LLOYDS BANKING GROUP PLC – Q1 2015 INTERIM MANAGEMENT STATEMENT PRESENTATION

FRIDAY 1 MAY 2015

António Horta-Osório, Group Chief Executive

Good morning everyone, and thank you for joining us for our first quarter results presentation for 2015.

I am joined here today by George who will shortly present the financial results in detail, and at the end we have some time for questions. Turning to slide 1, for the ones of you following the website presentation.

2015 is a milestone year for Lloyds Banking Group, in which we celebrate the 250th anniversary of Lloyds Bank and the 200th anniversary of Scottish Widows. We have made a strong start to the year with an underlying profit in the first quarter of £2.2 billion, an increase of 21 per cent compared to the first quarter of 2014, and we now have an underlying return on required equity of 16 per cent.

Similarly, our Balance Sheet continues to strengthen. Our common equity tier 1 ratio has increased by around 60 basis points in the quarter to 13.4 per cent.

And we have made a strong start to the next phase of our strategic journey. In October of last year we outlined our three strategic priorities of: "creating the best customer experience"; "becoming simpler and more efficient"; and "delivering sustainable growth".

We are already making good progress against these priorities. On creating the best customer experience, we continue to invest in customer propositions, including new digital initiatives, through our multi-channel and multi-brand strategy. We continue to make good progress on becoming simpler and more efficient. Our cost:income ratio for the first quarter was less than 48 per cent and we remain on track to deliver a reduction against the full year 2014 position of around 50 per cent including the bank levy. Delivering sustainable growth is a key element in supporting customers and the UK economy. We have lent an additional net £6.3 billion to our key customer segments, including £1.1 billion to SMEs over the last 12 months, an area where we continue to outperform the market.

We agreed the sale of our remaining stake in TSB to Sabadell in the first quarter, and as part of this agreement we sold approximately ten per cent of our stake in March. The full disposal of TSB will enable us to meet our commitment to the European Commission ahead of the mandated deadline.

Our strong performance has also enabled the UK government to continue to reduce its holding in the business, further enabling our return to full private ownership. Following its announcement in December to undertake a measured and orderly sell down of shares over the first half of 2015, the UK government has reduced its holding to 20.95 per cent, representing less than half its original stake.

Whilst uncertainties continue to exist, particularly around the political and regulatory environment, we firmly believe the Group is extremely well positioned for the future.

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

The increase in underlying profit to £2.2 billion was driven by income growth of 3 per cent, including net interest income which was up 7 per cent, driven by an expansion in the net interest margin to 2.65 per cent. And impairments fell sharply, by 59 per cent, reflecting the successful de-risking of our balance sheet, and the benefit of the continued low interest rate environment.

And on a statutory basis we delivered a pre-tax profit of £1.2 billion in the quarter, despite recognising the costs associated with the sale of TSB. Excluding this sale, which was an EU mandated action, our statutory profit was up 37 per cent year on year.

As I've already said, our common equity tier one ratio strengthened by around 60 basis points to 13.4 per cent. This was primarily driven by underlying profitability, and was after recognising a negative impact of approximately 20 basis points from the deconsolidation of TSB. Similarly, our leverage ratio has strengthened further and now stands at 5.0 per cent. Turning to lending growth,

Lending to our key customer segments grew by 2 per cent year-on-year, and we are making good progress on the lending commitments we set out in our Helping Britain Prosper Plan.

In mortgages, we provided gross new mortgage lending of £8 billion in the first quarter, and we continue to expect our mortgage book to grow in line with the market for 2015. We continue to support first-time buyers, and are the largest lender to this segment, lending more than £2 billion in the first three months of the year, and providing one in four of all mortgages.

In SMEs, we continue to outperform the market with net lending up around 4 per cent, against a market that has contracted by 2 per cent. Similarly in Mid Markets our 2 per cent growth compares with a market that is also down by 2 per cent. Through our commitment to the Commercial sector, we have supported over 23,000 business start-ups and remain the largest participant in the Funding for Lending Scheme.

Our Consumer Finance business also continues to grow strongly, with UK lending increasing by 17 per cent. This has been driven by our Asset Finance business where we have seen growth of around 37 per cent year-on-year, reflecting the strength of the UK market and the successful partnership we launched with Jaguar Land Rover last year. In addition, our credit cards business, which has recently returned to growth, increased by 4 per cent year-on-year, up from 2 per cent in 2014.

I would now like to hand over to George, who will run through the results in more detail.

George Culmer, Chief Financial Officer

Thank you António and good morning everyone. I am going to talk briefly about some of the key highlights of the results. Starting with net interest income on slide 4.

As you've heard, net interest income was up 7 per cent to £3.0 billion, largely driven by an improved margin of 2.65 per cent, some 33 basis points higher than the first quarter of 2014, and 18 basis points higher than Q4 last year. This improvement is largely due to continued benefits of reduced funding and liability costs, as well as the disposal of lower margin run-off assets, partly offset by lower asset pricing.

In addition, and as shown on the slide, the last quarter of 2014 was impacted by the simplification of our savings product range which reduced the margin by 5 basis points. While in comparison with Q1 2014, the margin improvement reflects the benefit of the ECN exchange that we undertook last year.

