LLOYDS BANKING GROUP PLC – Q1 2014 INTERIM MANAGEMENT STATEMENT

THURSDAY 1 May 2014

António Horta-Osório, Group Chief Executive

Good morning everyone, and thank you for joining us for our 2014 first quarter results presentation.

I am joined here today by our Chief Financial Officer, George Culmer, who will shortly present the financial results in detail.

Turning to slide 1, for those of you following the website presentation.

We continue to successfully execute our strategy to deliver a low risk, highly efficient UK retail and commercial bank, focused on our customers' needs, supporting the UK economic recovery and helping Britain prosper.

Underlying profit in the first quarter was £1.8 billion, an increase of 22 per cent compared to the first quarter of 2013, and up 73 per cent excluding the effects of St James's Place. This was driven by progress on income, costs and impairment. We have delivered a statutory profit of £1.4 billion.

Our strategy of putting our customers at the heart of our business has resulted in lending growth in all of our key customer segments.

Similarly, deposits have grown 4 per cent, ahead of market growth of 2 per cent, given our out-performance in commercial deposits, and as we have focused on growing our relationship brands in retail, rather than lower margin tactical brands. I will come back to lending and deposit growth in more detail shortly.

Our UK focused, low risk approach is embodied in our Helping Britain Prosper plan which we launched in the first quarter. This simple, but ambitious plan, sets out our seven long term commitments and aspirations to help Britain prosper. We are the first UK bank to launch a plan like this and it directly supports our business strategy. These commitments will underpin our vision of being the best bank for customers: offering simple, tailored products and great service, helping customers and their communities to prosper.

We are also continuing to deliver benefits for our customers through our Simplification programme, and at the same time, further improve our efficiency. Our cost to income ratio, already the lowest in the sector, reduced further to 50.7 per cent in the first quarter.

And we further reduced risk by strengthening our balance sheet and improving our capital position.

As a result, I am pleased that this improvement in our performance and the progress we have made on our strategy enabled the UK Government, in March of this year to continue the process of returning Lloyds to full private ownership, with its shareholding now reduced to 24.9 per cent.

In summary, the Group has had a strong start to the year. We are supporting, and benefiting from, the UK economic recovery, and are well placed to make further progress in the remainder of 2014.

Turning now to an overview of our financial performance on slide 2:

The increase in underlying profit to £1.8 billion was supported by loan growth in our key customer segments, and by an expansion in net interest margin, which increased by 36 basis points to 2.32 per cent. This was driven by improved deposit margins and by reduced wholesale funding costs, as you will hear from George.

At the same time, costs reduced by 5 per cent year on year as we further simplified the business. Impairments also fell sharply, by 57 per cent, as we continued to de-risk the balance sheet.

The improved profitability, together with a reduction in run-off risk-weighted assets, drove an increase in the Group's return on RWAs to 2.71 per cent, an improvement of 75 basis points.

George will talk you through the detail of the balance sheet shortly, but in summary, we have seen year on year loan growth in all key customer segments and a further reduction of £3.6 billion in the run-off portfolio in Q1 of 2014. Deposits have increased by £5.3 billion at the Group level, and the loan to deposit ratio has further improved to 111 per cent.

Our underlying profitability was the primary driver behind the improvement in our fully loaded capital ratio to 10.7 per cent. We also saw a substantial increase in the Basel III leverage ratio of 0.7 percentage points to 4.5 per cent, mainly as a result of the new AT1 securities issued.

Turning now to slide 3, and looking in more detail at the dynamics of loan growth.

Economic conditions in the UK continue to improve with more people in employment, growing disposable incomes, better business and consumer confidence and an improved housing market. We continue to support this improvement, as evidenced by the growth of our loan book across all of our key customer segments.

Our gross new mortgage lending was £9.8 billion, compared to £6.1 billion in the first quarter of 2013, and we continue to support first time buyers, lending £2.6 billion to over 20,000 customers to help them purchase their first home.

For SMEs, which are a key driver of employment and economic growth, we have supported around 29,000 start ups so far this year, and have continued to grow lending strongly to these customers. SME net lending grew 5 per cent in the last 12 months, compared to a market that has contracted by 3 per cent. This is testimony to our commitment to support this important part of the UK economy.

In Mid-Markets, we continue to gain share and grew 1 per cent year on year in a market that has contracted by around 5 per cent. In Global Corporates, lending fell in the first quarter, mainly as a result of a small number of large repayments, although it is up year on year.

I was pleased to see that growth in our newly formed Consumer Finance business increased strongly, as targeted, with UK assets increasing by 9 per cent year on year, driven by strong growth in Asset Finance. This includes motor financing through our Blackhorse business which has grown by 28 per cent in the last year.

Turning to deposit growth on slide 4.

In our Retail bank, our multi-brand approach has continued to deliver, with deposits increasing in our relationship brands, notably in Lloyds Bank and in Halifax. As we have reshaped the balance sheet, the increased flexibility this has given us has enabled us to de-emphasise the use of some of our tactical brands and our international on-line deposit business, supporting stronger, more sustainable returns given the corresponding reduction in our cost of funds.

We also saw strong growth in the deposits we gather through our Transaction Banking platform. There has been a 12 per cent increase in these high quality deposits resulting from increased investment in technology in this area.

In total, as I mentioned previously, we grew deposits by 4 per cent on the year against a market which grew at 2 per cent, reflecting once again, the strength of our business model and the strength of our multi -brand strategy and relationship brands.

Turning now to our outlook for the remainder of the year on slide 5.

We expect to continue to grow our lending during the year in our key customer segments, ahead of market growth rates, except in mortgages where we will continue to grow in line with the market.

As regards margin, given the benefit of about 7 basis points we expect to see from the ECN exchange offer, and better than expected deposit pricing trends, we now expect the 2014 full year Group net interest margin to be around 2.40 per cent, excluding the effect of the TSB disposal.

While we expect net interest income to increase, other income trends are expected to remain challenging, given the difficult market conditions in Commercial Banking, and ongoing changes in the insurance marketplace.

