LLOYDS BANKING GROUP PLC – 2016 RESULTS PRESENTATION

WEDNESDAY 22 FEBRUARY 2017

António Horta-Osório, Group Chief Executive

Good morning everyone, and thanks for joining us this morning. I will cover the key highlights for the year, economic trends and progress against our strategic priorities and provide an update on our guidance. George will then cover the financial results in detail, after which we will take your questions.

Starting with the highlights of the year. We made significant additional strategic and financial progress in 2016, which is made possible by our, simple, low risk, UK focused multi-brand business model.

We have delivered strong financial performance, with statutory profit more than doubling to £4.2 billion, driven by stable underlying profit and a substantial reduction in below the line charges, in spite of the lower level of interest rates following the referendum.

Our capital generation is also strong and we have delivered around 190 basis points during the year. Our pro-forma CET1 ratio stands at 13.8 per cent at the end of 2016, to include the retention of around 80 basis points of capital to cover the impact of the MBNA transaction.

We also remain committed to supporting the people, businesses and communities in the UK through our Helping Britain Prosper Plan, and in 2016 we have continued to deliver against our key targets, increasing net lending to SMEs, continuing to be the largest lender to first time buyers, supporting 121,000 start-ups and helping 10,000 clients to start exporting.

We are also a major contributor to UK tax revenues and were ranked as the highest payer of UK tax out of the largest 100 businesses in the most recent PwC Total Tax Contribution Survey, paying £1.8 billion in 2015, which has increased further in 2016 to £2.3 billion.

In December we announced our intention to acquire MBNA's prime UK credit card business. As our first significant acquisition since the crisis, this transaction represents a milestone in the transformation of the Group and is fully in line with our strategy to grow in attractive segments where we are underrepresented.

And, as a result of our progress, the UK government has been able to further reduce its stake in the Group to less than 5 per cent, at a profit, returning over £18.5 billion to the UK taxpayer in the last three years.

Finally, our confidence in the Group's future prospects is reflected in the increased dividends we have announced today and the strong financial targets we have set, which I will cover in detail shortly.

Turning briefly to the financials. The Group delivered good underlying profit of £7.9 billion. Income was marginally down, with stable net interest income and slightly lower other income, but operating jaws were once again positive with our continued focus on cost management delivering a 3 per cent reduction in operating costs. Our market-leading cost:income ratio therefore improved further to 48.7 per cent.

Credit quality remains strong with an asset quality ratio of 15 basis points, and we are seeing no signs of deterioration in the portfolio. As already highlighted, our statutory profit before tax more than doubled to £4.2 billion in the year, with below the line charges reducing significantly, given lower PPI provisions.

And this strong statutory profit has translated into strong capital generation, which has enabled the Group to fund the MBNA transaction, increase the total ordinary dividend by 13 per cent to 2.55 pence per share, and return surplus capital through the payment of a special dividend of half a pence per share.

I believe this reaffirms the strength of our differentiated business model. Indeed, this low risk and simple model provides us with significant competitive advantages, as seen in the consistently high and stable underlying profit the Group has generated over the last few years, where lower income given lower interest rates, the sale of toxic assets and a more prudent funding strategy, were more than substantially offset by lower nominal costs and much lower impairments.

The Group is now translating that underlying profit into strong statutory profit and capital generation, with the gap between underlying and statutory profit narrowing, and we would expect this trend to continue into 2017.

Our low risk competitive advantage has also been affirmed by the PRA's decision to lower our PRA Buffer going forward and this reflects the significant de-risking the Group has undertaken in recent years. However, we regard this as a buffer against expected future regulatory capital developments, rather than a permanent reduction in required capital, and have therefore decided to continue to target a CET1 ratio of around 13 per cent.

Going forward, we anticipate our ongoing capital generation to remain strong and now expect to generate between 170 and 200 basis points of CET1 capital per annum, pre dividend.

Looking at the UK economy. UK economic performance remained strong in the fourth quarter with consumer spending particularly robust since the referendum and GDP growth of 2.0 per cent for 2016 which compares strongly to most other major developed economies. Unemployment has also continued to track lower and now stands at 4.8 per cent, its lowest level for over 10 years.

Whilst a period of economic uncertainty is to be expected as the UK leaves the European Union, forecasts from both the Bank of England and the IMF suggest that the UK's GDP growth will continue into 2017.

When combined with a longer-term trend of significant consumer and business deleveraging since 2008, the UK economy enters 2017 from a position of strength. With inflation now forecast to rise, rate expectations have increased from their very low levels back in September, although our internal assumptions and margin guidance do not assume any base rate increase in 2017.

