations around those long term assumptions should sum to zero. But in any short period of time they will not. You know you can look at the total Insurance result at a profit before tax line, but because of the vagaries of the accounting, in terms of define any trend in that, you will struggle. The comment around the swap rates is a look forward comment, so that is particularly in terms of 2015 and it is one particular aspect to it. So it is something that you won't see those assumptions but you will see it in our numbers that come through. So if you look to the probable tax line you will see how that result has been impacted by actual market returns in the period. The reason why the insurance industry has gone that sort of long term assumption way is you are dealing with products with ten years of ten, twenty years. And the vagaries of how they get impacted on a yearly basis by some of those investment returns does not give you the good indication, hence the underlying.

Further question
I guess it leads to a follow-on question in terms of how does this compare to your assumptions on your own pension liabilities?

Answer: George Culmer
I can't give you an answer today in terms of line by line, we can get back to you with a comparison.

António Horta-Osório
No more questions? Okay, thank you very much everyone for coming, we will see you shortly.

End of Presentation and Q&A