We will complete our Simplification programme which will further streamline our business for the benefit of customers and help us to maintain our market leading cost position. We remain confident, therefore, of delivering a cost base of £9 billion, excluding TSB, for the full year.

On impairment, given our strong performance in the first quarter, we are improving guidance for our asset quality ratio in 2014 to around 45 basis points.

We reduced the run off portfolio by £3.6 billion in the first quarter, with capital accretion of over £300 million, and continue to expect a reduction to around £23 billion by the end of the year, down from £33 billion at the start of 2014.

And finally, on TSB, we continue to expect to launch the IPO in the summer of this year, subject to market conditions and regulatory approvals, and will provide a further update on pricing and size at that time.

With the bulk of the transformation as set out in June 2011 behind us, we are well positioned to grow and to make further progress in the remainder of 2014, taking advantage of the economic recovery underway in the UK.

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

George Culmer, Chief Financial Officer

Thank you António and good morning everyone.

Beginning with the P&L on slide 6.

As you've heard, we've continued to make substantial progress with our strategy and this is reflected in the Group's financial performance in the first quarter.

Underlying profit increased 22 per cent to £1.8 billion, with the movement in total income more than offset by the 5 per cent reduction in costs and the 57 per cent improvement in impairments.

Excluding St James' Place, which benefited our 2013 numbers, underlying income was up 3 per cent at £4.5 billion, and costs decreased 3 per cent, giving us positive jaws of 6 per cent, while underlying profits were up 73 per cent.

The Group's statutory profit before tax was £1.4 billion, and profit after tax £1.2 billion, with the effective tax rate of 15 per cent reflecting the impact of tax exempt disposals.

Looking now at income on slide 7.

Net interest income was up 10 per cent at £2.8 billion, mostly driven by the improved margin, as well as targeted loan growth, which more than offset the effects of disposals and run-off reductions.

The Q1 margin of 2.32 per cent is slightly ahead of Q4 and 36 basis points up on Q1 2013. As shown on the chart, the year on year improvement comes from better deposit pricing and lower wholesale funding costs, less the expected impacts of asset pricing headwinds and run off reductions.

Other income excluding SJP was down 7 per cent to £1.7 billion. This again reflects the impact of disposals and run-off which totalled £104 million of the £139 million year on year reduction.

Commercial Banking put in a resilient performance given the challenging trading environment for the markets business, which was offset within Commercial by a stronger performance in other lines of income.

In Insurance, we recognised a £100 million charge to reflect the announced cap on corporate pension pricing, which is to be implemented across the industry next year, and we also saw higher claims of £40 million given the damage from recent floods and storms.

These impacts were partly offset by investments in higher yielding assets and other actions which taken together contributed some £90 million of additional insurance other income.

And, while we continue to take action across the Group to strengthen our performance, as you've heard from António we expect the other income environment to remain challenging as we move through 2014.

Looking at costs and impairments on slide 8.

As mentioned, costs improved 5 per cent, to £2.3 billion. Disposals and run-off accounted for £127 million, including £44 million in respect of SJP.

Our Simplification programme delivered year on year incremental savings of £126 million, and we have now achieved annual run-rate savings of £1.6 billion out of our end-2014 target of £2 billion.

As you know, we continue to target full year costs excluding TSB of £9 billion in 2014, which includes the expected FSCS and bank levy charges.

On impairments we've seen further substantial reduction in the P&L charge, with a significantly improved AQR of 35 basis points.

Impairment has reduced in every division, reflecting better credit quality, and the benefits of reductions in the run-off portfolio.

And as you've just heard, as a result of this strong performance, we have improved our AQR guidance for full year to 45 basis points.

In terms of impaired loans and coverage, the quality of the Group's loan portfolio continues to improve. Impaired loans now stand at 5.7 per cent of total advances, compared with 6.3 per cent in December and 8.0 per cent a year ago, while the coverage ratio has increased to 51.1 per cent, up from 50.1 per cent at the year end.

On slide 9, we've set out the usual reconciliation from underlying to statutory profit.

Starting with asset sales, gains on disposals totalled £126 million, which included £105 million from the sale of SWIP. As you may recall, the Q1 2013 total of £823 million included £776 million of gains on the sale of government bonds. There were no such sales in Q1 2014.

The volatile items charge of just £6 million includes a £204 million gain from changes in the value of the ECN embedded derivative, which was broadly offset by fair value unwind of £140 million and an Insurance volatility charge of £64 million. This compares with an insurance volatility gain of £462 million in 2013, which was the primary driver of last year's volatile items total of £250 million.

On Simplification, we expensed £294 million in the first quarter. This brings total programme costs to date to £2.0 billion, out of an estimated total cost of approximately £2.4 billion to be expensed through the income statement.

And on TSB, we are making good progress towards an IPO this Summer, subject to regulatory approval and market conditions. Spend in the first quarter was £172 million, bringing the total costs to date to just over £1.6 billion.

Finally, the first quarter tax charge was £207 million. As mentioned, this represents an effective tax rate of 15 percent, due primarily to the tax exempt gains on disposals, predominantly SWIP.

Turning now to PPI on slide 10.

On PPI, there has been no increase in the provision. In the quarter, we have seen reactive complaints running marginally ahead of expectations and Q4, while uphold rates and average redress costs are marginally below forecasts. In quarter costs of £0.5 billion were also slightly better than our projections.

On proactive mailings, we remain on track and expect these to be substantially complete by the end of the first half of 2014.

Looking now at the balance sheet.

As slide 11 shows, the shape and strength of the balance sheet continued to improve. Over the first quarter, we have generated some £14 billion of funds, led by a £4 billion reduction in the run-off portfolio and deposit growth of £5 billion, which have driven a further reduction in the Group's loan to deposit ratio to 111 per cent.

RWAs are down by 2 per cent to £267 billion, led by the reduction in run-off assets, while underlying profits were the main driver in the 4 per cent improvement in shareholder equity and in TNAV which increased 2.2 pence to 50.7 pence.