The rise in swap rates in the fourth quarter does however mean we have taken the decision to start re-investing the structural hedge and this validates our strategy of building up liquidity during the earlier parts of the past year.

Now for a few comments on unsecured lending, which has received some coverage recently. While unsecured lending has grown in recent years, this growth follows a period of significant contraction between 2008 and 2013 as households de-leveraged. For example, card balances as a proportion of household income are below their pre-crisis levels, having fallen from 6.5 per cent in 2005 to 5.2 per cent only in 2016. Also, throughout the recent period of unsecured lending growth, mortgage balance growth has remained very low.

As a result, household indebtedness has improved significantly since the crisis, with unsecured debt as a share of disposable income well below the levels prior to the crisis. In addition, low interest rates mean that households' total debt repayment levels are the most affordable for 15 years.

Turning now to the progress we are making in our strategic priorities. Starting with 'Creating the Best Customer Experience'. Our multi-brand and multi-channel distribution model enables us to address the needs of different customer segments effectively, while ensuring our customers have complete flexibility in terms of how they choose to interact with us.

Our branch network is the UK's largest with around 2,000 branches, and while counter transactions continue to reduce, the branches are increasingly being used to advise customers with more complex financial needs. In addition, we continue to deliver our Commercial Banking client relationship model with over 3,000 client-facing colleagues across the SME, Mid-Markets and other Commercial Banking coverage teams.

We are a trusted partner of the intermediary distribution market with a strong proposition and are rated number one for mortgages in our net promoter survey, while in Scottish Widows we recently won two 5 star' service awards for our intermediary propositions.

And we operate the UK's largest digital bank with around 12.5 million active online customers, of which around 8 million access the bank via their mobile, and we had over 2 billion customer logons in 2016, which is up 24 per cent compared to 2015.

Looking at our digital progress in more detail. Digital is a critical element of our multi-channel distribution model and also increasingly a competitive advantage. We have seen significant growth across the channel and, in terms of simple customer needs met, we are now at 61 per cent, which is up from 41 per cent in 2014.

Our new business market shares demonstrate the attractiveness of our digital propositions, with the Group's overall digital market share at 21 per cent and strong market positions across our major digital product categories. We do expect this rapid growth in digital use to continue as our customers' behaviours evolve and we make additional significant progress in simplifying our key customer journeys, including an increase in the proportion of approved mortgage applications which proceed to offer within 14 calendar days increasing from 37 to 55 per cent and a simplified SME on-boarding process, which has gone from fifteen paper application forms down to just one digital form.

Looking to 2017, we are targeting further progress which will see the vast majority of account opening journeys in branch fulfilled via tablets and completed in less than 30 minutes across current accounts, savings products, credit cards and loans, where previously those would have required a 60 minute appointment.

Looking now at how we are becoming simpler and more efficient. As you have heard me say many times before, one of the key differentiators of our business model is our rigorous and proven cost management process.

Our market-leading cost:income ratio is delivered through our relentless focus on costs and its sustainability requires the right cost culture to be fully embedded in our organisation.

While we are currently ahead of our major UK peers in terms of cost efficiency, we are not complacent, and will continue to focus on becoming even more efficient, as we believe this is a strategic key feature in the context of the banking industry's on-going digital transformation.

In response to our customers' changing behaviours and the lower rate environment, at the half year we announced a £400 million increase to our Simplification run-rate savings target. We are now targeting £1.4 billion by the end of 2017 and we are on track to achieve this having delivered over £900 million of run-rate savings to the end of 2016.

Given this outlook, and in spite of lower interest rates than when we announced our strategic plan in late 2014, we are reaffirming our target for a 45 per cent cost:income ratio exiting 2019, with reductions every year.

Turning now to sustainable growth. The acquisition of MBNA is an opportunity to acquire a prime UK credit card business with a strong brand and complementary capabilities. It is in line with our strategic goal to grow in consumer finance, with strong economics that will enhance our future capital generation.

The transaction was agreed at attractive multiples, including a 6 times price earnings ratio, and importantly, we are not taking any additional PPI exposure following the acquisition. The transaction will therefore create significant shareholder value through strong financial returns, including a 5 per cent EPS accretion by end of the second year and a return on investment of 17 per cent, substantially above our cost of equity.

This was only made possible by our simple business model and superior cost management capabilities, which enable us to enhance financial returns for our shareholders given we transfer the acquired business' cost structure into our own.

Looking more specifically at loan growth. Over the past 12 months, we have continued to support the UK economy with loan growth in our targeted key customer segments.

In SMEs, we have once again outperformed the market, growing net lending by 3 per cent, with total SME and Mid-market net lending growth of around £2 billion, in line with our Helping Britain Prosper £2 billion annual target.

