LLOYDS BANKING GROUP PLC – 2015 RESULTS PRESENTATION

THURSDAY 25 FEBRUARY 2016

António Horta-Osório, Group Chief Executive

Good morning everyone, and thank you for joining us for our 2015 full year results presentation.

I will start with the key highlights for 2015, before setting out the trends we are seeing in the UK economy, and how our differentiated business model positions us well in the face of market volatility and the evolving operating environment. I will then turn to our strategic priorities and the progress we have made against them during the year. George will then cover the financial results in detail, after which we will take your questions.

Turning to the highlights of the year. In 2015 we made good strategic and financial progress as our differentiated UK focused model continues to deliver.

Our financial performance was robust, with increased underlying profit and returns being driven by higher income, a further improvement in our market-leading cost:income ratio and lower impairments.

Statutory profit before tax was, however, lower, reflecting £4.0 billion of PPI charges and the £0.7 billion charge of the sale of TSB, which we reported in the first quarter.

Our capital generation is strong, with our pro forma CET1 ratio increasing by around 300 basis points prior to dividends and the PPI charges we have taken. As a consequence, our pro forma CET1 ratio has strengthened to 13.0 per cent or 13.9 per cent pre dividends.

While the UK economy continues to be resilient, persistently low interest rates and market volatility are currently creating challenges for the banking sector. Given our differentiated, UK-focused business model, we are well placed to respond to these challenges.

Our low risk business model, reflected in our robust capital metrics, strong liquidity position and significantly de-risked lending portfolio, provides security and a funding cost advantage in the face of the current market volatility and uncertainties, as our leading Credit Default Swaps spread indicates.

At the same time, our cost discipline remains an additional source of competitive advantage. Indeed, we are already responding to income pressures and lower rates by accelerating our cost reduction plans and targeting further savings.

Today, we are therefore reaffirming our strategic targets for our return on equity and cost:income ratio, although, due to the additional tax surcharge and the interest rate environment, we now expect the timing of these targets to be deferred one and two years respectively. Consistent with recent performance, we expect our capital generation to remain very strong and have enhanced our guidance in this area.

Our success is not just measured in terms of financial and strategic performance, but also in the ways we continue to support the UK economy through our Helping Britain Prosper Plan. In 2015, we have continued to deliver against our key Plan targets, increasing net lending to SMEs and providing, amongst other things, 1 in 4 first time buyer mortgages.

Our progressive and sustainable policy for ordinary dividends is an important element of our strategic aim to become the best bank for our shareholders. I am therefore delighted to announce that, following the resumption of dividend payments in 2014, the Board has recommended a final ordinary dividend of 1.5 pence per share, bringing the total ordinary dividend for the year to 2.25 pence per share. In addition, in line with our commitment to return surplus capital, the Board has also recommended a special dividend of half a pence per share.

Before looking at the resilience of our model, let me turn briefly to the financials. Underlying profit is up 5 per cent to £8.1 billion, or by 10 per cent excluding TSB, leading to a 1.4 percentage point increase in our underlying return on required equity to 15.0 per cent.

Income was higher, driven by the strengthening of our net interest margin and resultant increase in net interest income. Against this, other income was lower than 2014, but, as expected, it recovered in the fourth quarter.

Our simple, low risk model and continued cost discipline have enabled us to deliver an improvement in our already market-leading cost:income ratio to 49.3 per cent, as well as a further 48 per cent reduction in impairment charges.

As already highlighted, our statutory profit before tax was lower, driven by the loss on the mandated sale of TSB as well as the actions we have taken in respect of PPI.

In 2015 we strengthened our PPI provision by £4.0 billion, with a £2.1 billion increase in the fourth quarter primarily reflecting our interpretation of the FCA's consultation on a proposed time bar as well as the Plevin case. George will cover this in more detail shortly.

In relation to TSB, the loss was £745 million in 2015, and the cost of delivering this commitment to the EU amounted to a total of £2.4 billion over the last five years. This has now been completed.

Turning to the balance sheet, our CET1 position has continued to strengthen, driven by a combination of underlying profit and a 7 per cent reduction in RWAs as we continue to de-risk the business.

And, as I already mentioned, the Board has recommended an increased ordinary dividend as well as a special dividend.

Turning to the UK economy. As a UK-focused bank our future is inextricably linked to the strength and success of the UK economy. While the recent market volatility and lower for longer bank base rates are currently creating challenges for the sector, the underlying economy in the UK continues to be resilient, providing a solid foundation for the Group's future prospects. Importantly, the recent economic recovery has been achieved on a sustainable basis, with continuing deleveraging reflected in reducing ratios of debt to GDP.

UK GDP has grown by 2.2 per cent in 2015, representing the third successive year of GDP growth above 2 per cent. It is expected to grow around these levels going forward.

As I have already highlighted, the Group has a strong balance sheet and low risk business model, which positions us well in the face of the current market volatility and uncertainties.

Starting with our funding position. Over the past five years, we have reduced our wholesale funding requirement by 60 per cent to £120 billion, while also repaying almost £100 billion of emergency government funding and building up our liquid asset portfolio. This has resulted in our funding less liquid asset position improving from around £200 billion at the end of 2010 to zero at the end of 2015.

Our capital generation is also a key differentiator, with our year-end pro forma CET1 and total capital ratios of 13.0 and 21.5 per cent, post dividends, stronger than the average ratios of our major banking peers.

Since 2010, we have also made strong progress in de-risking our lending portfolio, with run-off assets reducing from £194 billion, or approximately 30 per cent of the portfolio, to £12 billion at the end of 2015. This has been achieved in a capital accretive way, with the latest reductions also generating pre-tax gains.

Coupled with our low risk focus across the wider book, this has in turn, led to a significant reduction in impaired loans, which now represent just over 2 per cent of our lending portfolio, compared with over 10 per cent in 2010.

The combination of our strong capital position and our de-risked portfolio has also been reflected in our results from the recent PRA stress test, which demonstrated that our balance sheet would remain resilient in the face of an extreme stress, with no further capital actions required.

We are conscious of the concerns that have been raised about the sustainability of house price inflation. However, the combination of our low risk focus and strict underwriting criteria, with these recent trends, has led to a significant improvement in the credit quality of our mortgage portfolio, our largest asset class.

The average loan to value ratio of our book has reduced from 53 per cent to 46 per cent over the past two years, with the proportion of our portfolio with an LTV of over 100 per cent reducing to just over 1 per cent.

Underpinning this, there are a number of positive external trends impacting the book. The gradual improvement in UK employment levels over the past four years, supported by healthy and sustainable levels of wage growth and low interest rates, has led to an improvement in mortgage affordability despite the recent strong recovery in house prices.

Also, importantly, recent house price inflation has not been driven by customers overstretching themselves financially, as mortgage lending as a whole has been growing below nominal GDP, and we stress test every new mortgage request to a significantly higher interest rate.

Now turning to our differentiated business model. In an operating environment where changes to customer preferences, increasing competition, evolving regulation, market volatility and the prospects of lower for longer interest rates are creating significant headwinds for the UK banking sector, our differentiated business model positions us well to react effectively.

The way in which customers choose to interact with their banks and conduct financial transactions is evolving at an unprecedented pace, with more and more customers expecting a full service proposition and choosing to transact online or via their mobile. We are well-placed to respond to these changes, with our multi-channel and multi-brand approach, comprising the UK's largest digital bank and leading branch network, providing our customers with complete flexibility in terms of brand preference and how they choose to interact with us.

In recent years we have seen a number of new competitors come to the market as well as the strategies of our major UK banking peers converge with the one we have been successfully implementing for a number of years. This has led to increasing pressures in what was already a competitive market.

