LLOYDS BANKING GROUP PLC – Q3 2015 INTERIM MANAGEMENT STATEMENT CONFERENCE CALL

WEDNESDAY 28 OCTOBER 2015

António Horta-Osório, Group Chief Executive

Good morning everyone. Thanks for joining our 2015 third quarter results presentation. I am going to give a short overview and George will then cover the results in more detail.

Turning to slide 1, for those of you following the website presentation. In the first nine months of this year, our differentiated UK focused business model has continued to deliver, with the Group making strong strategic progress in becoming the best bank for our customers and shareholders, while also delivering a resilient financial performance.

Starting with the macro-economic environment, we are encouraged by the robust recovery in the UK economy, the sustainability of which has been reflected in low unemployment levels, increased house prices, increased consumer spending and reduced household debt.

As a UK-focused bank, our business prospects are closely aligned with the strength of and outlook for the UK economy, which we continue to support through our Helping Britain Prosper Plan.

We have continued to deliver against this plan in the first nine months of the year. For UK consumers, we remain the largest lender to first time buyers, having provided approximately 1 in 4 mortgages, or £7.7 billion of gross lending to 55,000 customers.

Similarly, we continue to support UK businesses, given their important role in the health of the UK economy. In the first nine months we have supported 1 in 5 new business start-ups, while also increasing net lending across our SME and mid-market clients by over £1.5 billion year-on-year.

Since the end of 2010, we have increased our SME lending by nearly £6 billion or 24 per cent while the market has shrunk by 16 per cent.

As you know, we have focused on developing two key competitive advantages: our cost discipline and a low risk business model. Our cost-income ratio has been the lowest of the UK major banks for some time and our low risk model is being recognised by the market, with our CDS spread now one of the lowest across the banking industry worldwide.

In the year to date, we have continued to make strong progress in both these measures by becoming simpler and more efficient while effectively managing the risks to which the Group is exposed. This has resulted in a significant additional reduction in impairment charges and a further improvement in our market-leading cost:income ratio.

Our underlying profits are up 6 per cent, with our underlying return on required equity up 1.7 percentage points to 15.7 per cent. We have also delivered a significant increase in statutory profit, despite additional PPI charges in the third quarter. At the same time, we have strengthened our already strong balance sheet position, with our CET1 ratio now standing at 13.7 per cent.

Underlying profit was, however, lower in the third quarter than the equivalent period last year. This reflected lower than expected other income in the quarter, partly offset by improvements in costs and impairments, both of which were lower than we had previously guided for. We expect OOI to recover in the fourth quarter and George will elaborate on this point further.

Although the regulatory environment continues to evolve, we are now getting greater clarity on a number of issues that are significant for the Group and the wider banking sector.

Specifically, we note the recent regulatory announcement on ring-fencing and the UK competitive environment. We believe we are well-positioned to continue to support the aims of these regulatory bodies in ensuring the stability of the UK financial system, and that small business customers, as well as retail customers, benefit from effective competition.

Our strong financial performance and strategic delivery have enabled the UK Government to make further substantial progress in returning the Group to full private ownership at a profit for the UK taxpayer.

The Government has now reduced its holding to less than 11 per cent, and returned approximately £15.5 billion, on top of the dividends paid so far in 2015, to the taxpayer. We welcome this progress and will fully support the proposed retail offer from the UK government.

The combination of the UK economic recovery, with our differentiated, UK-focused business model gives me strong confidence in the Group’s ability to generate strong and sustainable returns and, through this, become the best bank for customers and shareholders.

I will now like to pass the call over to George, who will run through the financials in more detail.

George Culmer, Chief Financial Officer

Thanks António and good morning everyone.

Total income for the nine months was £13.2 billion, with a 4 per cent increase in net interest income, driven by an expansion in the net interest margin, offset by lower other income.

Impairments fell sharply, by 64 per cent, while costs were down 1 per cent, with the cost to income ratio improved to 48 per cent.

As you have heard, underlying profit increased by 6 per cent to £6.4 billion, with the underlying return on required equity of 15.7 per cent.

Statutory profit before tax increased by 33 per cent to £2.2 billion, after TSB disposal costs and conduct charges, including a further PPI charge of £500 million in Q3. Statutory return on required equity rose from 3.9 to 4.4 per cent.

On the balance sheet, our core tier one ratio has strengthened to 13.7 per cent since the start of the year, or by around 1.1 percentage points pre-dividend, and the leverage ratio, at 5 per cent, remains strong, and significantly ahead of our peers and regulatory requirements.

Looking at the underlying business in more detail.

Within net interest income, the margin was 2.64 per cent in Q3 and year to date NIM is now 2.63 per cent, which is some 24 basis points higher than in the first nine months of 2014.

This improvement is once again largely due to the continued benefits of reduced funding and deposit costs, which more than offset lower asset pricing.

For the full year, we now expect NIM to be in line with our year to date performance of 2.63.

On other income, Q3 was a disappointing quarter with the expected reduction in Insurance, primarily relating to the bulk annuity deal in Q2, accompanied by tougher trading conditions in Commercial and lower income from run off assets. Looking forward, we expect other income to recover in Q4, however, we now expect full year performance to come in slightly below last year.

On costs, operating costs were down by 1 per cent year-on-year at £6.1 billion, with our cost:income ratio further improved to 48 per cent and this is after an increase in the level of investment and simplification costs of £319 million.

We continue to focus on becoming simpler and more efficient through our Simplification programme, and we have now achieved run rate savings of £291 million, up from £225 million at the half year, and are on track to deliver our targeted £1 billion of savings by the end of 2017.

Looking ahead, in Q4 our costs will as previously, include the bank levy, which was £254 million last year, and which will be greater this year. However, we continue to expect the full year cost to income ratio to be lower than prior year.

Finally, the impairment charge was £336 million, 64 per cent lower than 2014, driven by a significant reduction in run-off business and improvements in all banking divisions resulting in an AQR for the nine months of 11 basis points.

The quality of the loan portfolio continues to improve. Impaired loans now stand at 2.1 per cent of total advances, down from 2.9 per cent at the end of last year, and from 2.7 per cent at the half year, driven largely by the recent sale of the Irish commercial loan portfolios.