In mortgages, we remain committed to supporting first time buyers and continue to be the largest lender to this customer segment. We have continued to balance margin and risk considerations with volume growth and have therefore continued to track below the market, especially in the buy-to-let segment, resulting in a reduction in the open book mortgage balances of 1.6 per cent. This reduction has slowed down in the second half of 2016 and we now expect our open book mortgage balances to be broadly stable in 2017.

Our UK consumer finance business delivered strong organic growth within the Group's low risk appetite. Net lending growth was 8 per cent in 2016 comprising a 20 per cent increase in motor finance and a 4 per cent increase in credit cards. Our vehicle leasing business, Lex Autolease, also grew its operating lease assets by 17 per cent, which means in total, UK consumer finance customer assets grew by £2.8 billion and this is ahead of our £2 billion target for the year.

The acquisition of MBNA will allow us to build on this strong organic growth going forward.

Turning finally to the outlook. We have been successfully executing against our strategic priorities and have delivered strong financial performance and capital generation, in spite of the lower level of interest rates following the referendum. Our cost discipline and low risk business model continue to provide competitive advantage.

Looking forward, the UK enters 2017 from a position of strength and possesses structural advantages that mean it will remain competitive in the long term. For the Group, 2017 will see us focused on delivering the final year of our current three year strategic plan, as well as preparing our next strategic update for the period 2018 to 2020, which we will announce to the market around the end of the year.

Finally, our confidence in the Group's future prospects is reflected in our strong financial targets. For 2017, we anticipate our net interest margin being greater than 2.7 per cent and an asset quality ratio of around 25 basis points, higher due to the lower anticipated write backs. Both of these targets exclude the impact of MBNA.

On costs on the other hand, and as mentioned earlier, we are reaffirming our target for a cost:income ratio of around 45 per cent exiting 2019, with reductions every year.

In terms of returns, we now expect a Return on Required Equity of between 12.0 and 13.5 per cent in 2019, a slight reduction from our previous guidance to reflect the changed environment. This represents a Return on Tangible Equity of between 13.5 and 15.0 per cent.

Finally, on capital generation, we now expect to deliver between 170 and 200 basis points per annum, pre dividend, which is made possible by our, simple, low risk UK focused multi-brand business model.

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

George Culmer, Chief Financial Officer

Thank you António and good morning everybody. Looking briefly at the financial highlights. As you have heard, underlying profit was £7.9 billion, with total income of £17.5 billion, which was slightly down on the prior year and 3 per cent lower operating costs, which delivered positive operating jaws and an improved cost:income ratio of 48.7 per cent.

On credit, impairment performance remains very strong with a net AQR of 15 basis points, with the increase on prior year due to the expected lower releases and write backs.

The underlying return on required equity was also a strong 13.2 per cent and return on tangible equity an equally strong 14.1 per cent, with the movements on prior year primarily due to the movement in underlying profit and the impact of the banking surcharge.

Looking at income. Net interest income was stable at £11.4 billion with an 8 basis point increase in the margin to 2.71 per cent, offset by slightly lower average interest earning assets. The improvement in the margin once again reflected lower asset pricing more than offset by lower deposit and funding costs, where we have continued to reduce our more expensive tactical savings and wholesale funding, replacing this with relationship Retail and Commercial deposits.

Our loan-to-deposit ratio was 109 per cent at the end of 2016, consistent with 12 months ago, and within our target of between 105 and 110 per cent.

In terms of Q4, the net interest margin was 2.68 per cent for the quarter, but included only one month's benefit of the deposit rate changes that came into effect in December.

Moving forward, we will see the full benefit of this re-pricing in the coming months and we will continue our focus on margin optimisation. As a result, we now expect the full year margin in 2017 to be greater than 2.7 per cent, and this is before any benefit from MBNA.

Turning to other income, which at £6.1 billion was slightly ahead of expectations for the year, driven by a better Q4 performance that was 1 per cent ahead year-on-year and up 8 per cent on Q3. The quarter-on-quarter increase was primarily due to increased client activity within Commercial Banking and higher Insurance income in the quarter following year end assumption updates.

For the full year, the 1 per cent fall in other income includes a 5 per cent increase in operating lease income from Lex Autolease business that continues to grow strongly, a 17 per cent increase in Insurance new business income and gains from the optimisation of the liquidity portfolio, as well as a favourable impact from the timing of dividends from our strategic investments.

Offsetting this was continued pressure on fees and commissions, including the impact of the interchange fee cap on cards, lower returns in the Insurance in-force business and reduced income from the run-off portfolio.

Looking at total income by division. In Commercial Banking income was up on prior year driven by high quality deposit growth and pricing, while Group Treasury benefitted from the gains on sale from the liquidity portfolio and dividend timing as just mentioned.