Looking forward, given the performance over the first three months, we now expect the NIM for the full year to exceed our original guidance of around 2.55 per cent, with the expected pressures on asset pricing continuing to be offset by improvements in the liability spread and mix, and reduced funding costs.

On other income, the 6 per cent year-on-year reduction to £1.6 billion primarily reflects the disposal last year of SWIP and lower Retail fees and commissions. Compared with Q4 2014, other income was up 5 per cent, led by Retail, following a weak last three months of 2014, and Commercial Banking. Looking forward, we continue to expect other income to be broadly stable for the full year 2015.

Looking at costs and impairments on slide 5. Q1 costs were flat year-on-year at £2.3 billion, after additional investment in the business, which was more than offset by savings.

In terms of cost to income, our market-leading ratio now stands at 47.7 per cent, ahead of both Q1 and Q4 2014, although as you know the Q4 costs always include the bank levy, which was £254 million last year, and will be greater this year.

On impairments, the 59 per cent reduction in the year-on-year charge and AQR of 15 basis points reflects our effective risk management, the continued benefit of current economic conditions, and the significant reduction in the size of the run-off portfolio.

The quality of the Group's loan portfolio continues to improve. Impaired loans now stand at 2.8 per cent of total advances, down from 5.7 per cent at quarter one last year, largely driven by the reductions in the run-off portfolio, and down from 2.9 per cent at year end.

We have at the same time continued to strengthen our coverage ratio, which now stands at 57.1 per cent, up from 51.1 at the same time last year, and from 56.4 at December.

Given the lower impairment charge in Q1 and future expectations, we now expect the full year AQR to be around 25 basis points, compared to our previous guidance of around 30.

On the balance sheet, on slide 6, we show our usual reconciliation from underlying to statutory profit. The net charge of £111 million for asset sales and other volatile items compares to a net positive of £120 million in the first quarter of last year, which included £105 million from the sale of SWIP, together with a £200 million positive movement in ECNs.

On TSB, with the sale to Sabadell, this is the last time that TSB will feature in our earnings. And in Q1 we have dual running costs of £85 million, as well as a net charge of £660 million from the disposal of the business. This charge reflects the net costs of the Transitional Service Agreement, the contribution that we will provide to TSB in migrating to an alternative IT platform, and the gain on sale.

Finally, with simplification redundancy costs of £26 million and other statutory items of £82 million, this gives us statutory profit before tax of £1.2 billion and profit after tax of around £940 million, with an effective tax rate of 22 per cent.

On the Balance Sheet, again, as you've heard from Antonio, our strong balance sheet and key ratios continue to improve. RWAs have reduced by around 2 per cent in the quarter to £234 billion, primarily driven by the deconsolidation of TSB, while our fully-loaded CET1 ratio increased by around 60 basis points to 13.4 per cent, with the improvement primarily driven by underlying profit, which more than offset the 22 basis point negative impact from TSB.

On total capital, our ratio improved to 22.6 per cent, positioning us well compared to our peers, and for later in the year, when we expect to receive greater clarity on MREL requirements. And our leverage ratio, as you have heard, also remains strong, now standing at 5.0 per cent.

Finally in terms of net assets, our TNAV per share increased from 54.9 to 55.8 pence, driven mostly by our strong underlying earnings generation.

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

António Horta-Osório, Group Chief Executive

Thank you George. So to summarise, the successful delivery of our strategy is enabling us to drive a significant improvement in our financial performance, while delivering sustainable growth in targeted areas.

We expect the Group to continue to perform strongly. In 2015, we now expect our net interest margin to exceed our original guidance of around 2.55 per cent, and other income to remain broadly stable. Given the strong trend we saw in the first quarter, and our future expectations, we now expect our low risk business model to be reflected in a full year AQR of around 25 basis points; an improvement from our previous guidance of around 30 basis points. And we continue to expect the cost to income ratio to be lower than last year.

While we recognise that we still have a lot more to do, we believe that the Group's differentiated business model is aligned to the evolving political, regulatory, economic and competitive environment.

We are therefore confident in the Group's prospects, and are well positioned for further progress this year. It therefore remains our intention to pay an interim and final dividend in 2015, and we will provide a further update on our payout plans later in the year.

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

Thank you, this concludes today's presentation. We are now available to take any questions you may have.

Question and Answer Session

Question 1: Chris Manners, Morgan Stanley

Good morning António, good morning George. Two questions if I may. So the first one is on returns. Obviously you have printed 16 per cent return on required equity in the first quarter. I know you are targeting by the end of 2017, 13.5 to 15 per cent return on required equity. Just trying to work out, is the 16 per cent as good as it gets or is there a rationale here you might up your return on required equity target by the end of 2017, because that looks like you are on a good track there?

And the second question was really on net interest margin. I think obviously upping the guidance there, you have confirmed to a number of people who expect interest margins to see a bit more pressure from asset margin compression. Just maybe if you could give us a sense of how the drivers should be playing out over the second half of the year and next year? Should we be expecting more liability repricing to actually continue to see a bit of an upward drift ex-TSB? Thanks.