In the face of these challenges, our multi-brand operating model enables us to adopt a more appropriate and targeted approach to growth, product development and pricing for our very distinct customer groups and segments.

In addition, our low cost operating model enables us to deliver value to our customers, while investing in our propositions and generating superior and sustainable returns to our shareholders.

As a UK-focused bank that is not subject to multiple regulatory jurisdictions, we are well placed to respond to the increased regulatory requirements that the sector is facing. In recent weeks we have received greater clarity regarding the capital framework for UK banks. Given our strong capital and leverage ratios, we are confident we will meet these requirements as and when they fall due.

And while we await final clarity on the operational consequences of ring-fencing, we are confident that the transition to this regime will be fairly smooth and relatively inexpensive for us, given that the majority of our simple, UK-focused banking business will sit within the ring-fence.

Turning now to our progress against our strategic priorities. In 2015 we made good progress towards each of the three priorities, which collectively supports our strategic aim of becoming best bank for customers and shareholders: creating the best customer experience; becoming simpler and more efficient and delivering sustainable growth.

Starting with "creating the best customer experience". During the year we have increased our investment in our digital capabilities. We now meet around 55 per cent of our customer's banking needs digitally, and are launching new and innovative customer propositions and reducing the time associated with a number of key customer journeys, such as the opening of a new business bank account and applying for a new mortgage.

We have the UK's largest digital bank, increasing our market share of new business to 21 per cent in the year, and now have 11.5 million online and 6.6 million mobile banking customers.

Our success in creating the best customer experience can be seen in our net promoter scores, which are now over 50 per cent higher than in 2011. In addition, our customer complaint figures remain significantly lower than the average of our major UK banking peers.

Turning to "becoming simpler and more efficient". As part of our disciplined approach to cost management we are actively responding to the lower for longer interest rate environment through the accelerated delivery of cost savings and the targeting of further efficiency initiatives. Consequently, we are ahead of plan in delivering the £1 billion of targeted cost savings in the current phase of Simplification.

As part of our programme, we are also redesigning and automating a number of our key customer journeys on an end-to-end basis, with the aim of improving efficiency and reducing processing times for the benefit of both customers and shareholders.

The efficiency savings we have achieved have not only led to an improvement in our cost:income ratio but have also enabled us to double our investment spend in the last five years versus the level the bank had in 2010.

Turning to delivering sustainable growth. In 2015 we delivered growth in our targeted customer segments within our prudent risk appetite. Key highlights include another five per cent increase in net lending to SMEs against the backdrop of a market, which only last year turned positive.

Our Consumer Finance business has delivered year-on-year customer asset growth of £3.2 billion across its auto finance and credit card businesses, significantly above the strategic commitment of £2 billion per year until the end of 2017. Insurance is also targeting growth, entering the attractive bulk annuity market in the first half of last year and executing its first external bulk deal during the second half.

Regarding our retail business lines where our aim is to maintain our market leadership position: we successfully maintained our share of current accounts, with Halifax one of the key beneficiaries of the current account switching service. In mortgages, however, as I have previously indicated, we have taken the conscious decision to protect margin, growing our open book by around one per cent versus a market that grew by around two and a half per cent. We believe that this is the right approach as the leader in what is, at the moment, a low growth market, and also where growth is predominantly coming from Buy-to-Let.

Turning now to more detail of our lending growth by key customer segments. Over the last 12 months, we have grown net lending across our key customer segments by 2 per cent. As already mentioned, as market leader in mortgages, we have focused on the proper balance between margin and volume in this competitive and low growth market.

We have consistently grown net lending to SMEs ahead of the wider market, achieving growth of 25 per cent over the past five years compared to a 13 per cent decline across the wider market. We have also continued to deliver against our Helping Britain Prosper Plan commitment to small businesses, providing support to one in five new business start-ups in the year.

Our consumer finance business also delivered strong growth within the Group’s low risk appetite, with UK net lending growth of 17 per cent in 2015 comprising a 34 per cent increase in motor finance and a 4 per cent increase in credit cards.

Turning finally to shareholder returns and capital generation. In 2015, we made further strategic and financial progress, with our underlying profit in the year now over £8 billion versus an underlying loss of £800 million in 2010 and our underlying return on required equity strengthening in the year to 15.0 per cent.

In an increasingly competitive operating environment, our market-leading cost:income ratio, and our low risk model are ongoing sources of competitive advantage, which together with our multi-brand approach, enable the Group to respond effectively to the current challenges facing the sector.

We are confident in the Group’s prospects and expect our net interest margin to strengthen to around 2.70 per cent in 2016, with our cost:income ratio improving again from the ratio reported in 2015. Given our low risk model, the benign economic backdrop and low interest rates, we expect our asset quality ratio to be around 20 basis points in 2016, still considerably lower than our expected through the cycle ratio of around 40 basis points.

Looking further ahead, we continue to target a return on required equity of 13.5 to 15 per cent and further improvements in our cost:income ratio to around 45 per cent. In light of the 8 per cent banking tax surcharge and, for cost:income ratio, the continued lower for longer interest rate environment, we now expect to achieve these targets in 2018 and at the end of 2019 respectively.

Over the past few years, the strength of the Group’s capital generation has been a constant, with our CET1 ratio strengthening by 300 basis points or more in each of the past three years, excluding PPI charges and dividends, and including a very significant contribution from the reduction in run-off assets and other risks.

Looking ahead, we remain confident in the outlook for the business and are therefore increasing our guidance for pre dividend CET1 capital generation to around 200 basis points per year. This will, in turn, enable us to deliver progressive and sustainable ordinary dividends, while continuing to consider the return of surplus capital.

In summary, the combination of our simple, low risk business model, with our ongoing strategic delivery and balance sheet strength, positions us well to deliver sustainable growth and superior returns and, through this, become the best bank for customers and shareholders.

I will now handover to George who will run through the financials in more detail.

George Culmer, Chief Financial Officer

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

Starting with underlying profit which increased by 5 per cent to £8.1 billion, driven by positive jaws of 1 per cent and a significant improvement in impairments, which were down 48 per cent, with an AQR of 14 basis points.

The positive jaws reflect a 1 per cent increase in income, driven primarily by an improvement in the net interest margin, and lower operating costs. Excluding TSB, as you've heard, underlying profit was up by 10 per cent and a clear demonstration of the strength and resilience of our strategy and business model.

Looking at net interest income. The 5 per cent increase in NII, to £11.5 billion, reflects the continued improvement in the net interest margin, which at 2.63 per cent was 23 basis points higher than 2014. While the Q4 margin of 2.64 per cent, was in line with the third quarter.

As in previous periods, these trends reflect improved deposit pricing, lower wholesale funding costs, and the disposal of lower margin run-off assets, partly offset by ongoing asset pricing pressures.

Looking forward, we expect these factors to continue and that the Group's margin in 2016 will increase to around 2.70 per cent, including the expected benefit from the ECNs.

On assets, average interest earning assets were £442 billion for the full year, 4 per cent or £19 billion lower than 2014, although we did see a pick up in Q4, with core book growth exceeding the expected decline in run off.

The year on year decrease of £19 billion has been mostly driven by a £16 billion reduction in Run-off, with reductions in Retail, from the closed specialist mortgage book, and in Commercial Banking, partly offset by good growth within Consumer Finance.

Looking at other income. Other income is down 5 per cent, due to the disposal of run-off assets with the underlying performance in line with prior year. As expected, OOI recovered in the fourth quarter with improvements in every division, and was up 11 per cent on Q3, despite around £60 million of weather related insurance claims. Q4 was also up 1 per cent versus the same period in the prior year driven mostly by a stronger performance in Commercial.