Given the strong year to date performance and the quality of the loan portfolio, we now expect the AQR to be below 15 basis points for the full year.

Looking at the movement from underlying to statutory profit, the net charge of £955 million for asset sales includes a mark to market charge from ECNs of £369 million and a negative insurance volatility of £316 million. This compares with a net charge of £1.3 billion in 2014, which included a £1.1 billion loss on the ECN exchange.

On PPI, we've increased the provision by a further £500 million in Q3 of which £125 million relates to remediation and £375 million to reactive complaints. Reactive volumes were broadly flat on the level seen in the first half and higher than estimated, but the provision increase is slightly lower than the sensitivity run rate disclosed at the half year, due to lower redress rates.

On time barring and Plevin, we've obviously noted the recent announcements from the FCA, as well as the Government's review into the regulation of claims management companies, and await further clarity on what these might mean for the sector, once the outcome of the associated consultation processes are known.

Finally, our tax charge for the first nine months was £536 million, representing an effective rate of 25 per cent, slightly higher than the UK corporation tax rate, primarily due to the impact of things such as policyholder tax.

Turning then to the balance sheet and starting with lending growth. Over the last 12 months, lending excluding run-off has grown by 1 per cent, and by 2 per cent on a year to date annualised basis. Within mortgages, as you know, the market remains competitive and our 1 per cent growth compares with the market growth of around 1.5 per cent and reflects the focus on margin.

In the year to date, we have still however provided gross new mortgage lending of £27 billion, up from £16 billion at H1, and we continue to be the number one provider of mortgages to first time buyers, providing one in four.

In Consumer Finance we have delivered UK loan growth of 17 per cent, driven by new business growth of 34 per cent in motor finance lending, which has again benefited from our partnership with Jaguar Land Rover, and we've also delivered 5 per cent growth in credit card balances.

And within Mid Markets, we have maintained our lending in a declining market, while within SME, we have continued our strong performance, outstripping the market once again, with year on year growth of 5 per cent.

Elsewhere, on the balance sheet. On risk-weighted assets, the Group continues to make good progress in de-risking, with RWAs now standing at £225 billion, down 6 per cent, or £15 billion since the start of the year, and by £2.5 billion since the 30th June.

Average interest earning assets in Q3 are £439 billion, down 4 per cent, or £20 billion from Q3. The £4 billion reduction in the last quarter was primarily driven by run off and lower Global Corporate balances, where we do not set lending growth targets.

On capital, the business continues to be well capitalised and strongly capital generative. Total capital is a strong 22.2 per cent and CET1 is 13.7 per cent, up from 12.8 per cent at the start of the year which represents capital growth of around 1.1 percentage points, pre-dividend.

In Q3, CET1 increased 40 basis points driven by the strong underlying profitability, partly offset by conduct charges, and a number of other market related movements, including changes in the available for sale reserve.

Finally, our TNAV per share increased from 53.5 pence at the half year to 55.0 pence. This increase of 1.5 pence was again driven by the strong underlying earnings but also benefited from changes in the underlying value of the Group's DB pension schemes, partly offset by conduct charges.

So, in summary, the Group's differentiated UK-focused business model has continued to deliver in the first nine months of 2015.

We have continued to support our customers and deliver sustainable growth, by increasing net lending in our targeted areas and delivering on our commitments within the Helping Britain Prosper Plan.

We have also delivered a resilient financial performance, with a significant improvement in statutory profit and a further strengthening of our leading common equity tier 1 and leverage ratios.

We have been able to improve our guidance for NIM and the AQR, while updating our guidance for other income and re-confirming our remaining guidance.

Looking ahead, the combination of the Group's differentiated simple and low risk business model, and the robust outlook for the UK economy, positions us well for the evolving competitive and regulatory environment and we are confident in generating strong and sustainable returns.

That concludes today's presentation and we are now available to take questions.

End of presentation

Question and Answer Session

Question 1: Chintan Joshi, Nomura
Hi good morning. I have two questions for you today. The first one was on new mortgage business front book rates. If I look at the kind of business that you are doing on the front book, one in four share in first time buyers and you have got a strong brand in buy to let markets through BM and LTV bands that you compete in well. My guess would be that your front book business is at a meaningfully high level in the industry which according to the Bank of England was about 2.57 per cent. I just wanted to get a sense whether I am right on that and get some sense of where your front book business has been written at this year?

And the second question was a quick one on packaged accounts. I see you've taken a £100 million provision there. Can you elaborate on the trends you are seeing there? Should we expect this kind of run rate for the next few halves until we see a peak in this issue? Thank you.

Answer: George Culmer
Hi, it is George here. If I deal with the second one first. We took £100 million basically other conduct but that did not relate to packaged accounts, it related to things that have actually, you might have seen in the past, with regards to things like review of investment products, sales that were undertaken in a case by case review where actually the scope of those products we are looking at has got large. We have nothing in there for packaged accounts. We took a provision of about £175 million at Q2 on packaged accounts, we have made no increase and actually we have seen most recently a drop off in complaint levels with regards to packaged accounts coming through. So that's what we are doing. As you know packaged accounts, we have a good overturn rate, we have very good experience where we are down to single digit percentages, but nothing on packaged accounts.

Within the front book, I can give you potentially, the market remains competitive and you will see that in your rates and you will see that in our growth stats and as we talk deliberately around focusing on the margin, over the volume. We continue to see some of those asset headwind pressures in our NIM performance. So whilst the NIM was only sort of very marginally up in terms of year to date, in Q3 I think we saw about a couple of basis point asset headwinds which were offset mostly with a bit of deposit pricing. So you know it remains a competitive market. Some people have been pretty active out there but I can't give you the sort of numbers that you are asking for in terms of comparisons with markets.

Chintan Joshi
Alright, thank you.

Question 2: Michael Helsby, Bank of America, Merrill Lynch
Morning everyone, morning George and Antonio. I have got a couple of questions, both around margin actually. First George you just alluded to a little bit then, but I know the margin is only down a bit quarter on quarter but it does feel like there is a, the delta has changed. So can you talk a little bit more about the moving parts? Has asset spread headwind got sequentially worse or is it the liability tailwind just got a bit smaller?