Answer: George Culmer

Hi Chris. So to pick up on those. On the returns, I am not going to comment whether that is as good as it gets, there is a very good AQR, 15 basis points, which is well inside our long-term guidance, but obviously we've improved that for the year. Looking forward though, I would expect the NIM to stay robust. We can talk about that and the details for that in a few moments. And you know what our actions are on costs and I think the results of Q1 demonstrate that we are well on track to delivering those. So I am not going to comment in terms of what the ceilings might be, but I am confident in terms of being able to deliver strong, sustainable earnings with those attractive RoEs as we move forward. And managing the various factors, they will move around, but I would expect to be able to generate those strong type of returns.

In terms of the NIM, yes, as you say, we have improved our guidance for the full year and we have come in pretty strong in terms of 265bps versus the 247bps. As you can see there are a number of factors for that. There was the one-off which was disclosed on the slide in terms of savings consolidation that I talked about. Again in the quarter itself, we have about 6 basis points that have come from liability pricing. We have had about 5 basis points, I think we call it wholesale funding and other on the slide. I think actually about half of that is wholesale funding and a couple of basis points is other. There is always an 'other'. And going the other way is a couple of basis points of asset spread.

Going forward, what I would be able to say is I would continue to be confident in terms of managing liabilities and maximising our competitive advantage in terms of things like multi-brand. And optimising across those liabilities. So in Q1 we have seen continuation of lower rates across things like instant access, variable ISAs etc. None of them dramatic, but instant access has dropped from I think an average cost of about 61 basis points down to 57, variable ISAs gone from 98bps to 89bps etc. Fixed has gone from 265bps to 261bps. So you don't see dramatic changes, but what you see is shaving off funding costs and we have seen in Q1, we saw it last year, going forward I would expect to be able to maximise that mix of liabilities. As I say maximising that competitive advantage of that multibrand offering.

Separate from that is wholesale funding. As I said that is down and I would also continue to expect that to be down with a lot of crisis funding that will roll off. We have got the action we are taking on the ECN that you will see come through. So I would continue to expect to see an underpin from wholesale funding. Going the other way, the asset pricing headwinds will continue down a couple of basis points, we saw that last year and that will continue to move forward. But I would expect the first two to more than offset that.

And then obviously last but not least, there is the change in structure of the Group and I again I think we called out about 4 or so basis points from disposals and run-off. When you look at those average interest earning assets, we are down about 5 per cent year on year and a couple of per cent from Q4. But within that those run-off assets that hardly generate any NIM, they are down to about £17 billion of average interest earning assets which is down over 50 per cent on Q1 last year and down 27 per cent actually on Q4. And that changing shape of the Group and the reduction in those very sort of thin NIM dilutive assets will also be a feature.

So look, a long answer. We remain robust in outlook and that is a combination of how we manage the Bank and things like roll-off of terms of some of that crisis funding and the change in structure of the Group.

Further question
Perfect, so it sounds like the tail winds outweigh the head winds for the moment still then?

Answer: George Culmer
That is correct. That is a better summary, I should have said that shouldn't I.

Chris Manners
Thanks guys. Cheers.

Question 2: Rohith Chandra-Rajan, Barclays
Hi good morning, I have a couple as well please. One follow-up actually just on that very helpful NIM comment and then just also on capital. The one on interest margins, just to clarify wholesale funding benefit that you saw in the quarter. I mean just in terms of maturity profile, is that particularly lumpy during the course of the year or is this the sort of progression you would expect to continue in coming quarters? So that was the first question.

And then the second one was just on capital really. And Antonio you mentioned discussions around the dividend later in the year. Obviously the core tier 1 progression was very strong. So if you are able to quantify at all the potential impact of risk weighted asset inflation? And also just the timeline for discussions with the Regulator around the dividend? Thank you.

Answer: George Culmer
So I will do the NIM bit. I am not going to give a very precise answer I'm afraid Rohith. Look a couple of basis points, I would expect there to be a continuing benefit. I am not going to quantify, there are actions as such around the ECNs etc. that will come in and will add a significant benefit to that as we move through the year. I mean also from a general position as well. It is interesting when you look at some of the costs of our back book funding and the roll-off and the opportunities that we have got you know with the back book for senior funding, is probably still about 140bps above LIBOR. So we have got opportunities there as we finance that. And the sub-debt is probably about 230bps actually above senior. So we have opportunities to refinance that. So I am not going to give you a precise amount, but I would expect wholesale funding to be a continuing significant feature in terms of the NIM story at Q2, 3 and 4.

Further answer: António Horta-Osório
Rohith just to add a point on this, I mean as George was saying to Chris, this is what really we have said repeatedly over the last few years that we were developing a competitive advantage in the way we believe we manage margin. We manage the margin as you know very tightly between the asset margin and the deposit margin, as the difference of the two which we really believe it is the correct way of looking at it especially when you have reasonably the same amount on both sides of the balance sheet, number one. And second, we do it on a weekly basis, across all retail products. And thirdly, we do it at the highest level of the Bank. When you consider those three points that we have discussed in the past, together with a multibrand strategy and the holistic approach to funding in all areas of the Bank, including the

Corporate Bank, Consumer Finance, and all areas, this reflects in a competitive advantage which I think has reflected the difference to what peers have been saying. And we believe that this will continue for the rest of the year, that is why we are upgrading slightly our guidance versus what we said. On the other hand we don't want to look complacence, we are only in Quarter 1. And therefore we don't want to upgrade guidance in the start of the year unless it is really necessary and in this case it is necessary because of the numbers you just saw.