GC Slide 12: Further strengthening the balance sheet – CET1 and leverage positions further strengthened

Underlying profits were also a key component in our growth in regulatory capital. On slide 12, we show the movement in our pro forma common equity tier 1 position which has increased from 10.3 percent at year end to 10.7 percent.

We have also benefited from the announced changes to our pension scheme, and a further £400 million dividend from Insurance, all of which offset the impact on capital of the ECN exchange.

We have also significantly increased our pro forma leverage ratio to 4.5 percent on a Basel III basis, with a 50 basis point benefit from our Additional Tier 1 issuance.

GC Slide 13: Further strengthening the balance sheet – Strong total capital position with medium term AT1 requirement met

Slide 13 sets out our total capital position following the recent ECN and AT1 exchange.

Our pro forma capital ratio now stands at 19.5 percent, and we are the first bank in Europe to meet its full AT1 requirement.

As we have said before, this is a strongly capital generative business and our lower risk business model means that we are well positioned to meet future regulatory requirements.

And as we go forward, we will continue to review our capital position to ensure we meet these regulatory requirements and optimise costs.

And the confidence we have in our prospects means that we continue to expect to apply to the PRA in the second half of this year to restart dividend payments.

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

António Horta-Osório, Group Chief Executive

Thank you George.

In summary, you have seen that we have continued to execute our strategy successfully in the first quarter, delivering clear benefits for customers and shareholders.

As economic conditions in the UK have continued to improve, GDP has strengthened, and confidence and employment have grown. This plays to Lloyds' strategy and strengths. Lloyds is therefore well positioned to further play its part in helping Britain prosper and to grow as a consequence.

In the first quarter, we have delivered improved underlying profitability and a substantial statutory profit. We have further strengthened and de-risked the balance sheet, and improved our capital and leverage positions. And, as a result, we have improved our guidance for margin and impairments.

Therefore, we have great confidence in the future. Risks remain, and we are not, and will not be complacent, but the Group is far better placed to respond to these risks should they occur.

Also, we will continue to relentlessly build our key competitive advantages as we drive our cost to income and cost of equity down for the benefit of our customers and our shareholders.

In summary, we have created a low risk, highly efficient, UK retail and commercial bank focused on our customers' needs. We are well placed to further support, and benefit from, the continued economic recovery, and to deliver strong financial returns to our shareholders.

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

Question and Answer Session

Question 1: Chris Manners, Morgan Stanley

Morning Antonio, morning George. So just a couple of questions if I may. The first one was just to ask you a little bit about your view on the outlook for mortgage asset margins and how competitive the market is and where you see that asset margin trending?

The second one just on the balance sheet trends. I think that average interest earning assets maybe missed a little bit versus what some people were going for. Just on whether you would expect the core loan growth to pick up a little bit more?

And thirdly on the end state capital ratio. I know you have been guiding 11 per cent was where you were happiest at still for fully loaded Basel III Core Tier 1 ratio, the sort of level that you are targeting? Thanks.

Answer: António Horta-Osório

Okay Chris, thank you. I will take questions 1 and 2 and George will take question 3. On the first question, what is happening, as has been happening over the last few quarters and we have discussed at our IMS calls, mortgage margins are coming slightly down, which is in line with the level in my opinion of the interest rates for the economy in the UK following the FLS. The same is happening with deposits as you know. And, as all of you know, we do not target asset margins per say, we target the difference between assets and deposit margins, that is the way we manage it. We manage it combined. We manage it on a weekly basis which we think is exactly the right way to handle the retail market in the UK. And my expectation for the following quarters is that mortgage markets will continue to trend down in line with the past quarters as the same will happen with deposit margins. We have been managing the difference of the two margins slightly better than we thought and that is why we are upgrading our guidance for the NIM for the year.

On your second question, balance sheet trends, and I do understand Chris that looking at the numbers without colour, may look that loan growth, has disappointed a little bit, but I strongly believe it is not the case and I will explain to you why. First we have grown in all of our key loan segments year-on-year. And as you know, all of the corporate segments are going down still in the UK. But when you look at what happens combining the quarter and the year-on-year, the quarter has some seasonality effects. Therefore I will give you my take and colour on each of the segments going forward, taking into consideration both the quarter and the year.

On mortgages, as we have discussed before, last year stock growth has been around 0.7 per cent according to the numbers we have so far from the Bank of England. I continue to expect the stock to increase by around 2 per cent this year in net terms. Why is that? Because we have, number one, much more activity on the growth of gross mortgages. So as I told you we went from £6.1 billion of total mortgages in Q1 2013 to £9.8 billion of gross mortgages in Quarter 1 2014, which is a 61 per cent increase. So activity is absolutely picking up, which in my opinion is very good, not only in terms of activity on itself, but because it is reflecting the growing confidence of the UK economy. It is mainly driven by first time buyers which in its own right, they are stimulating the construction sector which as I said before, is one of the main drivers of employment in the country. At the same time, people are repaying their debts ahead of plan and that is also in my opinion healthy because private sector debt as a percentage of GDP and should continue to go down. And that is why you have a net impact in the market of 2 per cent. As we have said now for six or seven quarters, we will continue to grow mortgages in line with the market. We want to grow exactly with the markets and we don’t want, given we have a 24 per cent share of stock and we will continue to do so. Therefore I expect our mortgage net lending to increase by around 2 per cent on the year.

In relation to this segment, you have to take account Chris, into your models, that we have a closed book of specialist mortgages which came from non core into the core for the reasons we have explained. It is our customers, they have our credit cards, current accounts and it is a very healthy book at the moment now given it has already seasoned. But that is the closed book and you have to include in your model, the impact of the seasoning of that book. But in terms of our core mortgages, we will grow with the market, I expect the market to grow by 2 per cent as I have said before.