In terms of year on year performance, Retail remained challenged, falling by 7 per cent, due to the current conditions and regulatory environment, whilst both Commercial and Insurance grew by 6 per cent, driven by increased activity in Global Corporate and Mid-Markets in Commercial, and by our first transactions in the Bulk Annuity market in Insurance.

On costs, operating costs of £8.3 billion were lower than 2014, with efficiency savings from our Simplification programme, business disposals and run off, more than offsetting increases from pay and inflation and additional investment in the business.

We have already achieved around £400 million of Simplification 2 run rate savings, led by £185 million from organisational design changes and £150 million from sourcing activities, and we are ahead of our target to deliver £1 billion of savings by the end of 2017.

Our market-leading cost income ratio improved to 49.3 per cent and remains one of the lowest across the sector.

And we're responding to the lower interest rate environment through the accelerated delivery of cost initiatives and the targeting of further savings, and we remain committed to achieving annual reductions in the ratio with a target of 45 per cent, which we now expect, as you've heard, to achieve as we exit 2019.

On impairments, as mentioned, we've seen a 48 per cent reduction in the P&L charge to £568 million, with the AQR of 14 basis points compared with 23 last year.

Run-off was down by £195 million and our ongoing businesses by £339 million, reflecting the current economic environment, our effective risk management, as well as provision write-backs and releases, which reduced the overall AQR by approximately 14 basis points.

The quality of the Group's loan portfolio continues to improve. Impaired loans are now 2.1 per cent of total loans and advances, compared with 2.9 per cent a year ago and 2.7 per cent at the half year.

Coverage also remains strong at 46 per cent, with the reduction on prior year largely due to the sale of heavily impaired assets from the run-off portfolio, particularly in Ireland, as well as further disposals within Commercial Banking. Our coverage ratio, excluding run off, is 43 per cent, and in line with last year.

Our lending exposures across oil and gas, mining and commodities are small, representing approximately one per cent of our total loans and advances to customers.

And so far this year, we are not seeing any signs of increased stress in our wider book, and, despite the market volatility, we believe the real economy will remain resilient.
In terms of guidance, as mentioned, the AQR is expected to be around 20 basis points in 2016. This comprises a marginally lower level of gross impairments of around 25 basis points, compared with the 28 in 2015, and a reduced level of write backs and provision releases.

Looking briefly at the underlying financial performance by division. In Retail, we continue to deliver strong profits and returns, achieving a 9 per cent increase in underlying profit to £3.5 billion, with net interest income up 4 per cent and a 28 per cent reduction in impairments, offsetting a reduction in other income and a 2 per cent growth in costs.

In Commercial, underlying profit was up 10 per cent to £2.4 billion, driven by the 6 per cent improvement in other income, and significantly reduced impairments, partly offset by a 1 per cent increase in costs. The Return on Risk Weighted Assets was 41 basis points higher at 2.33 per cent, and we remain on track to deliver our targeted return of at least 2.4 per cent by the end of 2017.

Underlying profit in Consumer Finance was in line with last year at £1 billion. Income was flat year on year, and a 29 per cent reduction in impairments offset a 4 per cent cost increase, as we further invested to grow this business.

And in Insurance, there was a 4 per cent increase in profit to £962 million as income from bulk annuities more than offset reductions in pensions and investment and general insurance.

And finally, in Run-off, the reduction in the loss mostly reflects lower impairments, reflecting the continued success in managing down the run off portfolios.

Moving onto statutory profit. Asset sales and other items were £716 million driven mostly by fair value unwind and amortisation of intangibles. As you know, the £1.3 billion charge in 2014 included charges from the Group's ECN offers and negative insurance volatility.

Simplification costs of £170 million were significantly lower than prior year which included severance, IT and other business costs of implementing the first phase of the Simplification programme.

TSB costs of £745 million are from the disposal of that business, and are unchanged from the half year.

While on PPI, as you've already heard, we have taken a charge of £4 billion and I will cover this in a moment.

Other conduct charges were £837 million, £302 million of which was taken in the fourth quarter relating to a number of non-material items, including packaged bank accounts and a number of other product rectifications primarily in Retail, Insurance and also Commercial Banking.

And finally, the tax charge of £688 million represents an effective rate of 42 per cent, largely driven by the change in the tax treatment of conduct related provisions.

Adjusting for this charge, the effective tax rate would have been around 14 per cent, reflecting a number of positive one-off items including non-taxable and relieved gains, and a small prior year adjustment.

Going forward, I wouldn't expect these positive one-offs to continue and I would now expect a medium term effective tax rate of around 27 per cent, including the forthcoming 8 per cent surcharge This is lower than our previous guidance of around 30 per cent, reflecting the action we have now taken on PPI.

And on PPI, as you are aware, there have been a number of developments in the last few months including the FCA consultation on the time bar and Plevin, and more recently, the announcement by the Ministry of Justice on regulation of CMCs.

And while year on year reactive complaint volumes were down 8 per cent in 2015 and are currently averaging approximately 8,000 per week, we are now assuming that reactive complaint volumes, including those relating to Plevin, will increase to around 10,000 per week through to the currently proposed time bar in mid-2018.

As a result, in the fourth quarter, we've increased our PPI provision by £2.1 billion, with £3.5 billion now remaining unutilised.

Clearly actual experience could, and is likely to be, volatile through this period, but we believe that based on these assumptions, the amount we have provided should be sufficient.

Turning now to the balance sheet. Very briefly on risk-weighted assets, the Group continues to make good progress in de-risking, with RWAs down £17 billion, or 7 per cent, to £223 billion. This was driven by a £9 billion reduction from disposals, including TSB; and a £7 billion benefit from economic factors, including the increase in house prices.

On capital, the business continues to be well capitalised and strongly capital generative. And we continue to believe that our current capital requirement to grow the business, meet regulatory requirements and cover uncertainties, will be around 13 per cent.

In 2015, we've seen a further strengthening of our ratio from 12.8 per cent at the end of the prior year, to a pro forma CET1 ratio of 13.9 per cent, pre-dividends.

As previously, this increase was driven by strong underlying profitability and the reduction in RWAs, offset by PPI and other conduct.

The pro forma CET1 ratio includes a £500 million dividend paid up to the Group from Insurance in February this year. This would normally have been paid in 2015, but was deferred due to timing of the formal implementation of Solvency 2.

Total capital for the Group now stands at 21.5 per cent positioning us well for both current and evolving regulatory requirements. The leverage ratio is 4.8 per cent post dividends.

On net assets, our TNAV per share pre-dividend of 53.8 pence is down on the 2014 year-end, with increased underlying profit more than offset by conduct, the impact of TSB, and AFS reserve, pensions and the cash-flow movements.

Since the year end however, given market movements, pensions and cash-flow hedge impacts have more than reversed, giving an estimated TNAV of 55.6 pence as at the 19th of February.

Finally, a few words on structural reform and future total capital requirements. On ring fencing, we have a clear plan built around our simple, UK focused, Retail and Commercial business model. This will ensure continued customer focus and minimal customer disruption.

The vast majority of loans, around 97 per cent, will sit within the ring fenced bank, and costs of implementation are expected to be a few hundred million pounds, which will be spread over the next 3 years and charged below the line. And we are fully on track to deliver in advance of the 2019 implementation deadline.

Our simple model and strong capital position also positions us well to achieve our MREL requirements, which we will meet through the refinancing of maturing OpCo debt, rather than through a material change to our approach in funding the bank.

So, to sum up, in 2015 the Group made good strategic and financial progress.

We're creating the best customer experience, becoming simpler and more efficient, and growing the balance sheet in a sustainable manner in targeted customer segments.

At the same time, we have delivered a robust financial performance, with a 5 per cent increase in underlying profit and continued to generate strong returns with an underlying return on required equity of 15 per cent, and we have also further strengthened the balance sheet.