I think I sense you are a bit more positive on the outlook for NIM if rates stay lower for longer. So can you comment on that as well?

And secondly, George at the Q1 Trading Statement, you gave us some really helpful colour on the SVR books, the absolute levels, how they have moved, the yield, also on the fixed rate deposit book side and yield and that was good because we can then look at future margin repricing that we might see. I wonder if you could give us an update on that as at Q3? Thank you.

Answer: George Culmer
Hi Michael. Well to deal with the first one. Yeah, as implied, when you look at Q2 on to Q3, you go from whatever it is to 265 to 264. And you are dealing with fine movements. So there is a couple of basis points in terms of asset spread headwinds and a couple of basis points in terms of offset that from basically continued liability pricing that goes the other way. So you are talking about fine movements.

Yes we do still remain robust in terms of where the NIM goes from here and when we look out and see how we are able to manage those asset headwinds, which will persist, we can do a bit more on liability pricing, there will be more benefit coming through and wholesale funding that will come through in benefits as well, also the structural bit in terms of run-off that benefits NIM as well. So those are the aspects. But what we do also say is, I can manage the book and I can optimise those deposits etc. You know eventually if base rates stay flat forever, I can't define gravity and you would see those impacts come through, but as we look forward we remain pretty robust on the NIM as we look out.

Further answer: António Horta-Osório
Just to add a few points to what George is saying Michael before George moves on to SVR, I mean as George just said, we are more confident on NIM now than we were three months ago and that is why we have again updated our guidance positively. As you know we do believe we have a competitive advantage in the way we manage NIM and given that we manage together the assets minus liabilities which is the right thing to do in the Retail bank, given we have to fund whatever loans we give with deposits. Second, we do this on a weekly basis and thirdly, we do it at the top level of the organisation on a multi brand approach we have different brands to address different customer preferences and we do this holistically on a top down approach. So as we have moved into the third quarter, we think this has continued to perform a little bit better than we thought. The wholesale front costs if you noticed, our credit default swap moved to the top of the table in terms of the lowest credit default swaps of the banking industry. So our wholesale funding costs as we renew our maturing bonds will continue to improve. We have, as George said, margin on deposits to continue to accommodate the prices on mortgages which wanted to move slightly down and where we are not an outlier in the market so we move in line with the market. But we have given the multi brand strategy and specifically on the Halifax brands we still have room to continue to accommodate the evolution of the prices on the asset side.

And then in terms of mix as you know which is very important and we have been public about this on Quarter 2 already, we prefer on the market which is the mortgage market which is only growing 1.5 per cent, we prefer to grow slightly behind below the market, we are growing at around 1per cent, but to preserve margin which we think is exactly the right thing to do in a low growth market environment and which is competitive. And on the other hand in terms of mix, we are significantly outperforming on the Consumer Finance unit, where we have guided last year for growth this year of high single digits, and we guided at Q2 for low double digits. And now, as you see, we continue to be high double digits, which is now what we think will happen by the end of the year. And the Consumer Finance division which is growing significantly as I just described, has significantly higher margins. So in terms of the mix of the business as well, that has been favourable.

So as a summary, we will hold margin at current levels for longer than we thought three months ago, and that is why we have updated our guidance.

Further answer: George Culmer
And I will just come back to SVRs. In terms of things like, I'm backing up what Antonio has just said, in terms of things like funding costs etc, yes so we have seen, as I have said, a continued reduction in the costs of deposits and fixed savings, so as an example to give you those numbers, things like instant access is about 0.54 per cent was the cost at Q3, compared with 0.56 per cent at Q2, variable is at 0.64 per cent compared with 0.78 per cent, fixed ISA 2.15 per cent compared to 2.31 per cent, fixed 2.21 per cent compared to 2.30 per cent. So it is a more of the same in terms of just being able to take that price out which provides that underpin to the NIM. And on the other side in terms of those sort of asset type headwinds, in terms of SVR what we have seen is the Halifax book, it was about £53.6 billion at Q2. At Q3 it is about £53.5 billion so actually we haven't seen much in quarter movement within that. If you had gone year on year it is about down 9 per cent which is the same stat as it was for Q2. So you have seen sort of pretty negligible movement there. The other balances which obviously have lower rates than the 3.99 per cent, the Lloyds, again you have not seen tonnes of movement so the Lloyds is £40.4 billion, that was £41.9 billion at Q2, BOS was £11.3 billion, that was £11.8 billion. Birmingham Midshires £36.5 billion, that was £36.6 billion, and the rest £13.9 billion plays £14.4 billion. So again you are seeing you know, no new dramatic trends within those because, as I say, when we look at those factors it gives us the confidence that Antonio was just talking about.

Michael Helsby
Thank you, thanks for that, very helpful.

Question 3: Chris Manners, Morgan Stanley
Good morning Antonio, good morning George. I had a couple of questions for you on the capital return. The first one was, given we have got potentially adding a systemic risk buffer, the pillar 2A into the stress test baseline, would that have any impact on the capital stack you see, the 12 plus one year's dividend and the ability to repay and are we still confident about that level? At 13.7 it looks like there could be a really decent payout coming pretty soon.

And the other one was on the revision to the standardised approach, mortgage risk weight floors. As I understand it, there is a chance that may not be implemented in the UK, but obviously could have a material impact on business. If you could maybe run us through your thoughts on that, that would be really helpful to clarify? Thank you.

Answer: George Culmer
Well first up, our capital expectations remain unchanged. So the 13 per cent, the 12 plus 1 sort of thing is where we see our capital requirements. Yes, as you point out, there are forever a number of moving parts and whether it is the systemic buffer or changes to standardised risk weights etc. Some things we think will happen. So we think changes in Op risk will come through and so that will be 2018 time. As you say, things like standardised I think is receding and imposition of floors I think is back to the drawing board, as regards to that. Also noted there is recent stuff that has come out around stress tests etc. So I fully expect to have to deal with a continuing flow of people tinkering with the capital regime, be it requirements, be it base calculation, be it composition of buffers, that isn't going to stop. As we look out, our numbers stay as we have previously disclosed and what does matter which again I think we can say, we continue to be able to generate capital. So we are as we are, there is a weather eye out to stuff out there, but there will forever be people tinkering with stuff.