In terms of SMEs, we continue to grow substantially above the market, 5 per cent year-on-year versus a market which is contracting 3 per cent. And we are 21 per cent of that market. That is like a [8] percentage point difference to the market. When you look at the quarter, our SME growth is around 1.5 per cent. So I continue to expect that we will continue to grow at around 5-6 per cent net in the year as the first quarter and the year-on-year both indicate. I expect the markets which is -3 per cent to gradually turn positive by the end of the year as the economic recovery takes place because credit is normally as you know, a large indicator.

On mid-markets, where we have grown 1 per cent year-on-year, this may look a little bit less than what we have said before, but I reiterate my guidance that I expect us to grow by 3-4 per cent by year end. This will be more in the second half than in the first half. And the reason is because of the repayments which have been abnormally high in the first quarter. And I can tell you, I am not sure it is in the IMS, but I can tell you that in terms of mid-markets growth lending, we have increased year-on-year by 12 per cent. We have increased in a very healthy way. And the only reason why the year-on-year net growth is 1 per cent is because there were abnormally high repayments in the first quarter. So I continue as I have said at year end, absolutely convinced that we will accelerate our 2 per cent net growth of 2013 into the 3-4 per cent level by year end.

In terms of the market which is now contracting by 5 per cent, I expect it in line with the SME markets for it to become gradually less negative as the year advances and exactly for the same reasons.

In terms of Global Corporates, as we have said before we do not target loan growth on Global Corporates. It depends on their activity and capital markets activities. Our gross lending was very much in line with what we did in the first quarter of last year. We also have unusually high repayments in the first quarter, but that for us is not a target for the reasons I told you. What we target is share of wallet of those customers which is going well.

And on the Consumer Finance division, which I have guided you to become significantly positive in the year, I think the division is behaving ahead of target. It is growing 9 per cent year-on-year and 4 per cent when you consider Quarter 1 alone. This is due, as I said on my speech, by an exceptionally good performance of the car financing activities, especially through Black Horse. And I expect this net lending growth to accelerate as the year progresses. It is decomposed into credit cards being in line with the level they had a year ago and slightly down on the quarter for seasonal reasons, because of Christmas, and a very significant uplift in car financing. And the combination as I told you of the 4 per cent in the quarter and 9 per cent year-on-year should accelerate throughout the year and performance is exceeding our expectations. So in the whole, we continue very positive on the economy, we will continue to support the economy and benefiting from it as I told you.

And in terms of the model, just to be precise in terms of this, I think you also have to take into account the specialist mortgage portfolio decrease which obviously is a closed book. But we are quite positive and if anything I would upgrade my expectations for the Consumer Finance unit during the year.

Answer: George Culmer
You also Chris you also asked about capital a while back and you want to know about in terms of what we said about the ratios. At the full year I said that I expected on a steady state basis to be targeting a capital ratio of around about 11 per cent. That remains the position just to confirm that. In terms of what I mean by that, the steady state, if I look at the capital requirements, what we have to do as a business, there are a number of things in terms of completing our derisking so for example things like pension scheme etc, which obviously come through things like ICG. We have done a number of things to derisk that in terms of hedging out inflation risk, hedging out interest rate risk, rearranging the asset base, moving away from equities etc. So we have got to complete that activity. It is also, steady state means for example getting through, which we will do, things like the PPI etc which we will work our way through. So when you get to that steady state, yes around 11 per cent is the right number. Obviously it is a big year ahead of us in terms of stress tests etc, but we will work through that. But that is what we said at the full year and there is nothing that has happened that has caused me to change that view.

Chris Manners
Fantastic, well thanks guys for your comprehensive answers, that is really helpful.

Question 2: Jonathan Pierce, Exane BNP Paribas
Morning. I have got three quick questions and they are all relating to capital. Firstly on Slide 12, you have shown the 40 basis point hit in the quarter for DTA expected loss and AFS movements. I was just wondering where that is coming from because I would not have expected the DTA and AFS to have had a particular impact. So is there a big increase in expected loss there?

Answer: George Culmer
Hi Jon, it's George here. No the large part relates to the other statutory items; when you are referring to the 40 basis points. To be honest the main element of that comes from the first point which is the simplification costs below the line and things like that.

Further Question
So it is exceptionals, okay. And no particular movements in those other "funnies"?

Answer: George Culmer
No, things like DTA, we are actually, on the move to profitability, so for example the DTA asset has gone from about 5.1 to 4.9 so we are into the utilisation mode now.

Further question
That's useful thanks. Secondly, in terms of your capital build guidance for 2014/15, I mean you have done 40 basis points in the first quarter and that encompasses quite a big hit on the ECN which I guess was part of your thinking when you gave us the guidance back in February. Are you willing to move that capital guidance up a little bit, having seen how things have progressed in the three months?

Answer: George Culmer
The short answer is no, but let me explain, as you said, when we gave the guidance it was cognisant that we were likely to do an ECN but hadn't taken a decision at that point. And it was also cognisant that it was likely to be an offset with regards the pension action we have announced as well. You are right, underlying profit continues to drive through and I would expect that to continue. So that is one of the certainties if you like in terms of the scenario as it pans out. I still think the guidance is appropriate. We will still be capital generative, so those are the big two positives to stress. What uncertainties are out there? Things like pension risks still move around, there will still be things like impacts on things like cashflow hedging etc. We have also got one of the main items out there will be the uncertainties around things like the TSB IPO which as I said we intend to do ahead of June. If I ignore expectations of price and all those sort of things, what we will have is when we actually do that IPO we will recognise some of the costs up front relating to the long-term service agreements and we will also recognise some of the costs that relate to basically a commitment that we have given to enable them to basically move away from that contract. So we will have to recognise both of those at points of sale and that will run into several hundreds of millions at that point in time. So that is another sort of one-off if you like.

So as I look forward, I wouldn't change the guidance, there are certainties. The underlying profits will come through, the strong profit generation will come through. Still some vagaries around pension funds etc, cashflow hedging. There will be a hit as regards, as recognition of losses at TSB but that is nothing to do with what it IPOs at, that is just accounting, in terms of recognising. And also we will not touch PPI this quarter, but conduct does remain an uncertainty as well as I look out.