Retail again performed strongly with income of £7.6 billion benefitting from a resilient margin, including the reduction in the tactical deposits, while fee income was adversely impacted by lower ATM, packaged bank account and debit card interchange fees.

In Consumer Finance, NII was resilient with increased new business volumes but in higher quality, lower margin lending, while fee income was marginally down 2 per cent, due to the interchange fee cap impact on credit cards more than offsetting the strong growth in operating lease income.

And finally in Insurance, as mentioned, we saw an increase in new business income driven by growth in planning and retirement and protection propositions, but this was more than offset by lower existing business income due to the adverse economics.

Turning then to costs. Operating costs of £8.1 billion were down 3 per cent, with efficiency savings from our Simplification programme more than offsetting the increased investment in the business and the impact of increases from pay and inflation.

Our relentless focus on costs and proven cost management capability have allowed us to reduce absolute operating costs every year since 2010, and in total by around £2 billion, while continuing to invest in the Group's strategic priorities. This track record of delivery gives us confidence that, even in this lower rate environment, we can maintain our previous cost guidance and we are re-affirming our commitment to deliver a cost:income ratio of around 45 per cent as we exit 2019, with reductions in every year.

On credit, as you have heard, our asset quality remains strong with no signs of deterioration in the portfolio. The charge for the year was £645 million, with a stable gross AQR of 28 basis points and a net AQR after write backs and releases of 15 basis points.

The quality of the Group's loan portfolio has continued to improve and impaired loans as a percentage of closing advances now stand at just 1.8 per cent, compared with 2.1 at the end of 2015, and nearly 9 per cent back in 2012.

The loan to value profile of the mortgage portfolio has also continued to improve, with an average LTV of 44 per cent and the percentage of the portfolio with an LTV of less than 80 per cent now stands at nearly 90 per cent, compared with around 60 per cent of the portfolio back in 2012.

In 2017 we again anticipate the gross AQR remaining stable reflecting the strong credit quality of the book, while the lower level of releases and write backs means we expect a net AQR of around 25 basis points.

Moving on to statutory profit. Statutory profit before tax has more than doubled to £4.2 billion, reflecting the good underlying profit and lower below the line charges. As you know, these charges include the £790 million we took in Q1 for the redemption of the ECNs.

Market volatility and other items totalled a charge of £132 million. This includes the £484 million gain on the sale of Visa Europe, offset by other items, including the fair value unwind of £231 million and the amortisation of intangibles of £340 million.

On Restructuring, the £622 million includes costs relating to the Simplification programme, the rationalisation of our non-branch property portfolio and work on implementing the UK ring-fencing requirements.

And on PPI, as you know, the Group took a charge of £1 billion in the third quarter and no further provision has been taken in Q4. The unutilised PPI provision at year end was around £2.3 billion and reflects our interpretation of the FCA consultation paper with a time bar coming into force in mid-2019.

Other conduct was £1.1 billion for the year, with £475 million recognised in the fourth quarter. The charge for the year included £280 million in respect of packaged bank accounts, £260 million for arrears-related activities on secured and unsecured retail products and £94 million for insurance products sold in Germany, as well some other conduct risk provisions across the Group.

Finally, our tax charge was £1.7billion, representing an effective rate of 41 per cent. This high rate reflects the impact of the banking surcharge, restrictions on the deductibility of conduct provisions, the impact of net deferred tax asset of changes in the UK corporation tax rate, and movements in deferred tax assets in insurance.

Going forward, we continue to expect a medium-term effective tax rate of around 27 per cent. Looking briefly at the balance sheet. As mentioned, average interest earning assets excluding run-off were broadly stable at £426 billion, with growth in Consumer Finance and SME offset by lower mortgage lending. Going forward, the Group's average interest earning assets will benefit from the inclusion of MBNA's £7 billion of balances following completion.

Run-off continues to be managed down and reduced by a further £3 billion in the year to £11 billion.

Risk weighted assets reduced by £7 billion during the year as we continue to de-risk the balance sheet. This has been achieved through a range of actions including securitisations, disposals, and the continuation of the portfolio optimisation in Commercial Banking.

This pro-active balance sheet management in Commercial has been a key driver of the 8 basis point increase in their Return on Risk Weighted Assets, which was 2.44 per cent for the year and means we have met our 2.4 per cent target one year ahead of schedule.

Finally, on capital. Again as you've heard, the Group continues to be highly capital generative and remains well capitalised, with closing ratios of 13.8 per cent for CET1, 21.4 per cent for total capital and 5.0 per cent for leverage.

In the fourth quarter the Group delivered around 80 basis points of CET1 capital, with full year capital generation of around 190 basis points and ahead of our guidance primarily due to strong underlying profit and RWA reductions in the final quarter.