Answer: António Horta-Osório
And Chris just to add onto what George has said, I mean my feeling from contacts with the UK Regulators is that they are quite happy with the level that the UK industry reach in terms of capital and any changes like the ones you have mentioned would be more moving parts within the industry, but keeping the overall level reasonably constant. And we absolutely understand that there is no need in their view to have floors in terms of mortgage or RWAs, we are very comfortable about that.

Chris Manners
Fantastic, thank you. That is reassuring.

Question 4: Jonathan Pierce, Exane BNP Paribas
Morning, I have two quick questions for you. The first one is on the margin again. Can you give us an idea of the benefits in the margin in Q3 is as you did in Q1, of the rundown of the runoff portfolio? I think in Q1 it shrank by £6 billion and there was a 4 basis point benefit to the margin of that. So if it was a £3 billion run down in Q3, was there a 2 basis point benefit to margin in Q3 from that?

Answer: George Culmer
I don't have the number here. I mean there is a logic to what you say, but I don't have the number here. What I can tell you is that when I look year-on-year there is about a 10 basis point swing that comes from that movement. So in that 24 basis point 9 month on 9 month, there is about a 10 basis point structural benefit. So I am giving you a number for a different time period.

Further question
Okay, that's helpful. Thank you. The second one is just slightly more detailed question around what is happening to this AFS portfolio. I was surprised to see there was a hit in Q3 of about £352 million. I mean I thought the AFS portfolio for you guys was largely UK Government bonds and with the swap rate down in Q3 and I think the price of a benchmark bond up, I was just wondering why there was such a big AFS hit in Q3? I mean is the mix of that book still as it was? Is this hit coming from a corporate debt portfolio that has been building in that AFS portfolio?

Answer: António Horta-Osório
We have no corporate debt portfolio.

Answer: George Culmer
No, there are a couple of things in there. You have got our equity holdings. So we have taken a hit from Aberdeen and Sabadell. So that has come through that. So that won't be in your calculation. The other bit, I mean, it is around the asset swap spreads. So basically we swap the Gilts back. So the differential between the Government bond and the swap rate movement is what has come through to hurt us.

Jonathan Pierce
Thank you, that's helpful

Question 5: Claire Kane, RBC
Hi good morning. Can I have one follow-up on the capital comments you made and then a question on the OOI please. You mentioned I think operational RWAs to come in 2018. I just thought previously you mentioned that actually might get that inflation hit in the fourth quarter. So maybe you could just clarify and if you could give any guidance in terms of the quantum of that increase?

And then on OOI, could you just give us a bit more detail about the sequential decline and if you think we have reached a floor, and really where you see the recovery come in and what the timing effects were in Q3 please? Thank you.

Answer: George Culmer
To your first bit, no I did not expect the op risk to be a Q4 impact. As I said, I think it is 2018 I think it is when that comes into play. I can't, I won't give you a precise number. I mean it is not overly material. But it is about 2018. So it's not a short term, that is an out there type thing that we have to deal with and will deal with.

On OOI, there is a lot of attention on OOI and as I said in my presentation, we have been disappointed by the performance in Q3. Now some of that was in closing comments, expected in a sense that as I said in Q2 we had a big benefit from the bulk annuity deal in insurance which obviously wasn't repeated in Q3. Some of that again, as I said in the presentation, things like market trading conditions in Commercial were slightly worse than we expected. And also there were things like run-off where we had run-off businesses which essentially were a bit volatile. To give you an example, in Q3 of last year the run-off business contributed something like over £100 million, it was about £113 million. And this is where we are sort of exiting positions and taking gains on that. That was as little as £13 million in Q3. So that had an impact on us as well.

As we've clearly said, we do expect to come back from this and as both Antonio and I said, we expect OOI to recover in Q4 and to put in a stronger show. What drives that? A number of things. Within the Commercial business, I expect Commercial to recover. I expect to see stronger trading within Commercial in Q4 and I'm already seeing that in October. Insurance, I would expect to see a strong position in Q4, it tends to be a strong performance from a seasonality perspective from insurance in Q4 that will come through. And within some of that run-off business, I mean run-off was as I say was £100 million in Q3 2014, it was about £30 million or so in Q2 and I would expect it to get back closer to that sort of level in Q4 of this year. So those are the trends that I would expect to see for the short term and I would expect to see it would recover.

As I look further out, you know, what we have been speaking to people, I would repeat what we have said in those themes across the Group. Things will stay tough in Retail, that is everything that you know about in terms of the regulatory environment, impacts on productivity, product sales etc. expect to remain tough. I do expect Commercial to keep moving forward and we will see that as we move through into 2016. I would expect Consumer Finance to move forward, it won't be at the same rate as balance sheet growth because you have got things like margin compression that will come through that from things like interchange fees. And I would hope for progression in insurance, although there will be an element of volatility in that because you have got things like the bulk annuity deals that will come through. So I do think Q3 is a low. I do expect it to recover in Q4 and I have talked about some of the main themes that I think will take us forward as we move into, as I say, 2016.

Claire Kane
That is very helpful. Thank you.

<u>Question 6: David Lock, Deutsche Bank</u>
Morning everyone. A couple of questions. First one is on the NIM again. You have given the 2.63 per cent guidance, but I note that obviously average interest earning assets have been moving around quite a lot this year. So I just wondered if you could give us any colour on how you expect average interest earning assets to develop going forwards given they fell Q on Q?

And the second question is really on the impairments. I note the guidance for the full year that does imply a bit of a pick-up in the fourth quarter. Is there anything that we should read into from that, or is that just you being conservative around your guidance for this year? Thank you.