Further question
Okay, that is useful, I will ask a quick question on the ECN. What is your thinking post the latest ECN swap on the residual £4 billion or so of ECN that is out there?

Answer: George Culmer
You are right, yes we have three and a bit or something like that in terms of the residual that is out there. Obviously we are going through the announcement that the PRA got out yesterday in terms of the ongoing qualification and we are still analysing that. If we come to the conclusion that there has been a disqualification event then we will obviously let the market know. We haven't come to that conclusion yet. We are still studying what is said. But I think we made some statements at the time in terms of should the regulatory par call become enacted, how we would prioritise those outstanding loans which is basically, we would look to those that we would touch first in terms of utilising that. So at the moment we are just going through what the PRA said, well, it is quite clear, I think, what the EBA has said with regards applicability, but it is less [clear] what the PRA said. But I think what is evident is what we said at the time, that it is likely that going forward these won't count and remains very much the case.

Further question
And on that residual, is your view still that you will be fair to bond holders, or is there any chance you will invoke a regulatory power call?

Answer: George Culmer
Look I am not going to say how we will act. I think though how we actually conducted the ECN AT1 exchange shows how much we value those long-term relationships, and strike the balance between the good of the company and being fair to people who have stood by the company

Jonathan Pierce
Sure, thanks very much.

Question 3: Andrew Coombs, Citi

Good morning, I have one follow-up question and then two new questions please. The first one is a follow-up. Just going back to the point on average interest earning assets, down 2 per cent Q on Q. So despite the NIM improvement NII still down. Just going through some of the points that you raised Antonio. You have got a further £7 billion reduction in the run-off portfolio that you are guiding to by year end. But offsetting that you have talked about 2 per cent in mortgages so give or take that is £7 billion of growth, plus Consumer Finance, plus the SME growth. So is it fair to suggest we have potentially reached a turning point on the average interest earning assets? Should it be flat or even slightly up from here? So that would be the first question.

The other two questions. On PPI you have seen a Q on Q increase in claims, that is the first time since Q2 2012, I am sure there is some seasonality there, but is it also a function of proactive mailing? Perhaps you could comment on that increase?

And then the final question, just on loan losses. 35 basis points in the first quarter, and yet you are only willing to reduce the full year guidance to 45 basis points. So perhaps I could just ask why the caution there in your forward guidance? Thank you.

Answer: António Horta-Osório

Look, in terms of the guidance for impairments. We are a prudent management team as you know. Quarter 1 came out better than we thought, economic recovery continues to play out strongly. And that is why we are putting the guidance down to 45 basis points. We think as George said in his speech, it is the appropriate guidance to keep at this point in time. It is a fact that all the underlying trends on NPLs continue to go down and that economic recovery continues to go up strongly.

On the first follow-up question on the average interest earning assets, I think I gave you quite detailed colour on these several core segments and also on the runoff book, but I think George will be able to help you with more detail on the average interest earning assets.

Answer: George Culmer

Hi Andrew. Firstly on the NII stuff, I think Q4 to Q1, you are talking of the reduction that is sort of seasonality driven. So I think it is down about £100 million or so of which about £70 million of that is just down to days and then there is about £30 million that comes from things like disposals, runoff, Australia etc. And certainly, as I move through the period, I would not expect to see that trend continue in terms of quarterly NII trends. So I see that as a specific to Q4 to Q1.

In terms of PPI, yes you are dead right. And in terms of it, it has ticked up. And you are right, there is part seasonality in terms of Q4, you always sort of benefit a bit from the holiday season and you can see that, as you went through last year, you can see we were down sort of just going from the slide itself, you can see we were down roundabout 10 per cent per quarter and then it dropped to 24 per cent in Q4 so there is a sort of seasonality fact coming through. The past book review, it doesn't per say have an impact in the sense of reactive claims, but what it does do is sort of generate noise and activity. And I think awareness and activity does generate claims. And you are seeing not just from ourselves, but other banks, people are sort of the past book activity, past book reviews is going on with a vengeance. We expect to be complete as I said basically by the half year so you will get an awful lot of activity and around the year end you had quite a lot of awareness due to provisioning etc, when you track some of that stuff, it is interesting to see the responses between things like Lloyds branded complaints and Halifax branded complaints. So a lot of awareness, a lot of activity. As we said, it is slightly up, we were sort of projecting a slight fall in that so it is slightly above where we expected to be. Have been some offsets and we still have some £2.3 billion of the provision outstanding, so we are still in a relatively good position. And as I say it will be a key milestone when we complete that past book activity in the middle of this year just in terms of unto itself, but taking noise out of the system. So that is a key milestone. So a bit of seasonality, a bit of associated with past book reviews, but it was slightly ahead.

Andrew Coombs

Thank you. Just coming back to the first point on provisions, if we look at the first quarter, was there any large reversals or any one-off items in that or was it a relatively clean number?

Answer: George Culmer

Hi it is George here again. There were some asset sales, some small books in Consumer Finance, in the Retail division that assisted that. There were a number of write-backs particularly actually in the run-off book benefited from some write-backs going through. So there were some. But we had also seen some of that in Q4 as well. There is always a bit of seasonality Q1 to Q4 particularly in the commercial books in terms of having done a lot of the clean-up in Q4. So I think as Antonio has said, we still think as we stand, 45 is appropriate, but we still think that is a pretty prudent view of how the year is going to pan out.

Andrew Coombs

Perfect, thank you both.

Question 4: Manus Costello, Autonomous

Good morning everybody. I have a couple of questions please. I wanted to ask about your volume plans in the spreads in consumer segment. You talked about accelerating growth through this year. If I look at Bank of England data on pricing in that segment, it looks like it is coming in and it looks like spreads are compressing. So I wondered if you could talk a bit about the volume versus margin trade-off you are prepared to look at within that consumer segment as you grow it?