The Group has a clear strategy and a differentiated business model which is providing security in the face of recent market volatility and competitive advantage through our low risk approach and focus on costs.

And, through this simple, UK focused, multi-brand approach, we continue to be well positioned to deliver even in periods of lower for longer interest rates.

As a result, for 2016, we expect an increase in our net interest margin to around 2.70 per cent, are committed to further reducing the cost to income ratio, and expect a level of impairments significantly lower than our 'through the cycle' guidance.

We are also re-confirming our medium term return on equity and cost income ratio targets. And we remain confident in our ability to generate significant amounts of capital, and we are today improving our guidance for pre dividend CET1 generation, from around 150 to 200, to around 200 basis points per annum.

Our outlook is positive and we are well positioned to become the best bank for customers and to deliver superior returns for shareholders.

And that concludes my review and today's presentation and we are now available to take any questions.

End of Presentations

Question and Answer Session

Question 1: Andrew Coombs, Citi
Thank you, good morning, it is Andrew Coombs from Citigroup. Three questions from me please, two on capital and one on the cost:income target. The first question will be on capital. I noticed your Pillar 2A requirement as a function of equity has increased from 2.1 to 2.6 per cent and previously when you have given your guidance on where you consider special dividends you have said above 13 per cent give or take, so shall we now assume that is 13.5 per cent? I can see you nodding your head, but I will come back to that one.

Second question, you mention on page 52 there is a reference to the Basel consultation papers that came out in December, both on standardised credit floors and also the potentially revised methodology operational risk. I would be interested in a few more thoughts you have on both of those?

And then the final question. Your cost:income in 2015 was 49 per cent and if you strip out the operating lease depreciation, it is at 47 per cent. If you then adjust for your NIM guidance going forward next year, pro forma value at 46 per cent. So give or take you are already at or very close to your 45 target. So I guess my question would be given that you have postponed the 45 per cent target, does that mean that you expect NIMs to go up in 2016 and you expect them to go down in 2017?

Answer: António Horta-Osório
This is difficult. Shall you start with the capitals?

Answer: George Culmer
Yes you are right. So Pillar 2A was gone up to 2.6 per cent. I think as we say in the document, that is a reflection of economic factors, the reduction in RWAs. As you know we are limited by what we can say about that. But I should be very clear that yes it has gone up but our guidance is unchanged and that guidance reflected a regulatory requirement of around 12 plus our buffer on top; that is after that increase in the Pillar 2A number. So it fully reflects that within our guidance. And so yes that has gone up. Other aspects of our capital requirements have compensated for that and our overall capital position remains unchanged in terms of our expected requirement. And so I will make that clear.

Basel operational risk and all those sorts of thing. Some of those will happen. Some of those won't. Operational risk will happen. Standardised credit floors and all those sorts of things, I don't think will happen. And there is a lot of revision that is due. I would also point to comments made in terms of overall sufficiency's of capital within the sector and offsets and reductions in compensating buffers etc. So I think it is wrong to see everything implemented as an addition and particularly for example in terms of operational risk where I strongly believe if there is an increase in CET1 requirements, you will see compensating reductions in Pillar 2 requirements for that. So I do think, yes it is important to track each pronouncement but you must see it in the context of the overall capital picture for the group, for the sector and the expectations for that sector. I think that is absolutely critical.

And then on cost:income. We already deduct the operating lease from our numbers. So the 49.3 is already stripped out so I wish your numbers were true, but we already strip that out. Please don't see the deferral as any slacking in terms of focus and determination to deliver cost savings and to manage the cost base of the Group. We have a proven track record on that and our focus on that will continue. It is simply a reflection of since we put the original plan together there has been significant movements in terms of interest rate expectations and the pushing out of that. And potential impacts upon income, will obviously flow through into our ratio. But we are ahead of our second phase in terms of simplification programme. Costs, despite increased investment in the business, increased bank levy, FSCS, are down year on year and we will continue to focus on delivering that year on year reduction in the cost:income ratio that we have signed up to.

Answer: António Horta-Osório
I would just add that we have always been very clear that our cost:income target which is for us one of our key competitive advantages, I would like to remind that the UK banks so far presented results, they all went up in terms of cost:income ratio. We have been the leader of the market, have gone down so our difference, our competitive advantage has in fact increased. This is a target that has always been based on one hand of the external environment, which as George was saying, we do not control. And on the other hand, our internal management actions in terms of simplifications initiatives and trade off between cost and revenues. And we have expected when we announced our strategy here in October 2014, that base rates would be 2.5 per cent by the end of 2017. We now expect base rates to achieve 2.5 per cent during 2019 and it is the main the reason as George told you why the cost:income ratio is delayed, there is an exit rate of 2019 instead of an exit rate of 2017.

In relation to capital, well just a point which is important. I think what George has said is absolutely in line with FPC comments and the comments of the Governor of the Bank of England, which is the capital in UK is broadly okay and around 13 per cent overall, while there could be shifts between players or segments but it is broadly okay. So I think very much in line with what George has told you at sector level as well.

<u>Question 2: Chris Manners, Morgan Stanley</u>
Good morning Antonio, good morning George, good morning Juan. So Chris Manners from Morgan Stanley, two questions if I may. The first one was on the other operating income, I guess on the slide there you are indicating your underlying OOI is around £6 billion. How shall we think about that trending? Obviously you have got some headwinds, you have got some tailwinds. It's a key component and looked like it fell short a little bit of expectations; I know you had the weather related impact in the fourth quarter, just maybe if you could give some indication on how we should model that going forward?

And the second question was again on capital return. So at the moment £223 billion of risk weighted assets, you think you can do around 200 basis points per year of capital generation. That would mean around £4.5 billion of free equity flow. I take your point, you think you have enough capital now. That £4.5 billion of free capital flow what are we going to do with that? Does that all come back to shareholders? So the special should step up quite materially in 2016?

Answer: António Horta-Osório
George will answer that very easy question.

Answer: George Culmer
Okay, on OOI it has been a challenging year as you point out. And we expected Q4 to come back and it did with something like 11 per cent up. I am glad you did mention the weather, because the weather was quite a big impact upon that, it was some £60 million which we have called out and I think absent of the weather we would have been up something like 17 per cent and a few per cent up on the equivalent quarter last year. So it remains a relatively tough environment. As you look out what do I see in terms of trends? I think retail was down about 7-8 per cent in 2015, I would expect it to be a pretty challenging or to remain a challenging environment for retail as we move forward. Some of that is the continuation of the regulatory environment, some of that is in terms of customer trends, ATM usage, some of that would depend upon things like levels of new mortgage origination etc. But I would expect it to continue to be pretty challenging. Commercial was up in 2015 I think about 6 per cent year on year. I would be hopeful of Commercial continuing to move in positive territory with a large part coming from fees off well established relationships, transactional banking etc, supplemented by the more sort of fee based transactional elements that sit on top of that. But I would expect Commercial to be in positive territory. Similarly I think for Insurance, where again they are up 6 per cent in 2015 but hopefully in terms of continued success in the bulk market should lead Insurance in positive territory. And similarly I would hope for Consumer Finance, in terms of OOI, in terms of Lex business. So it is not so much an overall picture as sort of

different pictures for each element and it will stay a relatively tough environment, but taken in the round I would certainly be hopeful I think of moving into some form of positive territory in 2016.