This level of capital generation has enabled the Group to fund the MBNA transaction, pay an increased ordinary dividend and return surplus capital through the payment of a special dividend.

As you heard, we were also recently notified that following their annual review, the PRA has reduced our PRA Buffer to reflect the significant de-risking that the Group has undertaken in recent years. As you know, there are however a number of future regulatory capital developments expected, including the introduction of the systemic risk buffer, and as a result, the Board will continue to target a CET1 ratio of around 13 per cent.

Finally, on net tangible assets, TNAV per share has increased by 2.5 pence to 54.8 pence. This was driven by statutory profit and positive reserve movements totalling 5.4 pence, partly offset by the 2015 full year and 2016 interim dividends.

So, to sum up, in 2016 the Group made further good strategic progress and delivered strong financial performance. Our differentiated business model is delivering. Our cost discipline and low risk approach are providing competitive advantage, while the investment in our multi-brand and multi-channel distribution platforms is enabling us to create the best customer experience.

The business is also delivering strong statutory profit and capital generation, as the gap between underlying and statutory profit narrows.

2017 will see us focused on delivering the final year of our current strategic plan, and our confidence in the Group's prospects is reflected in the increased dividends we have announced today and the strong financial targets we have set.

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

End of Presentations

Question and Answer Session

Question 1: Chris Manners, Morgan Stanley

Good morning everyone. It's Chris Manners from Morgan Stanley. So just two questions if I may. The first one was just trying to square the circle on your capital generation and your return on tangible equity target. If I look at your 13.5 to 15 per cent return on tangible equity that looks to me, given £39 billion of tangible equity, a £5.3 to £5.9 billion net income number. On £215 billion of RWAs, that means you are doing 2.5 to 2.7 per cent of earnings to RWAs. If you are only going to generate 170 to 200 basis points a year, that does imply fairly rapid RWA growth. Is that right or am I missing a piece there?

Response

What was the conclusion to all that maths Chris?

Chris Manners

The conclusion was, if you can do almost £6 billion of net income and your RWAs are £215 billion, your capital generation should be a lot stronger than 170 to 200bps?

Answer: George Culmer

So the question was does it imply strong or not strong RWA growth? I mean as you have seen, RWAs have been coming down. I would expect as we move forward, particularly given what we are saying on things like open book and mortgages and stuff like that. In terms of RWAs from existing business, you may not see that rate of decline. What we will do though, is remain extremely focused on RWA optimisation and you have seen a lot of that in Q4, you will continue to see that as we move forward, so I am not expecting to see strong RWA inflation as we move forward. Is that the commensurate conclusion of your maths or was that a different answer?

Further question

So the way I come to it, if I look at your net income forecast versus your RWAs, you are going to be generating more than 200 basis points a year. So you need to have strong RWA growth to actually bring the capital generation to the 170 to 200. So either there is some RWA inflation or something else is what it looks like to me?

Answer: George Culmer

There will be MBNA in the RWAs as well.

Further question

Second question if I may is just on the cost base for MBNA. I guess you have given us the pro-forma of £333 million of costs for 2015 and you have told us you can take £100 million of cost savings out. What should we have as the run rate costs that Lloyds take into the P&L in 2017 and 2018? Am I right in saying you are going to leave some costs with Bank of America out of that £333 million?

Answer: George Culmer

Yeah that's right. So they had a cost base of round about £300 odd million, but within that there is a large slug of that, that will stay with Bank of America. So you are down to net, these are round numbers, round about £200 million. So I would have thought that after you take the £100 million, you are into a net of about £100 million is the number that comes through.

Answer: António Horta-Osório

Which is the half I was mentioning in my speech.

Chris Manners

Thanks

Question 2: Raul Sinha, JP Morgan

Morning everybody, it's Raul Sinha from JPMorgan. If I can stay on the topic of capital generation that Chris was talking about, I think what he was trying to say was that your 170 to 200 is conservative. But even if we take that 200 as a given, you know it looks like that 200 basis points capital generation would be worth somewhere around 5.5 to 6p of cash flow and that is probably what drives the ability to pay dividends. Now where you are today at 3p in terms of the total dividend, there is quite a big gap between the two numbers. And so my question really is, what is the balance that you would look to strike between growth and acquisitions and dividends to shareholders? Because if we take the 200 or 170 basis points of capital generation, that would imply that you have the ability to pay 5-6p of dividends this year?