Answer: George Culmer
Hi David, there is nothing I would point to, in terms of Q4 of a specific event. We have seen a good performance and actually as we look out one of the, potentially, if rates do stay low, you know we get more bullish on credit as we look further out in that regard. So there is nothing I would particularly point to, or there is nothing I would point rather in terms of Q4.

Average interest earning assets, I won't give you a particular number. Yes you are right, they are down in Q3. Now some of that was around the run-off book and I do expect that to have a reducing impact as we move forward, and then within the other assets, its predominantly global corporates which tends to be the most volatile. I think excluding that we were pretty stable in terms of other parts of the business; retail and Consumer Finance. Actually Consumer Finance was growing and stability in Retail. So if I strip out the run-off which as I said will have a diminishing impact just because of scale. I would expect a much more stable picture in terms of average interest earning assets.

David Lock
Thank you.

<u>Question 7: Raul Sinha, JP Morgan</u>
Morning Antonio, morning George. I have got a couple please. The first one is can you talk about a tax charge by the end of the year for the tax changes as well as the non deductibility of PPI and conduct? And would you be able to give us some sort of ballpark number for that for the next quarter?

Answer: George Culmer
What I can say is you are right. We talk about the 25 per cent, there is an accounting issue as to when you actually reflect the changes in the Budget etc. So what will happen in Q4 is you will essentially have a catch-up adjustment in terms of the tax that we have provided on PPI in Q3 basically being undone in Q4 which I know sounds all a bit bizarre, but that is just the way the accounting works. And that would add about £100 million I think to the tax charge in Q4 based on what we have seen in Q3. So it is a bit, sort of, screwy accounting, but that is the way we have to do it in terms of how far the tax legislation has been enacted. So I have provided for some in Q3 that I essentially will undo in Q4 and it is about £100 million is the impact.

Further question
Okay, and then the second one George, while I have still got you, is this PPI slide on slide 11. You do say your reactive complaints was flat in the quarter, but if you look at the detail of that, September was down materially and then October, even though you say it is an estimate as of 26 October, so pretty much flat on September. Any reason, firstly what is driving that? And secondly, do you expect a spike in that because of the time bar?

Answer: George Culmer
Two good questions, I wish I had two good answers! Look you know it remains volatile and yes having gone through the first part of the third quarter, with things being if not slightly up in terms of the first half, I mean it was good to see them drop off and see that sustained through in September and October. I cannot and will not predict what I think might happen in terms of reactions to consultation etc that is out there. It would be foolish for me to do so, you know. Beyond that as we go forward I would expect December to be lower for seasonal reasons, but we are showing you what we are currently seeing. And so you are as informed as we are. What happens in the coming weeks we wait to see, but we certainly, slightly broadening it out a bit, welcome things like the time barring etc. We are waiting for the Consultation Papers. We think that within that two years is excessive etc. It's not in the interests of customers who would act earlier with a shorter time scale, nor one where you need to actually communicate with people. But we wanted to show that trend, but I have been here too often to try to tell you with any great precision what will happen going forward.

Further question
Thanks very much. And just to finish off, maybe from Antonio. I didn't see a reiteration of the dividend policy. Obviously given the Q3 Statement, can I just ask Antonio if you might confirm that at the full year stage, if you have a core tier 1 which is greater than your minimum which is 12 plus one year's dividend applied to 2015 dividend, that you would still be looking to return excess capital on top of that?

Answer: António Horta-Osório
We are not going to comment further than we did at Q2. We absolutely reaffirmed the exact guidance we gave on dividends as approved by the Board in July, so we absolutely have exactly the same comments and guidance and we are not adding anything at this stage, okay.

Raul Sinha
Okay, thanks very much.

<u>Question 8: Chris Cant, Autonomous</u>
Good morning George and Antonio. A couple from me if I may. On the NIM, if I could just come back to this point which I think was raised in an earlier question on interest earning assets. If I look at your year over year trend, quarter over quarter trend in the loan book and whether I look at that in a sort of Group aggregate view or strip out TSB. Loan growth was positive on those measures and your interest earning assets trend has continued to come down and it looks like there is an increasing divergence there in the growth rate. So I was just wondering firstly if you could explain what is going on there? And secondly, when should we expect to see the loan growth we are seeing in the core businesses actually convert into higher interest earning assets? I know what you said, you expect it to be stable going forwards, but given that your loan book is growing, surely we should be expecting interest earning assets to start ticking up at some point?

And then on SVR, thank you for the very quick run through of the statistics on a couple of the books, I think one you did miss out was the Bank of Scotland book, which from memory at Q1 was £12 billion. There was an interesting data point recently from TSB on their mortgage enhancement book which is obviously drawn from the Bank of Scotland loan book and about 50 per cent of that book is SVR and in the quarter that shrunk by 8 per cent which was quite an acceleration on the previous quarterly trend which was about 5 per cent a quarter. And I am guessing potentially some of that was due to SVR refinancing. So I am just wondering whether you are seeing any similar uptick in refinancing within some of the other SVR books you did not mention particularly Bank of Scotland? Thank you.

Answer: António Horta-Osório
I will take the first question on AIEAs and George will take the second on SVR. So just to try to have some colour to what George has previously described on the AIEAs. And I think the best way to tell you is the way I have been telling you every quarter is to give you colour on each of the segments so you can make up your own models. So we do expect at this point that in the Consumer Finance Division as I said in one of the previous questions, we have growth which is significantly above what we expected, so last year we guided, so at the end of the year we guided for high single digits which we have reviewed to low double digits in H1 and I'm now telling you it is in Quarter 3 and will be at the end of the year high single digits. That is increasing at a much higher rate than we thought because the market continues very strong and we have had as you know, all the impacts of having this exclusive agreement with Jaguar Land Rover, where basically all new business becomes net business because there is no outflows redemption in the first 3-4 years. So with tight underwriting criteria and prudent risk standards we are increasing 37 per cent our car finance segment and we are increasing our cards business by 5 per cent. Last year we had for the first time increased the book by 4 per cent in line with the market we are now at 5 per cent. And this should continue, both of them should continue over the next few quarters which is the line of sight that we normally have. And the two combined are high double digits and you should assume that will continue.