My second question was just on a point of detail. I noted you saw quite a sharp pick-up in your liquid assets this quarter. I wondered if that is strategic or just a result of some asset sales or what is going on now and what is the potential impact it might have on NIM and NII if that is managed down? Thank you.

Answer: António Horta-Osório

Good morning Manus, it is Antonio. On the second question, you are absolutely right, it was just if you want a seasonal thing because we have a bit better deposits at the end of the quarter than we thought. So you should continue to expect our strategic positioning as we were at the end of the year and the quarter was especially good at the end of the quarter in terms of deposits and that is why liquid assets increased. So nothing there.

In terms of the first point, you are absolutely right. Spreads in Consumer Finance and in the different sub-segments are continuing to come down as I have described for the other asset spreads in the economy. And what we have been watching is that the trade-off between the volumes and the spreads is clearly positive. In terms of sub-segment, if you want I continue to expect credit cards as I had said at the year end to be more difficult because of the competition in credit cards and the behaviour of the leader is very much getting prices down and we want to do things in a way which is economically interesting. So I expect credit cards to be positive for the year as I had said at year end, but mildly positive because of this trade-off with spreads which we want to work out in a positive way.

In terms of personal loans, I expect them to turn positive and the trade-off is clearly positive in terms of margin versus volume. And the car financing activities which are booming as I told you. The spreads are coming down a bit more because the market is really increasing very much. But even that the volumes are increasing very significantly that result is clearly positive on car financing as well.

Further question

Okay, and as a quick follow-up on the mortgage points, I wonder if you could give us an update on what level of the mortgage book is currently on SVR and whether or not you are seeing with the mortgage market improving in the way you discuss, any increase in instance of SVR switching?

Answer: António Horta-Osório

George can you tell which per cents we have?

Answer: George Culmer

Yes there is round about, well SVR there is about £175 billion and in terms of churn, in the quarter you saw a net number of about £4 billion which wasn't so materially up on the quarter before. So some seasonality in that actually, so a slight pick-up, but it is about £4 billion a quarter is what we are seeing.

Answer: António Horta-Osório

I continue to expect Manus that attrition on the SVR book to be mild. We think it is accelerating slightly over time. I don't expect a change in behaviour, not only because of the pricing that we lever that the market has in the help-to-buy scheme, but also on our specific case because our SVR is 3.99 per cent, is in the middle of the market and therefore we are not specially affected like banks that have higher SVRs. So I would expect a continuation of slightly higher accretion, but nothing different except for seasonality as George mentioned to you. Nothing different to what we have discussed a quarter or two ago.

Manus Costello

Understood, thank you.

Question 5: Claire Kane, Royal Bank of Canada

Hi there, two questions please. The first is on your TSB cost guidance. Ignoring the several hundred million you mention in upfront servicing costs, is the previous guidance which I think was for around £200 million of other costs to come this year. Does that still stand?

And then my second question is on the stress tests. I know it is early days, but I wondered whether you could give us your initial thoughts and also talk us through how you would look at the negative equity that will come through on your mortgage book and typically what that does to your collective provisioning? Thank you.

Answer: George Culmer
Hi Claire, it is George here. Yes the TSB can get a bit confusing. There are two separate things. In terms of build cost and double running costs, there is still a couple of hundred million to come. So that will obviously be guided to and that will still come through and you will see that in Q2. Quite separate from that the point of IPO, that is just an accounting thing. I have to look at the contracts and I have to look at some of the commitments that we are giving with regards TSB being able to exit those contracts for an appropriate period of time. And I have to reflect the cost to Lloyds, the present value of that at that moment in time. So that is quite separate from and what I am sort of flagging is that there is a point of IPO again, ignoring what price it goes at, from an accounting perspective I would just have to make that charge. And that is the charge that I say will run, it will be several hundred millions. But there are two discrete things, so £200 million in Q2 and then there is that separate accounting charge with regard at point of IPO.

On stress tests, obviously we logged the details a couple of days ago, which we are obviously working through. A few things I suppose to say. What we have been asked to do is not dissimilar from stresses that we have run internally last year or so for ourselves. We have been asked to, when you look at requirements, some are a bit better, some are a bit worse etc. So HPI drop is a bit worse, interest rate is a bit lower etc. So there are some ons and offs when I look at them and compare them with previous stresses that the PRA have asked us to look at. What I do think is hugely important is that we go into them in this substantially strengthened position. That is both from a de-risk perspective but also from a capital base. And when I look at the requirements of the 4.5 per cent etc under stress, you know I look at my Core Tier 1 that I am now going in with that 10 per cent, I look at the AT1 transaction I have just done etc which I can call upon. So we go into it hugely better position. And on the mortgage book again in terms of things like the LTV, what has happened in the market has put us in a much better position. So when I look at the north of 100 per cent LTVs, the mortgage book is now down to just over 4 per cent and that was 5 per cent/ 5.5 per cent at the full year and that was back into double digit territory 12 months ago. So what I have seen in house price inflation has again put me in a much better position in terms of the position of that book which is down to just 4 per cent.

Claire Kane
Great, thank you.

<u>Question 6: Chintan Joshi, Nomura</u>
Just before I ask the two questions that I have, I just wanted to quickly follow-up on Manus' question. You mention the SVR book is £175 billion, how much of that is the C&G book that is capped at 2.5 per cent?

Answer: George Culmer
The C&G book, let's come back to you. I can give you a number, but I may be wrong.

Further question
No problem. The question I have, first on rates. If I have a unique window into the UK household, market is expecting the first rate hike in April, May next year. I am just wondering how you see trends and what your expectations are in terms of when we can see a rate hike in the UK?

Answer: António Horta-Osório
Right, it is Antonio here. I mean in terms of rates, what I could tell you is that as I think we have discussed at the year end call as well, is that we are very much in line with what the Bank of England has been saying. So we think that rates will rise later than people think and we think they will stay low for longer. So my opinion is that the long-term rates in the UK will not go again to the 4/5 per cent level, they will stay at the level lower than that. So we are very much in line with the guidance and signals that the Bank of England has been transmitting to the market.