Further question

So just on that guidance actually. If you take TSB out and annualise the Q1, you would get about 261bps for the full year and to use Chris's strap line, head wind greater than the tail wind, and it sounds like you are guiding something above that sort of 260-261bps level on your current expectations?

Answer: António Horta-Osório

I mean as George said. It is clear that we started the year better than we thought. So we thought it should increase, because we are always very transparent with you, we should upgrade our guidance because we started better. But as I just said, it is only Quarter 1, so we have three quarters to go. So we have to see how the rest of the year unfolds. But our expectation as we have been discussing I think over the last few quarters is that the continuing margin pressure on the asset side, we will be able to continue to offset it through better margin on the liability side and lower wholesale funding costs basically.

On your capital question, just some comment and then George may give you the timeline and other points. I mean we have as well on capital, a good start to the year. We are now significantly above all of the banks in the UK both in terms of core tier 1 and leverage ratio. And this is obviously going to be an important point on our Board discussions going forward. And we will make a view and give guidelines more precisely in the remaining part of the year about what we will do going forward. You know that our policy is to distribute at least 50 per cent of our sustainable earnings. So obviously the more sustainable and the bigger the earnings, the more we will distribute.

Further answer: George Culmer

Timelines, I am not sure there is much to say here really. As I say our intention is to pay an interim and final and we will give more details I think in terms of the go forward when we come to that interim stage. In terms of what Antonio said, in terms of the capital generations, obviously if I had to talk to a 60 or 80 basis points underlying, you know we are very pleased by that. We are not changing our guidance, but 1.5 to 2 which we have got out there, we are not making any special call-outs for 2015. I would expect the strong sustainable earnings to continue. There are some uncertainties. We will do the ECN exchange which will impact capital generation just because of the nature of that transaction. Conduct remains uncertain as well. So we are not changing guidance, but we are very pleased with what we have achieved in Q1

Further question

Thank you. And any sort of early indications of what RWA inflation impacts might be?

Answer: George Culmer

Sorry I forgot about that one. Look, you know as well as others, there is still consultation going on. We have a couple of standards out there that we have got to work through. Standardised credit risks and capital floors etc.

Further answer: António Horta-Osório

Obviously our business model is not predicated on the areas that will be affected by RWA expansion.

Further question

And on the mortgage side specifically, any comments there?

Further answer: António Horta-Osório

My opinion on that Rohith is that what will come out of the Basel agreement will likely be where assets are subject to good modelling. They are going to insist on model harmonisation, not on floors so you may have floors as a back stop, but the main point will be model harmonisation. And I think it is clear that both at European level and UK level they really believe mortgages are one of the best assets to model. I think that view will prevail. And in any case just to give you the full picture. We had a floor of 15 per cent portfolio which is a harsh view. It will impact our capital ratio by about 60 basis points to give you an idea.

Rohith
Thanks, that's very helpful.

<u>Question 3: Chintan Joshi, Nomura</u>
Hi good morning. Can I have two as well please. The first one is continuing on the NIM line. I want to think about where the pressures might be, where people have been talking the SVR book. Can you give some sense of what the attrition rate was in the Halifax book in Q1 and also on the Bank of Scotland SVR book? And also how big is the 2.5 per cent capped book because that is where margins probably are still improving and some visibility on attrition rate there as well?

And then the second one, shall I take one at a time please?

George Culmer
No give the second one as well.

Chintan Joshi, Nomura
On PPI, I think you are indicating, if I read your update in the Annual Report, contacted, settled and provided for approximately 45 per cent of policies sold since 2000. What is the go to ratio for that 45 per cent? Clearly I don't want to think it is 100 per cent otherwise gosh that would be hard, I don't know how to think about it. So if you could give some colour on that ratio of where it should land, that would be helpful?

Answer: George Culmer
Alright Chintan. Going back to the first question on SVR and attrition rates and competition and all those sorts of things. To be very precise about it, the SVR book in totality, at the end of Q1, stood at about £163 billion. And within that the Halifax Book was £56 billion, that is the 3.99 per cent book, we have the Lloyds book about 2.60 per cent, that stood at £43 billion. BOS book about 3.96 per cent, so at £12 billion and Birmingham Midshires which pays about 2.94 per cent, that is £37 billion. And then I think you have another of about £15 billion if my maths is correct which gets you back to the sort of total. On the Halifax book, that £56 billion compares to the year end that was about £57 billion and this time last year was about £59 billion. So you are looking at attrition of 5,6,7 per cent in that. Quite interesting, the Lloyds book, that £43 billion, that was £44 billion at Q4 and about £48 billion at Q1 this time last year. And actually on the Birmingham Midshires using the same time frames £37,38,39 billion. So I think we have seen attrition of around about the 5,6,7 per cent and that has kind of been across all books irrespective of price. And we have sort of seen a continuation of that as we have moved into the first quarter. So that is what we are seeing and that is what we would expect to see as we continue to move forward throughout 2015. So that has been our experience and that remains our experience.