When you go to mortgages as we have said already at H1, the market is growing less than we thought, around 1.5 per cent and we thought it would be higher at this stage of the cycle and we are growing around 1per cent so less than the market, because as I also said previously in the context of the NIM, we think it is absolutely the right thing to do in a low growth environment which is competitive, we should preserve NIM and if the price for that is to grow slightly below the market, we think that is exactly the right trade-off, like in consumer finance the right trade-off is to increase market share while the NIM in consumer finance is coming down. So I think you should expect our mortgage portfolio going forward to evolve slightly below the market as it has happened in the last two quarters.

When we go to SMEs, we have been fairly stable, I would say growing around 5 per cent a year when the market has been negative these last four years. It's still negative by around 1per cent and we continue to grow at 5 per cent and I think that is likely to continue for the next few quarters as well.

On the mid markets segment where it is almost as large as SMEs, we are around zero in a market which is shrinking 2 per cent and I think we will increase this going forwards slightly. So the two combined, if you remember what we said last year at the Strategic Review, we have a target of increasing £2 billion per year in each of the next three years and I think we are well on the way of achieving those £2 billion per year over the next three years, so £6 billion as a whole over the next three years.

And relating to large corporates where we don't have lending targets, this is more volatile, but I would expect if you see the slide we have the growth for each segment, you can see already that our loan portfolio is 1 per cent higher year on year. But the year to date annualised is 2 per cent and the reason why this happened is basically large corporates are positive in the year to date and we do expect as I have said previously, last quarter, that large corporates should reasonably evolve with the rest of the portfolio. Of course they are more lumpy because we don't target, obviously, loan growth in large corporates, but I would expect them over the next three years to have an average growth with the rest of the book.

So what is bringing the AEIAs down as we have also mentioned in the past and George alluded to? We have the run-off which is going down but now it is going down at a progressively slower rate and you can extrapolate how it could go down going forward. It is not a priority any more given that it is now around £10 billion, it is incredibly small. And we have the closed book of self certified mortgages and the Dutch mortgages which also runs down as time goes by, it elapses with time and which we give you the value separately in the same slide. So that is probably the best clarity we can give you in terms of how these different moving parts will evolve going forward to complement what George had previously told you. I think that versus our previous guidance, we are increasing slightly less in mortgages and we are growing significantly more on the Consumer Finance division, the rest is more or less in line with what we thought and targeted in the Strategic Plan. Sorry for the long answer.

Chris Cant
Thanks for the very comprehensive overview of your loan aspirations I guess. Just coming back to the quarter on quarter point though, your loans to customers were up overall and this was ex-repos at £2.6 billion. Your interest earning assets were down £4.2 billion. And that is still quite a big divergence which I don't really see how you get to a £6 billion gap from some run-off in your specialist book and it is not obvious to me how you reconcile the trend in interest earning assets with the trend in loans. So I still don't really understand why, if George your answer to an earlier question was, you expect interest earning assets to stabilise. Overall Antonio your answer suggests that we should expect loans to continue to go up. Should we continue to see this divergence going forward? Is interest earning assets flat from here, but the loan book grows overall or should that interest earning trajectory turn round going into 4Q and first half of next year? The importance here is obviously, we can all model your NIM, but if we don't know what the interest earning assets are going to do, it becomes quite difficult to implement your guidance in terms of what we plug into our models for NII?

Answer: George Culmer
Thanks for that Chris. I won't add anything to the go forward, but I will make the observation around when you look at the composition to make sure you are allowing for impairments obviously. Because the loans and advances are always net of impairments, where average interest earnings assets are gross. And particularly in the last quarter where you have had something like the Irish disposal which obviously are heavily impaired, does not do anything for my loans and advances, but that's quite a big impact on my average interest earning assets. So let's see if we can do a better reconciliation, but certainly that would be a big feature in terms of the divergence trends we have seen in the last quarter. But let's see if we can be more helpful.

Further question
The Irish comes through in the fourth quarter?

Answer: George Culmer
Q3. That was when the deal happened, Q3. So you would see a big reduction. And then Bank of Scotland, apologies for missing that out, balance is about £11.3 billion and it was £11.8 billion at Q2 and down about 12 per cent so a slight pickup and there is to your general point. We are seeing a pickup in refinancing, so that is a general observation. And obviously whenever we give you the numbers, you have got maturities into as well as exits out of. So we are seeing a general pick up. But 11.3 was the number that's for Bank of Scotland 3 book.

Chris Cant
Thank you very much.

<u>Question 9: Chirantan Barua, Bernstein</u>
Morning guys. You have been mentioning bulk annuities. I just want to understand how do you book it? Do you book it all up front and is most of it reinsured which is why you see the volatility? And also I want to understand, are you sitting on, do you have sight for some of the deals coming through in Q4 which gives you the confidence going into Q4? That is one on the insurance side.

And Antonio just one thing on risk appetite, I mean we are getting into a macro revisions negatively around the world and the macro picture is not as good and your corporate book shows it. So doesn't it give you, what gives you the confidence to grow the SME and Consumer Finance book at quite breakneck speed given where the mortgage book is, a sharp divergence? So just want to understand how do you modify that risk appetite going into next year if the macro is actually weaker?

Answer: George Culmer
On the bulk annuities, the inherent volatility will come round to transactions. So these are, well actually I was about to say there is no backbook but I will modify that with one aspect in a moment. But essentially the volatility will come from, these are deal

driven and that will sort of determine the flow. In terms of the accounting for it, essentially it is within the Insurance business, so you get benefits of present value accounting. So you will reflect a large part of the value that will come up front. The one caveat to that is what you do also recognise though, as they come over onto your books, and as you transition the assets from that which you perceive to your target asset mix, you will get increments as essentially you move through. So if I take a bit of business, it comes over and I will put it into a certain type of asset. If I then transition that over into more my model pick up that I want, you will basically reflect that pick up in value as you move through the period. So I do a deal, I get a benefit day one from doing that deal, but then subsequent to that if you think I will change the asset mix and I will reflect the benefit of that asset mix as and when that happens. So you will get an initial new business profit and then some follow-ups that will come through. So that is how it looks.