And on capital numbers. I can't dispute your math. But look, we have got a very clear policy, we will adhere to that policy. I am not going to give you any guidance or indication now other than reiterate that. I think we will continue to take, the Board will take a relatively cautious view, prudent view on base dividend growth and we will take whatever decision with regards to capital requirements and surplus a year from now. And I should emphasise that will be a year from now in terms of capital position requirement and any potential surplus. So that will be a decision for next year. But you know as demonstrated in our numbers today and as demonstrated in our guidance, there is an overall resilience and robustness to our operating model and we continue to expect to be strongly capital generative, that is what we have demonstrated and that is what we think we will continue to achieve.

Further question
Is it fair to say there is no real reason why you should not come back down to 13 per cent CET1 ratio that you can see at the moment?

Answer: George Culmer
We have been very clear about our guidance and what our expectations are, and going back to Andrew's questions, as I said 13 per cent reflects some of the recent developments so that requirement remains what we believe to be our capital requirement.

<u>Question 3 : Tom Rayner, Exane</u>
Good morning, Tom Rayner from Exane BNP Paribas. Could I just ask you a little bit more on the margin guidance please, 2.70 per cent up from 2.63 per cent. I know there are some numbers being put out for the ECN benefit. On our maths assuming no sort of Tier 2 swap element to this, that should explain most of the increase in the margin if not all of it for the current year. So I just wondered if that was correct and if you could then talk about some of the moving parts in the latter part of the year so we can get a better idea of how the asset spreads and the deposit spreads have been moving in the last couple quarters? That would be quite helpful, thanks.

Answer: António Horta-Osório
Let me just make a small framing of this. As we have discussed for many quarters and several years, this is a really important point to managing a UK retail context as we discussed many times. And we do believe that our multi-brand approach especially in a low interest rate environment and the way we manage margin in terms of the difference of assets and liabilities on a weekly basis at the top of the organisation provides a competitive advantage. I think numbers have been demonstrating this, especially lately. And again we have been managing this a bit better than we thought. We have held our margin in the fourth quarter and we see in our guidance as you just said, we see the future now a bit better than we saw it a quarter ago and we continue to be able to hold our margin in a context of very low interest rates. As you said there is an impact of ECNs, which George will describe in a moment but basically we see the interest rate environment which continues to be competitive, so there is continued pressure in mortgage prices as you have seen and other assets. There is a continued downward movements in deposits. We have been, I repeat, in this multi brand context and with special focus on the way we manage the margin been able to continue to withstand an adverse environment because we are positively exposed to rising interest rates which have not happened yet.

Answer: George Culmer
The expected benefits from ECNs would be 4 to 5 basis points, of that order which you are right, gives you most of the sort of pick up in terms of last year to this. But what also you are seeing is a relative robustness in terms of the underlying NIM. And I endorse everything that António says there. And within that, on the asset side, the SVR roll off continues around about the 8 per cent rate when you look at our total SVR book I think we are about £153 billion at the end of Q4. I think that was compared with about £155.6 billion at Q3 and within that the Halifax which is the 3.99 per cent book, that was £52.5 billion at Q4 compared to £53.5 billion so it gives you an indication of the rate of decline of that. And obviously it is the benefit from the low rate environment that that book is being stickier than certainly we expected. And then on the other side and again to emphasise the point António has made, in terms of managing the costs of funds, managing those liabilities, I know we normally read out the costs and rate in terms of savings. So if I look at my savings portfolio, the retail savings which is sort of £185 billion book, the average rate on that was about 106 basis points in Q4 and that compares with 114 at Q3. So you can see we continue to be able to shave that. What I would also make the point in terms of overall balance sheet management. So when I look at deposits they are relatively static at £418 billion, close of year, start of year for 2015. But within that the Commercial book has risen from about £122 billion to £126 billion and obviously those costs for those commercial deposits are in the 50 basis points. Whereas my retail book has gone down from about £195 billion to round about £185 billion. And those, we have just heard the sort of

price of that. So it is just indications of trying to show the point, the active management of the book and being able to flex between businesses, being able to flex between products and managing it all on a single joined up basis so there is a cohesion and co-ordinated approach to how you manage this. It makes it for a more effective and more efficient machine than most.

Question 4: Raul Sinha, JP Morgan

Good morning can I have three please. Just a couple of follow-ups for George and a broader one for António. I mean the first one for George is in your 2014 annual report George you talked about the average cost of deposit for the Bank of 115 basis points. I was wondering if you had the 2015 equal number in your mind, given that you have just given the savings book?

Answer : George Culmer

You might have to wait for 2015 Annual Report. I don't know that number to hand.

Further question

The second one is I wonder if you might be able to give us some indication of the below the line costs that you can foresee this year? I know it is hazarding a guess, but I think you have talked about £0.7 billion costs related to the ECNs in Q1 if I read that correctly, is there anything else? You talked about the ring fencing potential costs to come. Is there anything else apart from that?

Answer: George Culmer

No that is a good question. And in terms of 2016 you are right. There is the basically the ECN which is an accounting, it is the removal of the embedded option and then we have taken that out of par so it is the impact of the pull to par on that that comes through. In terms of things that are featured in 2015, so things like other conduct, we continue to work through legacy issues. I am not going to stand up here and say there won't be any other, another conduct charge. I would expect it to be on a downward trajectory. But you know looking back, we posted the last couple of years, I would expect there to be some form of other conduct charge. You are right, ring-fencing as we said, a few hundred million over the next three years. So a bit below the line, not a very material amount. There will be further elements in terms of delivering redundancy costs and simplification programmes. And then you have some of the hardly perennials around things like the fair value unwinds which again are on a sort of decreasing trajectory. So no TSB obviously done and dusted. Asset losses, you know significantly reduced to a de minimis type level. Run off will continue to run off as a book of business. But we are much in the sort of, what we have got we can hold onto etc, so a de minimis amount. So slightly more than a guess, but that is what I would see.

Further question

Just a last one Antonio, if you could give us some thoughts on how you consider capital return in terms of the differences of buy-back and special dividend? Your stock price dipped below book value in the few weeks prior to this announcement and I was wondering if yourself and the Board has considered potential for asking for approval for a share buy-back as an option that you could then deploy let's say if there was placing? Thanks.

Answer: António Horta-Osório

The guidance for capital as the Board has said, it was just repeated by George. In terms of that specific point, the Board has both options open. So we have debated that. We decided to repatriate capital through a special dividend. It is a decision that we will take again in a year's time and both options are open so we will just take stock then and make a decision then.

Question 5: Chintan Joshi, Nomura

Good morning. Can I ask on margins and then on PPI. On your margins, can you help us think about how you expect the SVR churn rate in the Halifax book to develop in a low interest rate environment? My thought that it would be remain low for a longer period, but just want to check your thinking on that?

And remaining on margin, I know the hedge contribution from NII, you have not called it out in the past, I was hoping you could put an upper band to it, i.e., not more than say 20 per cent of NII or whatever number you think is the upper band, so at least we can say it is not going to be worse than X when we think about the hedge?

And I have a couple more follow-ups.

Answer: George Culmer

On the Halifax book, in a lower interest rate environment, throughout this year, I have just talked about it being 8 per cent. It has been pretty consistent around about the 8 per cent. So I would say that is not a bad indication of what the attrition of that book looks like in a low rate environment. So it has been 8 per cent. I have not expected a sort of cliff event in that. But 8 per cent has been the number.

Structural hedge, I am afraid I am not going to give you any kind of parameters. We are sort of pretty fully invested, you know the sort of weighted average life etc, you know the composition. But certainly we have taken advantage going back over the last year or so of making sure we are fully invested from a structural hedge perspective which I think puts us in good stead in, if it is a lower for longer environment. And we would certainly expect to see a robust contribution and support for the NIM as we move forward, but I am not going to frame for you.