On the PPI, look there isn't a go to rate. We have disclosed that number in terms of those we have contacted, paid out on etc., since 2000. You are absolutely right, it is not going to go to 100 per cent. The best evidence I can give you of that. When we do these past book reviews and one does proactive mailings and these are very explicit proactive mailings, you have got to mail people up to three times if you have a PPI policy, the response rate is about 30 per cent, just under that. So even though where you have clear evidence you have had a policy, as you say you have about a 30 per cent response rate. So it is not going to go to 100 per cent. I can't tell you whether it is 48, 50 or whatever. What I can tell you on PPI as we have disclosed, obviously we made no provision at Q1. What we are seeing on the three elements, you have got the past book review and remediation and the reactives. On the past book review and remediation we have previously said we expect to be complete basically first half of this year and that very much remains the case. So we would complete those. Because we are going through those, the monthly spend has gone up. I think we have spent about £800 million in this quarter, the norm would be about £600 million, but what that reflects, that is good news because that represents us clearing cases and getting through that remediation. So hopefully we will be through that in the first half. Reactives again as we say in the RNS, I think we are about 11 per cent down Q1 on Q1, slightly up on Q4 but part of that is seasonality. It does still remain uncertain and risks do still remain. I should point that out and we did disclose at Q4 that were reactives to remain flat, there would be approximately £700 million charge at the half year of that order. That risk still remains. So at the moment we have got about £1.7 billion I think left unutilised on the balance sheet. And as I said we are taking no action at Q1, making good progress on the first two elements, but there is still risk attached with regard to the reactives, although obviously once you are through the first two and just into reactives, it moves down to a different scale of issue so a different scale of financial outlay, but that risk does still remain.

Further question
Thank you for that, a quick follow-up on the first one. If I think about your new lending, can you give some sense of what makes that, what does a two year or five year make? I just want to get a sense of which way the market has moved in recent quarters in terms of what is the most popular product? Two years always has been, but has there been a little shift away from it?

Answer: George Culmer
I don't have the stats to hand Chintan, we will come back to you on that.

Chintan Joshi, Nomura
Sure, thanks for the very clear answer, it was great, thanks.

Question 4: Raul Sinha, JP Morgan
Morning Antonio, morning George. I have got two as well please. The first one is on costs. And obviously on slide 5 you give us some very good disclosure. Now revenues up 3 and costs flat is a great performance but if I look at the details on the slide, if you did not have that other increase in the quarter then clearly you would have done even better. And your simplification benefits are clearly offsetting pay inflation as well as investment. So my question is, how should we expect the rate of investment spend to progress during the remainder of 2015 and should we start to expect costs to be down materially going forward from what we are seeing in Q1? So that is the first one.

The second question is on other income which was a touch weaker than expected for us. So if you could give us some detail on your confidence of achieving a broadly stable run-rate which you talked about for the rest of the year, that would be great? Thanks.

Answer: António Horta-Osório
On your first question. You know that we consider the cost to income as one of our strategic competitive advantages together with the cost of risk in terms of low risk bank. And having the lowest cost to income which we believe is critical in a very competitive environment in the retail markets going forward, we believe is the only way to ensure good service and value for money for our customers together with superior returns for our investors. So in those terms, we manage the two as you know together very tightly. We have guided at the end of the year for you to expect the cost to income story to shift from a cost story to an income story in terms of jaws, when you should expect costs slightly up throughout the year with income rising more than the costs and therefore our target cost to income ratio by the end of 2017 being 45 per cent and jaws positive every year, which means the cost to income should decrease every year. That is exactly what happened in this first quarter. As we said at the time, should income which is obviously not totally within our control, prove more difficult, we would act on costs as we did in the past. So you can expect and you can see the 3 per cent jaws in that context. I would guide you for the rest of the year as per the year end, that we continue to expect costs to be slightly up, we continue to expect revenues to outpace those costs and the cost to income to trend downwards from the 50 per cent cost to income as of last year and the 50 per cent is completely comparable to the 48 per cent we presented now. You know there is the Bank levy at the end of the year, but we do continue to expect to have positive jaws and have the decreasing cost to income. So increasing our competitive advantage by the end of the year. You should expect it to continue to be now going forward a revenue story. So I would continue to point you to costs slightly up for the year, revenues above costs. I repeat it is more difficult in revenues, we will obviously act on the costs which we believe we completely control.

Answer: George Culmer
And on other income, it still remains a pretty tough market, a pretty tough environment for reasons that you are aware of. Within that going through the divisions, I think I called out in the presentation Commercial Banking was up on Q4 which was pleasing and we have seen volumes come back. And we have seen some asset value gains therein. So we would continue to be confident in terms of Commercial Banking pulling ahead in terms of 2015 versus 2014. Similarly Consumer Finance, particularly with the growth and some of the asset growth you have heard from António and the growth in things like Lex Autolease, I would be confident in terms of Consumer Finance pulling forward as well.

Insurance is tough and will remain tough although some of the new initiatives that we talked about at the end of the full year, things like new bulk annuities and improved business mix and pensions, new business, corporate pensions new business, should offset some of the economics, but it is going to be a pretty tough environment. And probably still most tough in Retail and I think in the presentation Retail was up Q1 on Q4, but that was more about Q4 than Q1 and Retail was down Q1 on Q1. And again the reason it is up relatively well now, we have the regulatory pressures on certain product types, you have got things like increased ATM charges and all that flowing through into lower new business charges. So I think it is going to be quite a tough year for Retail, but taking the performance of the divisions in the round, that is still where we would still stick with hopefully coming out as stable for the year 2015 on 2014.