Further question
Thank you. And the second question I had was on capital. If I look at mortgage risk weights, how some of the geographies in Europe like Sweden and Norway have acted, they have put in a floor on mortgages grades to both trap capital in the system as well as to dampen the housing market. How do you see that debate in the UK? And is it even relevant given the kind of stress test scenario the PRA is testing, sounds like implicitly they are already going for a fairly hawkish scenario? Thank you.

Answer: George Culmer

It is not a discussion we are having with the regulator. And in terms of across the book in position of front book, back book of new risk weighted, it is not the approach that we are taking and discussions we have had and these have been a while back actually. The discussions we have had are focused actually around differentiating between front and back book and if they were to act just in terms of taking some of the heat out of the system it is more about looking at what they might do on the front book, but certainly there have been no discussions about them imposing blanket type, as they have in Sweden or Scandinavia, floors on mortgage books.

Answer: António Horta-Osório

I think if you read the FPC last report, it is exactly on this direction as we have also discussed previously in previous calls. I think the Bank of England FPC are also quite positive and reassured by the mortgage market review which is increasing the underwriting standards in the UK in my opinion appropriately so. This will give even tougher underwriting criteria in terms of knowing your customers and in terms of knowing and stressing the customers for their disposable income after expenses, which will have positive impact in terms of asset quality. And therefore, as George is saying, all of the interactions we hear as we read on that FPC report in terms of actions, in terms of new business, in terms of flow and as you know the situation of UK housing market in terms of prices and loan growth versus what it was in 2007 is very different. And versus what is happening in Scandinavia is very different as well.

Question 7: Chirantan Barua, Bernstein

Morning. Antonio I have one question for you on the branch network. Around about one and a half years back when we asked you, some of your peers were running down branches in the UK and you said you want to hold onto your network. Now I just want to know your latest thinking around that?

And secondly, on the insurance business, we have got a suite of news coming out. You said that other income would be suppressed. So if you could quantify some of that and give more detail, that would be helpful. Thank you.

Answer: António Horta-Osório

Okay, good morning. I will take your first question on the branches and George will answer you on the insurance part. Yes I said exactly as you said that we would keep our branch network. We have kept it, we are committed to keeping it in those terms until the end of the year which we will. We have opened a few branches of Halifax in Scotland which is also interesting because Halifax is a challenger brand with lots of clients in Scotland, but only a digital presence, not a branch presence. And going forward, what do I think? I think as you know that competitors have been going down in terms of their branch network and will continue to do so. We are reviewing now our strategy update because we are coming to the end of the first three year period and we will have a new three year period very much BAU given the success of the strategy. And we will re-address the question of the branch network also at the life of the IPO, of the TSB bank which are 630 branches which we are selling as you know. And my expectation although we will only have final positions for the end of the year, is that you should not expect anything spectacular on our side in terms of branch network. We are a retail and commercial bank, very much focused on the multichannel and multibrand approach to our customers. And to have a strong presence in the communities and therefore supporting our Retail Business Banking and SME customers and will continue to do so. And therefore if competitors continue to shrink their branch networks aggressively which I think could be the case, we will review ours. But you should not expect at all our market share of branches to decrease.

Further question

Just before we get on, a follow-up question to Antonio around that. So are you looking at revising your strategy? Are we expecting something by the end of the year or early next year, just on a broad refresh of your strategy?

Answer: António Horta-Osório

We do three year plans. So we presented a plan in 2011 which goes to the end of 2014, we will now do a new three year plan and by the end of the year we will give you some update on that. As I told you it is mostly BAU, it is mostly a new 3 year plan because I believe that for you to have a high performance organisation, you should have ambitious target. You should make them public and that is what we have been doing all the time, referring back to the June 2011 targets. And we will continue to do so because I strongly believe that this is the way to improve performance and to have at all levels of the organisation, strong commitment and public target in my opinion is the best way to drive performance.

Further Question

Thank you. Sorry George.

Answer: George Culmer

It has been a tough first quarter for Insurance. A combination of announcements, weather etc, all the things you know about. I mean you know we don't break down or give divisional performances at Q1 and Q3, but at Q1 just so that you know, the insurance is down Q1 2014 versus Q1 2013 is down just a bit over 20 per cent and when you look at what is driving that. Part of that is you have an extra £40 million from the storms, the floods etc, which we saw obviously in the early part of this year. You have got the £100 million for the changes that were announced a few weeks back in terms of the 75 basis point cap to pensions. And we have basically reflected the cost of that come through. We have also within the Group, done a slight change in terms and conditions in terms, we did this last year, talked about this last year in terms of just moving income out of insurance into the retail business. We have also got ongoing run-off things like off the legacy books and the aggregates of those two have probably taken about £30 million off of income. Those have been offset by one of the things we were able to do in terms of the advantages of having the insurance business within the Group, is in terms of move assets around so assets originated in the commercial business into things like the infrastructure, social housing etc., moved them into the insurance business to back some of our shareholder businesses like the annuities business. So it has been pretty tough, a combination of weather one-offs and announcement one-offs lost a bit of income from the changes on annuities. But as you heard, we are not a massive player in that particular market. So it is not a huge number. The main year-on-year drivers of that sort of 20 per cent reduction are weather and that change in the corporate pensions announcement that I talked about.

Further question

Just a quick follow-on, given the dividend was around £400 million if I read that right, so are you expecting, what should we think about going forward in terms of the dividend coming from that Group?

Answer: George Culmer

The insurance business make each year, talk round numbers here, you know give or take about a billion something like that. So after tax you have got £700-800 million, give a bit for growth. There is a bit, you can work out what the sort of ongoing dividend distributions are likely to be. We were able to take out last year an exceptional amount, given the prudent way the business has been managed. But that sort of profile, I don't see any material shift in that profile.

Chirantan Barua

Perfect, thank you.