Answer: António Horta-Osório
Just one point which might be helpful for you. We expect as George was saying, we expect SVR to have a different attrition in case interest rates would rise. So the two aspects that you ask, the structural hedge and SVR, they are very much connected. Because should interest rates start to rise, SVR obviously should have higher attrition. On the other hand the structural hedge should be reinvested at higher rates. When interest rates are very low the structural hedge is not reinvested or not reinvested at higher rates, but the SVR rates of attrition is low. And don't forget that is only in part of the book, because more than half of our book is locked in at 2 per cent spreads so does not have the 3.99 per cent rate in the market which is quite important.

Further question
Just remaining on NII, you show your overall market share across various products at about 18 per cent, and mortgage balances are at about 21 per cent and you are losing market share already to protect your margin rather than chase volumes. I am just wondering if 18 is your natural market share even for the mortgage book?

Answer: António Horta-Osório
We don't see the 18 as our natural market share. 18 is our current market share, it is the same as last year and as you say, and we said it last year, we have gained market share in the segments we targeted so we increased market share in car financing. And we have increased market share in SMEs although there is a sign we increased because we grew 5 per cent across the market that has barely started to be positive, but on the roundings it seems the same number. And we have slightly lost market share in mortgages because as I said, we do believe that in a low growth environment and where most of the growth is coming from buy-to-let which is growing around 12 per cent and we are only growing 4 per cent in buy-to-let, they are prudent and appropriate combination between new business prices, risk criteria and volumes being as the leader of the market is to make the trade-off more towards protecting margin. If the market was growing at a different rate, we would probably take a different decision. To give you the opposite view, in car financing, where the market is growing 12 per cent we have decided to grow significantly more, we are growing more than the market and overall 34 per cent which includes obviously the Jaguar Landrover deal where we got if you want, one more product and many more points of sale. And until three or four years elapse there is no redemptions. And we have decided to increase our presence in that market because it is growing a lot, we are under-represented and the margins were higher so we don't mind losing margin because we are increasing market share in a market where both we are under-represented and it is growing very significantly and we think strategically that is the right trade-off to take in the current environment in both segments.

Further question
Thank you and a very quick one for George. The PPI quarterly cost for fourth quarter excluding PBR and remediation, can you give us a sense of that number, as I just want to get a baseline?

Answer: George Culmer
On the reactives. Well yes so the quarterly cost in Q4 was £750 million so you are in £250 million a month of which about £150 million of that is remediation and PBR activity. Now on that, I think as we say towards the back of the RNS, I think PBR is done and dusted and we are up to about 77 to 80 per cent in terms of remediation. So I would expect that to decline and go down to just the reactives basically as we get to the half year, just tip into Q3, but that is what I see coming down to the reactives.

<u>Question 6: Arturo de Frias Marqués, Santander</u>
Arturo de Frias from Santander, two questions please. One on capital generation again and one on loan growth. The one on capital generation. If I look at your chart, your bridge on capital generation, I see that the underlying profit generated 340 basis points of capital and obviously there are negative items there such as conduct. But I think we all should expect the conduct element is going to be substantially smaller in 2016 and forward. So when I look at that 340 basis points of organic capital generation and then I compare that with your 200bps capital generation guidance, it is true that has been improved from the 150 to 200 range before, why is it not higher? Why are you not going closer with your guidance towards what your underlying profit is doing? Because the other element obviously is RWA growth but I don't think we are going to see much of RWA growth. So why you are not getting close to your underlying profit capital generation in your guidance? That is one.

And the second one is also on growth, but from a loan book perspective. You just mentioned that your Consumer Finance book is growing strongly. And your SME book is growing well. But both Retail and Commercial books overall are not growing. Well I guess nobody expected them to grow. But the fact is they have been very, very flat. And you keep talking about the low growth environment. When do you think the conditions will be there for both big loan books retail and commercial start to show some growth for Lloyds? Thank you.

Answer: António Horta-Osório
George will take the first one, I will take the second one. Just one small thing on the first one. You should consider that our performance is very, very stable. I think the model we chose, retail focus UK, retail and commercial bank, 97 per cent of our assets will be in the ring-fence. 95 per cent of them are in the UK. This is a really, really stable model in terms of retail and commercial banking in a AAA rated country. And we have on top of it two competitive advantages, costs and low risk measured by the credit default swap and provisions. So this is very sustainable. So you should understand that we are not giving any indication of a change in the line of profitability. We are upgrading the guidance and George can elaborate on that and I will come back to the loan growth?

Answer: George Culmer
It is a strong number the 340. I mean I am not going to give you a complete reconciliation as to why 340 does not equal 200. It relates back to some of the things I talked about in terms of the earlier question that will be there as an amount that will dilute that number. So I am sorry I am not going to give you a huge reconciliation. The underlying profitability generation will remain strong, but there will be some items even when I am through all my other conducts and stuff like that, the fair value unwinds etc, there will be some below the line items which will dilate from that. But the key element which the underlying profit will remain strong is absolutely correct.

Answer: António Horta-Osório
In terms of the loan growth Arturo, that is an interesting question and quite relevant strategically. I think as I said in my presentation, that actually low loan growth in the UK at the moment is good because the UK as a whole had too much debt and to be able to grow for the third year in a row above 2 per cent, the highest rate of any developed economy, with less that in both households which needed it, in corporate which did not need it, and now in the public sector. And the total debt to GDP ratio decreasing almost 10 per cent in three years is very positive. The UK should have lower debt levels and to be able to grow in spite of less debts will I think generate a longer economic cycle than otherwise. That is why we are really positive on the UK economy on top of the fact that house price going up with very low net mortgage lending has a very positive impact on the quality of our book value because the LTVs go down a lot given that new business is very small versus the stock. And so loan to values go up very much and that improves our capital strength and improves the customers net worth and commercial possibilities.

So in that context how do I see it going forward? I see that we will continue as we have been doing for five years to gain market share in SMEs. It is now 25 per cent net loan growth as stock versus a market that decreased 13 per cent. So we went from a 13 per cent market share to 18 per cent in five years. And I think market now turned positive only 1 per cent at the end of the year. We will continue to outpace the market. In the mid market space, although we are growing only 1 per cent the market is still negative so we are growing a little bit of market share there, but the total corporate market is still negative excluding SMEs. And in terms of Consumer Finance, where the market is growing around 12 per cent in auto finance, we are growing very much more than the market and we will continue to outpace the market. Credit cards, the market is growing around three and a bit, we have now started to increase our market share, last year we turned the book positive for the first time. This year we rose 4 per cent. We gained a little bit of market share, very competitive market in terms as you know of 36 months offerings to change balances with zero interest rates. We want to do the right thing for customers. The right thing economically for shareholders. So in a tough market we started gaining market share and you should expect that to continue.

And then in mortgages which is two-thirds of our book, we are doing this trade-off which I repeat as leader in a low growth market, where growth comes from buy-to-let. And I think having the proper balance between margin risk and volume is absolutely the right approach, especially in the market as a whole that doesn't grow very much.

So those are the segments and you can extrapolate those segments in terms of loan growth. Given that we have a closed book that is decreasing, and the run-off now which is only £12 billion and will go towards zero, the overall growth of the loan book for the next two or three years will probably not be very different from what it has been. But I repeat, this will for sure ensure a longer economic cycle for the UK economy given the healthy signs that this represents together with a mortgage price impact on the bank's books.

<u>Question 7: Andrew Hollingworth, HollAnd Advisors</u>
Good morning, it's Andrew Hollingworth from HollAnd Advisors. Just a couple of quick clarification questions and then one on insurance capital. Just the difference between P&L tax and cash flow tax I presume is all to do with deferred tax assets being used. I appreciate you have given a guidance for the rates but I presume that is a P&L rate and going forward you see the cash tax rate being lower than that as deferred assets?

Answer: George Culmer
That is correct.