Raul Sinha, JP Morgan
That is really helpful guys.

<u>Question 5: Arturo de Frias, Santander</u>
Hi good morning. One question on Capital, on the very robust improvement in core equity ratio during the quarter, I was looking at the bridge you have on page 7 of the presentation and I am confused with the numbers. You say that most of the improvement is driven by the underlying profit, the 90 basis points improvement driven by the underlying profit. But if I take these 90 basis points and I multiply by the £234 billion of risk-weighted assets that would give me an improvement of around £2.1 billion which is basically the underlying profit, but not taking into account or apparently not taking into account the impact of taxes and the impact of one-offs. So first part of the question, where is the impact of taxes and one-offs in this reach?

And the second part of the question, if as it seems here most of the improvement is driven by underlying profit and we should expect probably the underlying profit to be similar if not better in future quarters, can we expect similar improvements in the core equity tier 1 in coming quarters? Thank you.

Answer: George Culmer
Hi Arturo, I commend you on your maths and you are correct, the underlying profit is as it says, we actually show the underlying profit. So that is pre-tax, the one adjustment we do make is we do actually strip out Insurance because their profits only count to the extent if that dividend is up. So we take out underlying profit and we take out Insurance, but we do actually add back insurance threshold in the sense of actual grow of other capital. The insurance allowance increases. So we separate it. It is the underlying profit. There are effectively no taxes because of our deferred tax position. Our profits essentially flow into our capital position on a tax free basis and we would certainly call out, we have many regs, we have got many other items below the line. So if I exclude TSB which we show separately I think we just put the other ones into other as it says. As I say with material we would separately disclose, but your maths is absolutely correct, the underlying profit is what it says and that comes off of the underlying profit number as adjusted for insurance.

Further question
You are absolutely right, I forgot the DTA impact. So to the second part of the question, if we see for the next three quarters another £2.1, 2.2 billion really on underlying profit, should we expect for the next three quarters another 90 bps uplift to the current core tier 1 profit? Because that could suggest a very substantial original improvement to the expected core tier 1 for the rest of the year?

Answer: George Culmer
You are absolutely right Arturo, were we to generate another £2 billion £2.1 billion, whatever the number is yes. That would flow through with those 90 basis points and it would not attract tax etc. What I would say though is referring back to one of the earlier questions, there are still uncertainties out there. They are around things like conduct. There will be an impact when we do the ECN exchange. So there are some uncertainties, so you may see some other lines populated to that chart as we move from left to right, but you are absolutely right in terms of the first block; each quarter should look a bit like it looks at the moment if we continue with our plans.

Arturo
Okay, thanks very much.

<u>Question 6: Jonathan Pierce, Exane</u>

Morning, I have got a couple of questions. One is back on the margin. Thank you for all of the extra numbers you have given us this morning, it is very helpful in understanding the moving parts. I just wanted to clarify something I think you mentioned earlier which is the fixed rate deposit cost. I think you said that was still 261 basis points, is that correct across the whole stock? And if it is, how big is that deposit book please?

Answer: George Culmer

The deposit book, within the retail side of things we have got fixed ISAs which is about £34 billion and then basically we've got our fixed which is £33 billion and the cost of those, one is about 2.6 per cent and the other is about 2.4 per cent and they were about 2.65, 2.56 per cent in Q4 so that is the sort of amount and the sort of cost of those books and you can see just a few basis points coming off quarter on quarter.

Further question

And you are obviously not writing anywhere near 2.6 per cent on new business?

António Horta-Osório

That's private information.

Further question

And on a similar line of questioning, you have given us the senior debt cost which across the book I think you said was 140 basis points above LIBOR and we can obviously compare that to where costs are today. On the covered bonds and securitisation, can you give us an idea what the stock is paying there so we can get a sense of potential for improvement moving forwards as well?

Answer: George Culmer

I don't have that number so let's see if we can get that number out as well. Let me have a think of that Jonathan, I don't have that to hand.

Further question

Okay, thanks a lot for that. On capital, the second question. As other people have alluded to and we can see in the numbers, the capital build is really very substantial now and you are appreciably ahead of your own target and while even people like us would think you need to move to an equity tier 1 and total capital just as importantly. Is discussion starting to take place at the Board level around the different forms of payout? I noted António you mentioned payout plans without being specific about dividends. Are you starting to have discussions around buybacks, special dividends? And on that question, how is the PRA thinking about this? Do you get the sense that they are comfortable so long as you are passing stress tests and the ICAP etc. anything over and above those required levels can come back to shareholders and they won't get too involved in that regard?

Answer: António Horta-Osório

Well Jonathan, we really don't want to go into this too much at this stage because as we said at year end we focused on resuming dividends. We said we would resume at a token level and then would move to a sustainable payout of at least 50 per cent of sustainable earnings. We said we would start the Board discussions after what we announced to you in quarter 1 which we did so to your question, yes we did start our discussions at Board level and as George said, we will report to you our positions and guidance with H1 results. We have been discussing both things, so both what we will announce for Interim and year end. And also about excess capital position which we have as you just pointed out. So yes we started those discussions. We will make a criteria at Board level by then and of course we will involve our Regulator as appropriate in the process and after that. So that is what we can say at this stage.