And in Q4, yes we are active, I mean we have done the first deal we did, which was the internal deal with the Scottish Widows with profits fund, but we are active in the external market and there is an element of confidence in terms of winning and there is also an element of confidence in how I actually deal with the deal I have already got on the table in terms of how I know I am going to transition assets relating to that in Q4, if that makes sense to you.

Further question
Are these deals in the size of like the millions that we are talking, or are you talking of £1.5 to £2 billion growth every year?

Answer: George Culmer
I won't go into the specifics, but you know the with profit deal was a special deal, that was the size of about £2.5 billion of liabilities. I mean at the moment the ones in the market are of a significantly smaller scale than that. You are into the £500 million type size to that order.

Chirantan Barua
Got it, that was very helpful. Thank you.

Answer : António Horta-Osório
On your comments on the economy and loan growth, what I would tell you on that is the following. In spite of the slightly weaker number on the quarter GDP yesterday, we see the UK economy very robust as I said in my comments. And we see it growing at around 2.5 per cent both this year and next year. I think one of the best things of the UK economy as the growth has unfolded is that you started with additional consumer spending which was possible together with additional consumer savings, given the funding for lending scheme and the liquidity measures implemented by the Bank of England. This has enabled a very important thing which I don't see in other western economies, which is that the UK is growing robustly as the consumer confidence leads to consumer spending and to business confidence and business investment. This has happened with lower household debts. So household debts as a percentage of GDP has gone down sustainably by almost 10 percentage points over the last three years, which is a big credit to the UK economy recovery because we are growing more, with less debt on households, where we should in corporates, where we were already quite low as a country. And now the public debt is now also starting to fall. So the economic recovery is taking place with less debt overall and specifically on the household sector which needed to do that. So we are quite positive on the economy. We also think that the house price recovery to the pre 2007 levels is positive in terms of the banking sector given that the market is growing very little and therefore the house price increases translates growingly in lower LTVs of the stock which makes our capital position more and more robust and our commercial opportunities with customers to increase. So macro economically speaking, I don't think we should take this quarter with any special concern. The economy is growing robustly and we expect it to continue to do so and this is what we see across the board, both on the retail sector and on SMEs and Mid Markets in all of our geographic regions.

When you ask me about the specific growth on SMEs and Consumer Finance, as I have said before on Consumer Finance, the market is growing around 12 per cent. We are not managing at all the risk curve and we keep our very prudent underwriting standards. The only reason we are increasing 37 per cent which I agree with you looks very high, but on a like for like basis is 12 per cent. The additional growth comes from the fact that we have an exclusive agreement with Jaguar Land Rover, one of the biggest car makers of the country. And this means on a retail language if you want, that we have an additional product to sell and we have many more shops because some of the shops were exclusive to Jaguar Land Rover. So we are selling more across the board if you want again on a retail language, but this on a proforma basis is the same growth as the market. We monitor very tightly residual value risk. We keep the underwriting standards and we are not at all going up on the risk curve. And as you can see on the margin of the consumer finance book, which is going down as I told you, part of the reason why it is going down is because of the Jaguar Land Rover, given the high quality of the book, we have lower margins.

On SMEs where we are growing 5 per cent year on year versus the market, which is going down 1 per cent, we are doing this now for 5 years so 24 per cent up since the end of 2010 which is £6 billion net versus a market that shrank by 16 per cent, we absolutely monitor very well the risk of the new cohorts versus the existing stock. And you can see the series over time; our RWAs have been going up less than the assets, which shows the quality of the new business which is included. We have strict limits for commercial real estate. We manage this on a customer to customer basis. We are the largest bank in the country, we operate through SME centres very well implemented in the communities with people that know the customers for decades, with credit officers that know the customers as well for decades. We feel very comfortable about the segment given our business model and our implementation. And it is a fact, but that's external to us, that some banks have deliberately decided not to play at all or as much in this segment and we have been taking advantage of that. Nevertheless our market share is only 17 per cent, it has increased from 13 per cent five years ago to 17 per cent. We can continue to grow, we are only the third largest player in the country and we intend to continue to grow it around these levels.

Chirantan Barua
That is very helpful. And just a quick follow-up on risk. Will you be able to give us some idea in terms of your exposure balance sheet to commodities? That is something that has been forefront in terms of risk for investors around the world in banking, just your exposure?

Answer: George Culmer
Well it is a small number, less than a percent, a very small number.

Answer : António Horta-Osório
We can give you that separate, it is very small, George is saying it is less than 1per cent of the book, we can give you that separate, but it is very small and diversified.

Chirantan Barua
Thank you.

Question 10: Andrew Coombs, Citi
Good morning. A couple of follow-ups and then one new question on mortgage pricing please. First follow-up would be on the dividend. I note that there is a footnote on page 13 of your release stating that you have not accrued for a dividend in the core tier 1 capital because the Board has not yet considered the appropriate level of payout for full year 2015. With that in mind, is that just an issue that the Board has not discussed the guidance that you gave at Q2 of paying out anything above a 13 per cent ratio or is it the case that we should take it that that is not guidance you gave at Q2?

The second question would then be on the global corporates book. Can you tell us how much that balance is now in absolute terms and I appreciate your comments that it is quite lumpy, but you seem to infer that you plan to now grow that book on a three year basis in line with the wider loan book? Is it a case of the contraction in that book has now finished and we would expect it to grow again? Perhaps you could just clarify that.

And then the final question would be on mortgage pricing. You obviously put through some quite sizable cuts to a range of your products; I think it was 50 basis points on some of those products in July. But you then reversed a large part of that reduction in August. Perhaps you could just elaborate on the rationale now for that change and what you are seeing in terms of competition now? Thank you.

Answer: George Culmer
On the first question, our dividend position policy remains absolutely the same and as I think Antonio responded to an earlier question. So the disclosure we put in, I mean we are in exactly the same position where we did not accrue anything in the final dividend at the half year. So absolutely nothing has changed, it is simply a reflection of where we are as a Group and how we interact with that particular requirement. Please do not read anything into that.