Further question
That has happened this year and it will happen in the future?

Answer: George Culmer
That's correct.

Further question
Okay, great, thank you. And just two other quick things on sort of exceptional. Is it really right that redundancy and simplification are seen as exceptional charges and a sort of ongoing ever rationalising banking world?

And then with that in mind, the 13-15 per cent RoRE target you have given, just to be clear, is that after exceptional charges i.e. is that a net-net number?

Answer: George Culmer
Yes it is a net-net number. And so to be clear about that. And you are right, in terms of below the lines, above and below the line, and the first simplification programme we took all of that cost below the line, but this one, you are right, it might be a slightly artificial construct in terms of taking the redundancy below the line. But what we wanted to be able to say is that this commitment to reducing the cost:income ratio year after year after year. And it may be about messaging, but if I take my redundancy above the line that may mean stepping off doing the right things in terms of accelerating that. So that is going to be lumpy by nature. So it is a presentational type thing, but to the extent there is a methodology, that is it.

Further question
Okay. One last thing then, I may have misunderstood this, but my understanding is in the insurance division there is about £6 billion of regulatory capital and that you can't recognise all of that in the Group. Could you clarify whether that is right or not right? And if it is, are there mitigation ways you could think about releasing that capital in the future?

Answer: George Culmer
Yeah, essentially there is a sort of disallowed type element.

Further question
Yes so to clarify what those numbers are and what you could do if anything hypothetically in the future to improve that?

Answer: George Culmer
Taking one extreme, you could sell part of it, and you could basically bring that onto the balance sheet. So I don't think we have disclosed previously how much the amount is in terms of the sort of bit that does not flow through into our capital, but it is about a billion or so, couple of billion of that order, that might be slightly high.

<u>Question 8: Claire Kane, RBC</u>
Thank you. It is Claire Kane from RBC. Can I firstly have a follow-up question on the capital and then a question on the mortgage book. So the first is, on the Pillar 2 requirement, so in absolute terms I think it has gone up by about a billion in total capital add-on, which given over the year and even since May when the amount didn't change, you have done a lot to derisk the book and provision extra for PPI, is there anything you can do now to get that absolute add-on down? Or should we see any downwards revision to that Pillar 2A add on being only if the Pillar 1 RWAs rise or a countercyclical capital buffer comes in?

And the second question is on the mortgage book. So you have been quite aggressively increasing your front book rates and the rest of the market is also following, but to a lesser extent. Can you give us an update on what your retention rates are like on refinancing and of that SVR attrition, how much you are retaining? Thank you.

Answer: George Culmer

I will kick off with the first one. You are right, so the Pillar 2A picks up risks not covered in Pillar 1, so I have got pensions concentration, interest rate, operational, blah, blah. We have managed those downs and will continue to look at ways of managing those down. And so do I sit here and think the only way I can remove that is by growing my balance sheet? No, because when you look at things like pensions risk etc., we have done an awful lot over the last few years to de-risk that and therefore reduce the capital charge that we attract. And we continue to work at that. So there are more levers to reduce that charge than simply growing the balance sheet and spreading it across a bigger base. So I would be hopeful of continuing to work at that and seeing a reduction in that number.

Answer: António Horta-Osório

In relation to the mortgage book, I already made a brief overview of how the mortgage book works in our case. But apart from what I said and given your question, many people think that this is a matter of new business price versus margin and I think you are implying this in your question. This is much more complex because this is not a pure break even analysis. But it is an analysis that has to take into consideration SVR attrition and also retention which is transferring to internal products apart from the new business volumes. And what we think that as leaders this is absolutely the right approach to take. And as you say, part of the market is following us. But in terms of retention, this has kept our retention stable. So we think as well from a retention point of view, apart from SVR which George has already explained, that this is the best approach because customers, in terms of going elsewhere, have additional costs and therefore the convenience of staying with us, and we have different prices which for new business and some of the retention products and they have costs of moving, this is the best approach and our retention within those movements have been stable.

<u>Question 9: David Lock, Deutsche Bank</u>

Hi, its David Lock from Deutsche Bank. Two on net interest income please. Firstly when we look at the average interest earning assets, this has been pretty difficult to forecast over the last year. I am just wondering when we are going forward, I wonder if you could update on how you see the run-off element of the average interest earning assets developing and how we should be thinking about that growing, going forward?

And the second question, just looking at the deposit rates, I wondered if you could update on where your ISA rates are and whether it would be correct to think that in your margin guidance you are assuming that deposit rates overall for the UK come down or that the spread between yourselves and the rest of the market reduces? Thank you.

Answer: António Horta-Osório

Look David we are really not going to tell you what the deposit rates are, because of the way we manage margin as we explained before, but everything depends on competitive movements and what the market does. What we believe is irrespective of what the market does, given the multi brand approach and the way we manage the margin so there is difference between assets and liabilities in the different segments of the bank on a weekly basis at the top of the bank, provides competitive advantage. And we will respond to what the market does in a way that we can give you the guidance that we give. But we are not going to go into specific assumptions of what we think might happen in ISAs because that is only a small part of the picture and I don't want to give commercially sensitive information either for our competitors. George will answer you now in terms of the AIEA trends versus the loan book trends.

Answer: George Culmer

Yes so the AIEA trends, did you specifically ask about the run-off?

David Lock

You said earlier that the gross bit was growing and that had caused the fourth quarter to be more stable?

Answer: George Culmer

That's right. So the run-off book started about £23 billion and was down to sort of £11.4 billion in terms of average interesting earning assets. But in Q4 it just dropped from something like £13.2 billion or something down to the £11.4 billion. And I would expect there to be only a gradual decline in those run-off average interest earning assets as we move forward. Because as I was saying earlier, the imperative to dispose is sort of less interest in realising capital losses. So whilst I would expect them to decline, I would not expect there to be a rapid decline in that run-off bit. Elsewhere as I said in the presentation for 2015, we saw the growth in Consumer Finance. And I would expect Consumer Finance AIEAs to continue to grow. We have done a great job in Commercial in terms of bringing down our RWA exposure, let's see where business takes us from here on in terms of what the future direction. But certainly we have done a great job and it will depend on market flows etc. And Retail it really comes back to where the mortgage market goes and how we respond to that and that is the big swing factor there.

<u>Question 10: Chris Cant, Autonomous</u>

Hi good morning, a couple from me please. I just wanted to follow-up on the earlier question on the hedge. So I appreciate you don't want to give specific numbers as to how much is contributing to NII, but in the past you have stopped hedging when gilt rates dipped. And I just wanted to get an update on how you are approaching the hedge. You said you are fully invested. Are you changing the tenor of investments? You did push it out to ten years in the past at one point, are you still sticking with the five year duration? And in terms of the volume of the hedge, again I appreciate you maybe don't want to give us specific numbers, but is it fair to assume that as people turn in deposits, you will see an increase in the volume of the hedge because there are more non interest bearing funds on the balance sheet and that might provide some offset to the margin pressure you are undoubtedly going to face there?

And if I could ask one on provision guidance as well. So you guide to 40 bps loan impairment through the cycle. I am just curious, that must assume some rate normalisation. Antonio you mentioned a 250 bps base rate assumption for 2019. So is it fair to assume that if the market is correct and we don't actually get anywhere near that base rate environment by 2019 you would miss your cost:income guidance but your provisions would remain some way below that 40 bps level? Thanks.

Answer: António Horta-Osório

Okay, so on the second question because it is much quicker. Absolutely. So cost:income targets has two dimensions, our simplification management initiatives and interest rate assumptions we told you exactly which of those are. If interest rates would be further delayed the target would be further delayed. We would probably accelerate again simplification initiatives. On the other hand as you say, the 40bps normalisation of the credit cycle would also take longer to occur. So you are spot on.