Jonathan Pierce

Okay, thanks very much.

<u>Question 7: Andrew Coombs, Citi</u>

Good morning, just one question on Slide 3. I am interested to know your expectations on how long you expect the drag from wealth and global corporates to continue? And perhaps you could also try and quantify the run-off time frame or the average maturity of the assets, particularly with regards to the £15 billion run-off portfolio and also the £10 billion of assets sitting within the other category as well please?

Answer: António Horta-Osório
Excuse me Andrew, the drag of global corporates and what was the other one?

Andrew Coombs
And wealth as well, you draw out lower balances in wealth as the reason for the decline in unsecured personal and other retail? Thank you.

Answer: António Horta-Osório
We went into global corporates as they had also guided at year end. I do expect global corporates to evolve reasonably in line with our target segments as a whole for the year. So as you know it is volatile, we don't target obviously global corporate's credit because we do whatever they want. If it is credit or capital markets or whatever funding they choose. But my sense is that you should count reasonably in line with the progression for the other books as a whole for the year which I think should be around 2 per cent.

In terms of unsecured personal, we look at it together. So we look at it UPLs plus credit cards and car financing which as you know, which are on the Consumer Finance division. So as I told you, car financing is above our expectations significantly, I had guided you to upper single digit growth this year. We are in upper double digits so I now expect the year to be on the low single digits, significantly above the upper single digits I had guided you at the end of the year. And credit cards was growing 2 per cent. It is now growing 4 per cent and we expect that 4 per cent to continue throughout the year. And when we consider UPL in the mix, we are above what we had said at the end of the year. So I would consider that point for negative as a blip. It is just the way we look at the three products and the way we best serve the different customer needs because as you know they are alternative products for basically the same customer needs. So altogether UPL split, credit cards plus car financing, they are above our expectations, above what we had guided you at the end of the year. On the other hand, as I said, mortgages is slightly down on what I guided you. We thought the market would be around the same level as last year which was 1.8, the market is so far 1.6 and we are at 1.2. Of course again a quarter does not have much significance. We feel very comfortable we will grow in line with the market as we have been doing over the last three years. So by the end of the year we expect the market now to be slightly lower, so around 1.6, the present level and we will grow in line with the market more or less. So this is broadly the balance Andrew of the different factors.

Answer: George Culmer
On the run-off Andrew, I can't give you a fixed term or anything like that. But when you look at the composition of what is left from £15 billion of assets, you know within that you have got things like £1.6 - 1.7 billion of Treasury which will be price dependent and those ones that don't cause us concern, it is all a question of when you would realise those. CRE now down to a couple of billion. And that compares with well over £6 - £7 billion back in 2013 so that is a good position, corporate portfolios, shipping a couple of billion for example. Ireland down to about £4.6, 4.7 billion. We have made good progress on Ireland, that is down from £8-9 billion before. And I have got about a billion and a half in international retail. So we are at the point now Andrew, I can't give you in terms, it is actually in terms of some of those assets, we are not going to sell them you know, I would expect the £15 billion to continue to reduce as I move through the year, but we haven't given a target because some of it is in terms of price dependent. They don't cause me credit issues, it is about realisation and what is a good price.

Answer : António Horta-Osório
And I would add to what George has said, you are right, when you look at the run-off £12.2 billion, it looks obviously the double of the core segments of group, excluding run-off and other. But as George said, I mean this is a bit misleading in terms of trends because at the end of the year given we had only £17 billion in run-off, it was no longer priority as we discussed when we told you at year end results. In the first quarter we only decreased the run-off book by one and a half billion pounds which is 10 per cent basically of the remaining book. So as you go through the year the one and a half obviously will not go to 12 or anything near to that because it is no longer a priority. We have a much smaller book. So as the total Group excluding run-off and other will continue to be around 2 per cent, the run-off as we move through the quarters will be a much smaller number.

Andrew Coombs
That is very helpful. Thank you very much

<u>Question 8: Fahed Kunwar, Redburn</u>
Hi, morning. I just have a couple of questions. Thanks for the information on the SVR book. You are seeing from your peers they are talking quite a lot about pressure on the SVR book whereas you guys aren't really seeing it the same. I was just wondering what is the LTI on that SVR book and the LTV above the kind of 4.5 and 95 per cent? Is the MMR helping you guys keep the back book rate broadly stable and is that why you are not seeing the same level of attrition coming through? That is the first question.

And the second question was just a clarification on your earlier two answers. Your AIEA in the quarter fell by about 2 per cent excluding TSB but I assume a lot of that is run-off. So just to be clear going forward ex the run-off as that gets lower and lower, you would expect that AIEA to be flat this year and then increasing thereafter, is that a fair assessment? Thank you.

Answer: António Horta-Osório
Shall I take the second, George will take the first. As I was saying to Andrew, I think what you have described is a fair picture. Our total Group run-off level will be around 2 per cent so each consecutive levels are slightly higher. And the run-off 1.5 first quarter, so it will be less than the total Group excluding run-off and other. That is correct, that is what you should expect.