Answer : António Horta-Osório
The Board has not discussed it further since H1. We had only one Board in September and we have not discussed it, we will discuss it in November and going forward into January and February for the Final Results. So that is absolutely the reason why we are not giving any additional input because there is no additional information since the H1 communication and the information we gave you.

Relating to corporate. I did not say that exactly. You can infer it like that. But what I just told you is we don't target loan growth in large corporates because large corporates can get loans, they can go to the capital markets, securitisations, we don't really target it. We see them as customers, we do whatever they prefer to do. It could be loans or capital markets, it does not make any sense to target loan growth. But I think and I would expect, that is what I was saying, and what happened year to date so far, that given the major restructurings we did in the large corporate book finished last year, that they should evolve reasonably in line with the rest of the other corporate segments going forward. But of course this can be volatile, but I think the best estimate is probably in line with the rest of the portfolio, but it is an estimate it is not a target and it is the best I think estimate you should assume, given we don't target this loan growth.

In terms of the margins, mortgage prices that you mentioned, I am not aware of those specific details. I would not read too much into that. We have several brands, several channels, we do mortgages through all of our brands, including the tactical brands and the strategy that we have overall which is what matters because we manage this Bank top down in that respect, is that we will continue to prioritise market margin versus volumes and therefore in terms of the mortgage market, the market should continue to grow by the end of the year around the same level around 1.5 per cent. We are slightly below and should continue to do so because, I repeat, in a low market growth environment such as the mortgage market and which is competitive, it makes much more sense to preserve margin and which does not occupy capital than to just fight for market share when the market is not growing in any case. And repeating again, we do exactly the opposite in Consumer Finance because the market is growing a lot and we are outperforming the market very significantly. So I think you should expect in mortgages that the numbers will follow the guidance we are giving you.

And I think George has the number for you of large corporates here?

George Culmer
It was about £27.7 billion is the balance at Q3 and I think that is down from over £29 billion I think at Q2, so that is the balance.

António Horta-Osório
But going up in the year.

Andrew Coombs
Okay, thanks very much.

<u>Question 11: Joe Dickerson, Jefferies</u>
Hi good morning guys, thank you for taking my question. Could you please go over just back on trading income? Could you please go over some of the product areas say within, for lack of a better word, fixed income, that were weak in Q3. Was it rates, was it FX? What drove that weak performance on a product level?

And then, what are the sources of the recovery that you see to date in Q4 on a similar basis by product if you would? That would be very helpful to me given the move was quite sharp in that line item.

I have a second question which is a conceptual question. You talk a lot about giving up market share in the mortgage business to preserve your margin. Why is there not a greater focus on say the marginal return of these businesses? Because presumably for you guys the marginal return on equity of a mortgage must be somewhere in the range of 30-45 per cent which is probably 50-100 per cent higher than the marginal return on consumer finance products given the different capital requirements. So I was wondering if a return, a focus on return on tangible equity might be more useful than trying to preserve the net interest margin? Thanks.

Answer: António Horta-Osório
Well George will answer you first on the OOI product evolution and then I will take care of the more conceptual question.

Answer: George Culmer
Hi Joe, yeah look I am not going to go through product by product and the focus of your question is on the Commercial business. As we described earlier in answers, there are a number of reasons for the reduction in the income in Q3, Insurance, run-off etc remains tough. What I will say is yes it was tougher in Commercial and Commercial in Q3 was down on Q2, but whilst we don't normally give divisional information at the Q3 stage, I would say that Commercial's Q3 discrete result was actually ahead of where they were a year or so ago. So you know Commercial was less in Q3 than Q2, but you know we are not an investment bank, we trade on behalf of our customers. So it is sort of a balance sheet relationship led business, that is what we are about there. And you see that in the numbers. That while it fell Q2 to Q3, when I look at Q3 2015 versus Q3 2014, commercial was up. So just to give you some form of context for that.

So, apologies I won't do a product by product trawl, but it is not particularly relevant, it is a relationship, it is a customer, it is a franchise business and you see that robustness in the year on year position.

Answer: António Horta-Osório
On your more conceptual question, it is a very interesting question and I will tell you it depends on how you look at it. First I would suggest that when you look at the marginal return, I think you should include the cost of funding associated. Because as a prudent retail bank we want to keep our loan to deposit ratio, as you know, at around 110 per cent and we are at 109 per cent and therefore for every mortgage we give, we have to fund it. I would suggest that you should include the marginal return including the marginal cost of funding, number one. But secondly and probably more important, you cannot look at the marginal return of a mortgage per se, because you have to understand the whole impact it has on the book in terms of SVR impact, people that stay on SVR, people that move into new products by internal transfers. And therefore there is a whole series of equations that make it much more complicated than the pure marginal return of that specific mortgage. Therefore we think this is absolutely the right thing to do and we think the marginal return on Consumer Finance more than exceeds our cost of equity, but that for the total cost of equity of the Bank on the mortgage side we see it as exactly the right strategy, and for that it is very important to bear in mind the third point which I have said in the past, which is not yet clarified by the regulator, which is the binding restriction. If you are assuming the binding restriction to be the CET1 ratio for mortgages which we believe will change in the near future, as the ring fenced Bank is a fact in the UK, and if the ring fenced Bank, when the ring fenced bank will become a reality you will have the mortgages inside the ring fenced bank and therefore they will have to, they will have the cost of equity determined by their leverage ratio and not by their CET1 ratio. So the binding restriction will become the leverage ratio and we strongly believe, although this has not yet been confirmed by the regulators, but we believe that the leverage ratio of the ring fenced bank will be higher than the Group's already announced leverage ratios. Therefore if the leverage ratio is going to be higher, number one, and secondly, if by definition the leverage ratio immediately increases the cost of equity on mortgages, we do believe that it is absolutely the right thing to do what we are doing, because as you can see, for example, we are at a 5 per cent leverage ratio, that immediately more than doubles the cost of equity for mortgages if you think that is binding restriction.

So those are the type of strategic considerations that we use when we decide the right strategy to follow on the mortgage market and this is why we are doing what we are doing.

Joe Dickerson
Thanks.

End of Q&A