Answer: António Horta-Osório

I will just make some comments about acquisitions and then George will answer you about the dividend policy and how that matches, because as you correctly are saying, we have held around 80 basis points this year to totally pre-fund the MBNA acquisition. The MBNA acquisition as we have been saying all along, we said all along since we announced our second strategic plan, that we wanted to grow in consumer finance. We are growing quite well organically. And we said, if any portfolio of good quality, low risk, would come to the market, we would look at it to basically grow faster in an area where we are underrepresented. And this was clearly the case of MBNA. So it is an 11 per cent market share. We were able to completely limit the risk, not taking any additional PPI liability and given to Chris' questions, that we are able to halve the cost structure from Bank of America, given our own cost:income, it has both provided the best price for Bank of America and a 17 per cent return on investment for our shareholders. Which is substantially above our cost of equity. In which other areas are we underrepresented? In SMEs where we have been growing 5 per cent a year for the previous 5 years and 3 per cent last year, slightly lower post referendum. In the last 6 years we grew 30 per cent our net book in SMEs, taking our market share from 13 per cent to around 19 per cent. So we are growing organically quite well and sustainably. And also on card finance, within consumer finance, we have only a 13 per cent market share, but we are growing organically 20 per cent basically based on the Jaguar Land Rover representation which as I told you many times in the previous 4 years, all gross business is net business. So we are growing very well in those areas. Should additional portfolios come up in the market in those areas, we would look at them as we looked to MBNA but we are not seeing anything in the market that we are aware of in those areas and we are growing organically very well. So you should consider the MBNA transaction as basically a one-off transaction. It is not a change at all on strategy, we had already flagged, if this would happen, we would look at it and we were able to do it because it was in very good conditions for our shareholders and without any risks in terms of taking any additional PPI liability.

Further answer: George Culmer

In terms of capital, I mean a few points to make. I mean look this business has been and will continue to be strongly capital generative, some simple facts. One, I mean in terms of the precise amount, I think 170 to 200 is the right range to be targeting. Within that when you look at the components there are elements I would point to that I think are going to be consistent, strong, pretty predictable. When you look at this year's capital generation, you have got 2.2 per cent from underlying, you have 0.2 per cent from insurance. I think our underlying profit is going to be a pretty predictable, stable number, so I have got a relatively secure base of 2.4 per cent. Then on deductions you have got things like conduct. I do expect conduct to be on a downward trajectory that will go against that. There are other elements such as things like pension fund movements, below the line movements etc. We also know from experience that there tends to be you know one-offs that one has to deal with and accommodate. Things like IFRS9 out there, etc, that we have to work through as well. So I think this business is strongly capital generative, we will continue to be so. There was a core to that which I think is strong, stable, consistent. There are uncertainties. I think what we have demonstrated this year is that when we confront those, we will seek to manage through those in the best interests of shareholders and I think we have demonstrated that in today's results. But that is the challenge that will face us each year as we come. But the key is I think that we have been and will continue to be strongly generative.

Further question

Thanks, that was very clear. Can I have maybe one more António, just on the branches, just because you have given us this new slide with all the branches and the strategy around branches. If you look at the last slide in the pack, which shows the branch presence for all the big brands. One conclusion, maybe I am nit picking, that you can draw is that you have lagged other peers in terms of branch reduction. If you look at the big brands or if you look at the Scottish brands, you have more branches in Scotland than RBS does. Is there anything that has been holding you back in terms of branch reductions? That is the first point. And secondly should we think that as a static number?

Answer: António Horta-Osório

We look very much at this slide because as you know we are very focused on our multi-brand strategy. So there are no Lloyds banking group branches, there are branches per brand, and this is the way which we look at the market. We look at the Scottish market on one hand where we compete with Royal Bank of Scotland, that is a geographic segmentation. We look at England and Wales where we compete through the Lloyds bank brand and then we have a challenger brand which is Halifax across the UK. And we show you there, the three major segments and how our branch network competes with each of the peers in those segments.

The second conclusion from that slide I think is, as you say, we were 5 years ago in terms of Lloyds Bank we had the third largest branch network and given others closed branches much more aggressively than us, we now became the second largest branch network on the Lloyds brand alone. As I have always said, we really like our multi-channel approach. We have the largest digital bank, we have the largest branch network as a whole and several of our clients can use the other branch networks in order to do counter transactions which is helpful. So we are focused on a multi-channel approach in which customers contact us however they want. Digital bank 21 per cent market share, branch network around 22 per cent market share.