<u>Question 8: Fahed Kunwar, Redburn</u>

Hi, morning. I just have a couple of follow-ups on the impairment line actually. You mentioned write-backs earlier. I just want to get an idea and further clarity on that. So the write-backs, what actual businesses were they in and how much was in run-off and was there any in the kind of non run-off business as well?

And just thinking about the 35 basis points for this quarter, how much of that was lowered because of those write-backs and have you factored in write-backs into the 45bp guidance as well? Thanks.

Answer: George Culmer

Hi Fahed, sorry I am going to frustrate you a bit, I am not going to give you precise numbers. But we do factor a certain level of write-backs within the number. We have seen, I think I have said in answer to an earlier question, there was quite a bit in the run-off book. There was some left material in terms of the core business as you would probably expect. So we have benefited particularly in the core business. But given where we impair and the prudent approach we take, I would expect a degree of, but I am going to frustrate you in terms of certain numbers, because all I will do is I might just get you chasing wrong trends and stuff. It is more important to hear what we say about where we are going, but also we continue to say, it is right to take a prudent view.

Further question

Fair point. And one quick follow-up. The thing with the flow of new NPLs, did you see a reduction in those or have those remained pretty steady?

Answer: George Culmer

Yeah we are seeing those coming down. We are seeing a reduction in that, NPLs and you would have as a proportion of the impaired loans and how that has been dropping. So across the book we are seeing positive trends.

Answer: António Horta-Osório
All segments as I have said before. All segments are going down in terms of new NPLs. And if you look at our impaired book as a percentage of assets, you will see a very material decrease from 6.3 per cent of the assets to 5.7 per cent in a single quarter.

Fahed Kunwar
Perfect, thank you.

<u>Question 9: Arturo de Freias, Santander</u>
Morning. I have three very quick ones if I may. The first one is margin guidance versus Consumer Finance growth, you mentioned you are increasing your NIM guidance because of the ECN impact and because of better trends in deposits. But given also that Consumer Finance is growing much more strongly than expected, this should also at some point have a positive impact on NIM? I note your comments about margin pressure and Consumer Finance, but still in absolute terms, margins will be much better than your other books. So if you continue to grow this strongly in Consumer Finance, should we expect an additional improvement in your NIM guidance before year end? That is one.

The second one is you might not be able to comment on this, is related to the TSB IPO. Because I am not sure what is going to be the way you are going to consolidate TSB after the IPO. And of course that relates to the size of the stake that you are going to sell. Do you think it is going to be proportionally consolidated or globally consolidated with minorities etc? So that would be the second one.

And the third one, just to clarify. You mentioned that you are growing now in SMEs 8 points ahead of the market, do you expect the market to gradually improve as the year goes by as you said, credit is a lagging indicator. So do you expect the market not to fall 3 per cent but probably be a stable? But you also said I think that you expected SME growth to be around 5 per cent by the end of the year. So which seems to imply that your advantage in terms of growth was the market will narrow from the 8 points now to only a couple of points by the end of the year. I just wanted to make sure I have got this right or not or you still expect to grow well ahead of the industry by the end of the year? Thank you.

Answer: António Horta-Osório
Okay Arturo, I will take your question on SMEs and George will give you some clarification on the other two. On SMEs, this is a good question actually. I think you should expect us to, given that we are a low risk, prudent financial focus on retail and commercial, you should expect us to be prudent as economic recovery takes hold. And on the other hand, we have been growing SMEs on net terms for more than three years now and our difference to the market of 8 percentage points as you mentioned, which is actually 10, because we are 21 per cent of that market, is a huge difference. So my expectation is that the market will recover gradually as you have just said, but I don't expect it to be very positive, so if I have to guess a number, I would think that the market would go from -3 as of now to probably around +1 by year end. And I think we will be on the 5-6 per cent net lending growth range. This is a bit brave giving such clear predictions, but that is what I think. I think you should see that in light of what I told you which is the economy is recovering and people are being less risk averse. We have a huge difference to the market now for three and a half years. And therefore if we grow by year end 5-6 per cent and the market is around +1, we will still have a material difference to the market. And again we are 21 per cent of that market at the moment.

Answer: George Culmer
And on the first two questions. On the margin guidance, yes you are right in terms of Consumer Finance margin, but in reality, in terms of proportionality and in terms of flow, it is you know, yes we are growing fast in that area, but it will take a while for it to be able to move with the overall dial and the change to guidance we have given which is part ECN but part what is happening on the retail, deposit and mortgage book. And they will continue to be the main drivers. So I will not be standing up this year to revise guidance due to Consumer Finance. It is just proportionality, it is just how that flows through. So over the longer-term yes, but not in the horizons you spell out.

And then TSB, basically, we will as you say, looking to launch the IPO ahead of the end of June, that is a minimum size out of 25 per cent. We will fully consolidate that business until we drop below you know 51 per cent control of that business. And we will continue to fully consolidate. Then when we get just below, just basic accounting, when we go to below 20. But we will fully consolidate whilst we own more than 50 per cent of it. Our requirement is, we have to be out by the end of December 2015 but there is no time line in terms of how you actually move to that position, but as we say, we will fully consolidate whilst we own more than 50 per cent of that business.

Further question
So a quick follow-up. We are not going to see any impact on your revenue and cost dynamics because of the TSB deal. If you continue to consolidate globally, the costs and revenues will still be there?

Answer: George Culmer
That is correct. When we guide to this year for example, we assume that we sell £9 billion, exclude anything to do with TSB, you are right. If I come to the end of this year, this is all hypothetical, and I still own 70 per cent of TSB or whatever the number is, I would still be fully consolidated and you will still see it in my revenues. We will separately call it out, so you can see what is the underlying business and see how we have tracked that £9 billion guidance for example. So we will separate it all out. But in the headline numbers that you see, it will still be in there.

Arturo de Freias
Thank you very much.

António Horta-Osório
Thank you Arturo and thank you everyone.

End of Q&A