Answer: George Culmer

And on the hedge. So what you said is mostly sort of correct. We flexed in the past, we have come into this year as I said pretty fully invested. You are right in terms of hedgeable balances have been growing which is a good thing. Where we go from here in terms of rates that are now on offer, we will wait and see and make a decision as a business and a group and management team. But we have flexed in the past so we could flex again.

<u>Question 11: Martin Leitgeb, Goldman Sachs</u>

Good morning, it is Martin Leitgeb from Goldman's. Two questions please. The first one on buy-to-let and I think you mentioned earlier that buy-to-let accounted for a large part of net new mortgage lending in the UK. Could you help us a little bit how to think forward for that business segment in terms of lending volumes?

Do you think the tax changes announced last year will meaningfully impact lending volumes going forward or how should we contextualise cross lending volumes in that segment going forward?

And would you be able to give us the gross lending figure you had in buy-to-let in 2015? I think we have the net figure of 4 per cent growth. It would just be interesting to get the gross figure there?

And the second question is just quickly on net stable funding ratio. I think your comment that you plan to fully comply with the requirement by 2018. Would you be able to give us the number where we stand now? Thank you.

Answer: António Horta-Osório

George will take the second question, I will answer the first one. Look what is happening in the UK for you to be very clear, because this is quite important by the way. We do not think this buy-to-let surge is a result of investors speculation on the housing market. What is happening in the UK is that given the increasing house prices which has recently gone throughout the country as a whole recovering pre-crisis levels people have more difficulty in getting onto the housing ladders as first time buyers, especially in London and the South-East which are significantly above pre-crisis level. And therefore given people cannot buy their first home they let, for the alternative is to stay in their parents' home. So the buy-to-let surge is a consequence of more people choosing to let. But as I told you on the broad macro-economic picture, the fact that the UK consumer is deleveraging makes the total mortgage market growing sub-nominal GDP, only 2.5 per cent. So it is more a shift between buy-to-let driven by demand and less first time buyers given the house price level than a surge in lending because overall mortgage growth has been sub-nominal GDP for three years and people really can, when they cannot buy they let. If buy-to-let is made very difficult they will stay longer in their parents' home. So we are trying always to support our customers in that shift of preference or need if you want. We have grown 4 per cent in a market that grew close to 12. We expect as you say the tax changes in April to have some impact on the market. At the same time we have been quite strict in terms of underwriting criteria and we also stress test our borrowers both in terms of the interest rate and the coverage of their rent versus their income. And therefore we are growing less than the market deliberately because again we are the leaders of the market, we have quite an important position and we think overall this is what we should do because of the trade-offs that I told you between volumes, margins and risks. But overall what is happening here concerns to potentially other points in the past, is a customer preference given the problem of first time buyers not being able to access easily their first homes, especially in London and the South-East.

Answer: George Culmer
On the NSFR, we obviously fully comply with all liquidity requirements and will do so. LCR north of 100 per cent, but I am afraid I don't have what we are in terms of NSFR today so I don't have that.

Question 12: Peter Toeman, HSBC
Peter Toeman from HSBC. You have highlighted your preference for special dividends over share buybacks, but if you had the opportunity to do a share buyback with your principle shareholder, the Government, would that be something you would contemplate?

Answer: António Horta-Osório
Peter I did not highlight my preference, I said that the Board in their discussion this year about excess capital, and after due consideration decided, number one, to distribute excess capital and number two, thought the best way to proceed this year was through a special dividend. At the end of each year the Board will have the same thought process. So we will have to wait for next year.

Question 13: Jonathan Pierce, Exane
Jonathan Pierce from Exane, sorry to come back on capital, it is obviously important this distribution policy. If we add up your fully loaded capital stack to include the systemic risk buffer we now know. The Pillar 2A counter cyclical buffer of let's say 1 per cent coming in due course. We get to 13 per cent before any management buffer. So that is also before IFRS 9 and I think in note 21 you make it explicit there could be a material impact certainly on the balance sheet provision from upcoming accounting changes as well. So can I just press you a bit more on what your target of 12 plus one year's worth of dividend is capturing? And maybe just to make the questions very simple. If we get a counter cyclical buffer this year will your target change as we approach 2018 and the systemic risk buffer is becoming ever close, will your target change for that? Thank you.

Answer: George Culmer
You are asking for a lot of crystal ball stuff in there. I would make a couple of comments. One in terms of repeating what we said at the outset in terms of comments from the Governor and others in terms of adequacy of capital in the system and you have to see it as a totality and offsetting of buffers etc. You are right, these things are going to transition in and within that to one of the earlier questions from Claire I think, in terms that has got a Pillar 2A number in that, I would certainly be hopeful of bringing down. So you will get explicit offsets and you will get things that we are going to be able to look at how we manage and how we reduce. So 13 per cent remains our number.

Answer: António Horta-Osório
And Jon just one comment which might be helpful for you. We are quite confident that at system level the counter cyclical buffer will be counteracted by several parts in other buffers as the Bank of England has already stated. So I am not saying it will be totally countered, but imagine that you have a 1 per cent introduction of a counter cyclical buffer, I am quite sure that part of that will be countered by other things in other buffers that will be decreased, just to give you some more colour on what George just said. And that has been told to us by the regulators. So you should expect it.

Further question
So to be completely clear, you are fairly confident based on what you see that you can run at 12 per cent plus one year's worth of future dividends for the foreseeable future?

Answer: António Horta-Osório
Yes and I repeat to you that we are a low risk bank based in a AAA rated country and that when you look at our peers we have the highest capital ratio so you should also ask them that question I guess because they have a much bigger difference to 13 per cent.

Question 14: Joe Dickerson, Jefferies
Hi it is Joe Dickerson from Jefferies, I just have a couple of quick questions. I suppose rephrasing David's question on the average interest earning assets, one of the welcome developments in the fourth quarter if you look at the average interest earning assets ex-run-off is that they grew at an annualised rate of about 2 per cent. So I suppose asking David's question another way, would you expect that in 2016 average interest earning assets should mirror underlying loan growth, in other words they should be about the same?

And then secondly, we have talked about rising interest rates but we actually field a lot of investor questions on negative interest rates and I was wondering how likely would you see that in the UK and if you see that as a prospect, what type of measures would the bank take to counteract such trends?

Answer: George Culmer
To answer the first question, I mean there are sort of two questions in there. One is the tracking of loans and advances and two the overall sort of direction. I would expect them to track more closely to the overall loans and advances, there was divergence as we moved through 2015 in particular for a of couple of reasons. One was things like the sale of the Irish which was a heavily impaired book which gives the difference and, two, in terms of sale of assets that we were moving out of commercial into insurance which still sit as loans and advances but actually now go through OOI. There will still be those types of assets that will be small, there will still be some going back to some earlier questions, there will be some run-off disposals, i.e. more heavily impaired, but they will be of a much smaller scale. So I would expect the two to track more closely. And then in terms of the trend, I am afraid you will get the same answer there which is there are bits that I have got some certainty around run-off trajectory, consumer finance trajectory etc. But around the Retail it will depend a lot upon what our response is to what the market actually does.

Answer: António Horta-Osório
In relation to your point about negative interest rates, we don’t see negative interest rates. We told you what we see as interest rates in our forecasts. The Governor says very recently he did not see negative interest rates either and there is still room where interest rates are. Of course we would do exactly the same as we have been doing. If interest rates are lower for longer than we think, we will act more on costs. We will manage margin more tightly so we will counteract with management actions what will be a more negative external environment. But that is the only thing I can tell you.

Thank you very much, we are now after 11 o’clock. Thank you very much for coming. Good morning.

End of Q&A