Are we going to close more? We have a plan announced. We only started closing branches as you know with a second strategic plan, that is why others have closed much more than us. And what we are doing here is not a cost matter. What we are doing here is to follow our customers' behaviour. So given that our customers are growingly accessing us through mobile or digital, so transactions are exponentially growing and as I told you, simple needs now are met more online than with all the other channels, we obviously have to adapt our physical branch network to whatever they want to do. And we will continue to do that so the trend will depend on our customers' behaviour. We don't look at it as a cost measure and then we try to influence customer behaviour. We look at how customers want to interact with us and we adapt our multi-channel approach including the branch network to their needs. For example in Scotland and in the UK, outside the big cities, we are now having a significant programme of mobile vans in order to cover the small locations that we leave and we are last bank in town. And in order to serve the clients that don't use digital we are having the service of mobile vans to cover those cities for a certain number of hours per week for them to be able to do banking with us. So we look at this from a customer perspective and not from a cost perspective.

Raul Sinha
That's very clear, thank you.

Question 3: Andrew Coombs, CITI
Morning, it's Andrew Coombs from Citi, three questions but I promise to be quick. The first one George you have been kind enough in the past to provide the instant access, fixed ISA and time deposit rates outstanding during the quarter. Would be great if you could provide that again for the fourth quarter.

The second question would just be for your guidance on the mortgage open book balance, down £4.5 billion in 2016, you are guiding to broadly stable in 2017, that is despite arguably quite a challenging industry environment. So would love to know what gives you the confidence there on that guidance?

And then the final question. Thank you for the extra slides on digital. Just on that topic, you had a DDoS attack in January, I think a 2 day outage. So just with that in mind, how much of your focus goes towards cyber? How much of the annual IT budget is on that? And is that something you are investing in?

Answer: George Culmer
Shall I do the first one? Yeah so the instant access which is about £96 billion of funds. And within that the rate at Q3 was about I think 42-43bps. The rate at Q4 is 23bps. So you can see the action that we are taking and similarly for things like the variable ISA where we have got about £31 billion. That was 53bps at Q3 and it is now about 35bps. And the fixed, about £27 billion of that, that pays about 164bps, it paid about 175bps. So we talked at Q3 and we talked about the action we were taking to offset the impact of those base rate cuts on mortgages. As I said in the presentation, we are starting to see those come through, and as those come through for the full year, that is where we get the benefit in 2017 and that is a key part of underpinning our margin guidance.

Further question
Is that the blend over the quarter or is that the end of the quarter?

Answer: George Culmer
That is the end rate.

Answer: António Horta-Osório
And on the mortgage guidance that you ask. So I mean I agree with you. I don't see the mortgage market different in terms of competitiveness than what it was 6 months or a year ago. So this change of guidance is not a result of any different assumption about competitiveness. This is a result of the fact that as we told you in previous quarters, we have had an abnormal influx of deposits following the referendum vote, especially on the Lloyds brands and the commercial division. I think I mentioned to you we had £6 billion of additional deposits which lowered our loan:deposit ratio in the summer from 109 where it was to 107 and then to 106 in the third quarter. And because those deposits continue to come and it was unexpected. Positively unexpected because Lloyds Bank commercial deposits have as you know lower prices in the market than retail deposits in general. And as I told you, we would recycle, not those. We would recycle our deposits in order to come back to 109 loan:deposit ratio so that was an additional lever we have at our disposal in order to prune high cost deposits on tactical brands for example or on wholesale funding. And at the same time we have the TFS as we mentioned from the Bank of England. And therefore we were able during

the second half of the year to go back to the 109 loan:deposit ratio that we told you we would go to. End of December we are at 109, and that provided us lower cost of deposits and therefore a buffer if you want that we could invest on the mortgage market and therefore it enables us to tell you now that our open book will be reasonably stable during the year because of the great work that we were able to do in terms of mix and size of deposits in the bank, which has enabled us to go back to the same loan:deposit ratio and invest additionally in terms of, if you want, market share in the mortgage market.

So our view is that it is prudent to be stable in the mortgage market. We continue to think that given the uncertainty out there, given the buy-to-let reservations of the regulator and given that prices have risen significantly, we think it is prudent to be below the market in terms of growth in the mortgage market. We also continue to believe, as we told you many times, that given the specificities of the mortgage market, this is not a straightforward, breakeven equation between new business and margin. It is much more complex than that, given retention, SVR etc. And given everything taken together, we think this is the right strategy. In the last 6 months, given the abnormal influx of deposits and given we manage the margin, as you know, as the difference between assets and liabilities, we were able, through great work in terms of mix, to have an additional buffer if you want to invest more on mortgages. It is not at all an assumption on easier conditions on the mortgage market going forward.

Juan Colombás,

I will take the cyber one, on cyber you are right, so cyber is one of the key risks of the financial industry, I would say of any industry, and we take it very seriously. We have been investing heavily, particularly in the last 4 years and we are talking in the high hundreds of millions of investment.