Answer: George Culmer
And to put that into maths, the AIEA of £476 billion as you said, take off £22 billion for TSB, there was £23 billion as run-off gives you about £430 billion in terms of your average interest earning assets and at Q1 you had £468 billion, lose £22 billion for TSB, £70 billion for one-off, you are basically flat. You know, so you are right in terms of where the shape of those are going.

In terms of actually attritions and LTVs and LTIs, I don't have the stats to hand so I don't have a number to give you to say whether, it is certainly not MMR as a factor as you would expect because that would be a sort of pan industry factor. So it is not MMR as the factor, but I don't have views to give you to say it is because of LTV or interest only or whatever characteristics. So I can't give you any greater detail on that one I am afraid.

Fahed Kunwar
Okay, thank you.

<u>Question 9: Chris Cant, Autonomous</u>
Good morning all, I have two quick ones if I may. The first on the deposit mix shift benefit in the slide of 6 basis points. George you mentioned the multibrand strategy, I was just wondering if you could give us an indication of roughly how much of that 6 basis points came from the core brands and how much came from repricing of the taxable brand books?

And the second question, the ECN you said would be a capital hit. I just wanted to check I was understanding how you arrive at that because I think there was a £646 million ECN book liability at the end of the year, you say that the charge related to that liability of £65 million in the quarter. So that would be an additional liability of £711 million that you would be cancelling if you took out all of the ECNs. And if you are going to reg par call some of them and presumably if you did reg par call them and the others traded down, I struggle to see how you would end up paying out more than your net liability position really when you take into account that £711 million. So I don't understand how you end up with a capital hit from that? Thank you.

Answer: George Culmer
The main element will be in embedded option that we take through reserves which currently has a value of whether it is £500-600 million of that order and moves around dependent on the price of these instruments versus their equivalents without that embedded option. So we value that option, we take it essentially through with a capital, we have taken it through in the past as a capital benefit and obviously when one cancelled these instruments you lose that capital benefit.

So it is essentially the value of the embedded option within those instruments that gives us the benefit and when I cancel that instruments I will lose that option. So you will lose whatever the number is and it does move around. The variable that you refer to, that is just the differential in terms of the price of ECN I would say versus the pricing of an equivalent instrument without that option in. But that is where you will get the bulk of that hit. The embedded option we carry through capital, the benefit of that will disappear. So that is the main bit.

I don't have the analysis on the tactical brands and differential between tactical and relationship, so I will just repeat to you what we said in terms of the competitive advantage it gives us in terms of being able to move between them and as Antonio said earlier, how the Bank is run in terms of manages as a single entity and looking across the brands. And what we also do actually you know it is not just a question of Retail, but also within Commercial and Corporate as well. And with commercial deposits costing whether it is 50 basis points as well, being able to move between commercial operations, between retail operations and then within the retail operations between brand and managing that as a single unit and looking both on the liability and the asset side, we believe gives us a unique advantage in terms of the franchise that we have got and then how we manage that franchise.

Chris
Okay, thank you.

<u>Question 10: Claire Kane, Royal Bank of Canada</u>
Hi good morning. Can I have a follow-up on NIM please. When I look at the underlying Group ex-TSB and ignoring that Q4 one-off, you had a very stable NIM in the second half of 2014, it went up only 3 basis points. And regarding the positives you have had in Q1, I am struggling to see why we have had such a step change and have gone up 13 basis points in a quarter when we didn't really have much of an impact in the past, and also why we shouldn't then think that this 13 basis points could continue quarter on quarter, given you think the positives will continue to outweigh the negatives? So that is my first point, if you could just give us some context around step change in Q1 relative to the second half last year?

And then my second question is on the ECNs, you mention in the notes you have the Court date around 18th May, is there any risk do you think to your ability to call back those bonds at par? And if not, when do you expect to do that and when would we see the benefits in the numbers? And is it still your expectation to just reg par call the ones that didn't take the exchange offer and when would you address the remaining bonds? Thank you.

Answer: George Culmer
Okay Claire, hi. You know the ECN reg par call, we go to Court, week commencing 18th of May, we are fully confident in our position in terms of what the purpose of these bonds are for, that there has been a capital disqualification event and therefore our ability to do the reg par call, we intend to proceed with that. And yes you are right, at the moment our intent is to evoke that on those prioritised bonds we touched before. We will await and see what we do on the others. And so that is a matter for our discussion and decision and that lies ahead. But at the moment in terms of those that we prioritise before it is our intent to evoke the reg par call and we believe that will happen and that will be some time after that May meeting. And the benefits of that will flow through into our numbers.

In terms of Q1 versus H2, I don't have a perfect answer for you in terms of why one has moved and the other hasn't. I can think about change, for example, in net interest margin in terms of the average interest earning asset and we did some big disposals at the back end of last year, particularly in things like Ireland. So the sort of 4 basis points, you talk about 13, but actually 4 of that came from the thing we talked about earlier so that was back-ended. So that may be a benefit. Part of the answer may lie in average interest earning assets which we can go back and have a look at. I think that would be part of the answer. And let's see if we can get a better one for you, and more complete and get back to you.

Claire
Alright, thank you.

End of Q&A