Question 4: Claire Kane, Credit Suisse

Hi there, it's Claire Kane from Credit Suisse. Two questions please. First is a follow-up on your mortgage strategy comments just there. Can you tell us, do you, have you seen much change in your SVR attrition rates since you cut the rate for borrowers? And is your outlook for stable volumes around a reduction in attrition versus net new lending? And also if you intend to change some of your product offering, for example offering residential mortgages to limited companies, which I don't believe you currently offer on a mainstream basis?

And then my second question is just another way to look at the capital generation guidance. Before the EU vote, you had around 200 basis points of capital generation. Since then as you said, the underlying profitability is broadly stable, and you have now announced MBNA acquisition. So could you maybe give us a bit more detail about where the uncertainty is coming from to bring back that range of 170-200 and if it is around more below the line items like the restructuring charges if you have an update there on what we can expect? And also IFRS9 if you have any quantitative numbers for us? Thank you.

Answer: António Horta-Osório

So thanks Claire, George will answer the first one and Juan the second and George again the third.

Answer: George Culmer

The SVR attrition, so it actually remains remarkably constant. So for example the Halifax, is now about 9 per cent for the year and I think that is remarkably flat through the course of 2016 and I think it went up 1 per cent at most I think as a sort of intra-quarter variation.

Answer: Juan Colombás

We don't do residential mortgages for companies, but we do buy-to-let for companies and that is part of our SME business and we have been doing it all the time. So it is a small portfolio compared with the buy-to-let for individuals. We do it in the retail space.

Further question

Would you maybe offer those through your Birmingham Midshire intermediary brands? I think that is where you are not offering the limited companies and where the share is being taken?

Answer: Juan Colombás

The strategy for buy-to-let portfolios after the last revaluation that came up, we have until September to define it. At the moment we are restricting the buy-to-let for only individuals through the retail space. We do something for companies through the SME business.

Answer: George Culmer

Capital generation, I mean if you go back a year ago Claire, when we set targets then, we were talking about capital of around 200 basis points, we were talking about returns on required equity of 13.5 to 15. The backdrop at that time when you know we looked at 2018/2019, I forget the precise number, the base rates we were assuming was sort of 2.5 to 3 per cent or whatever, that was the backdrop. The numbers that we have sort of talked about now in our assumptions, we don't expect any base rate action in 2017 and we are sort of assuming the base rate is still below 1 per cent by about that equivalent time period.

Now you know, that does have an impact on us and it is obviously incumbent on us to manage the book and try to respond to that and I think you can see that in the way that we have stuck, despite that deterioration in the sort of base economics, to our cost:income ratio and so we can respond to that. But I can't offset in full and that changed economic environment is key in terms of what you have seen as the slight reduction in our return guidance. But also as you said in terms of capital, we sort of came in at 200bps a year or so ago, this equivalent point with that backdrop. But you are right, post Brexit, when it actually occurred, we talked about, we just gave a qualitative type statement, we thought it could be slightly less. You know, we are now further on, we have got better visibility, we have been through another planning round etc. And we have replaced that qualitative with the 170-200bps range which you see now. Yes MBNA helps that, but I am still up against fundamentally different economics. But I think what we are saying in that environment, is even if I am assuming as I am assuming the base rate is now stable at 1 rather than 3, I can still make a decent, what I think is a very good capital return and a good return on equity, but I can't entirely immunise myself from that change.

Answer: António Horta-Osório

And as you know, we had said at the time and it is the same position, we are very positively exposed to rising interest rates. So having no interest rates, less than 1 per cent versus previously around 2.5 to 3 per cent, it makes a very significant difference in terms of impact, should rates go again to the 2.5 to 3 per cent which we are no longer assuming in the guidance we are giving you. Jonathan?

<u>Question 5: Jonathan Pierce, Exane BNP</u>

Thanks very much, it's Jonathan Pierce from Exane. Three questions. The first one is on gains from the gilt portfolio. I can't see there has been any recycling from AFS so I assume there was maybe some sales on the held to maturity stuff on the transfer. But maybe you can tell us how big those were? Is it pretty much all of the £300 million in Treasury that you alluded to? And maybe as a broader question on this, non-interest income for 2017, can you give us any steer there? That is the first question.

Answer: George Culmer

So on gains, I think as I said in the presentation, and we say in the release, we have been essentially optimising the liquidity portfolio and as I said at the time, I think we were a net seller of gilts. The gain is more like £100 million, which is the number in 2016, of which about £26 million or so was in Q4 and that is both through things like covered bonds etc, as well as gilts within that. OOI, as we said, the year has ended slightly stronger than we thought at a certain point. And that is not just about gains, we saw a strong performance from CB, slightly stronger from insurance. As we move forward, and I have said this before, it will stay tough. Generation of fee income products will stay tough. Within our businesses, I would expect CB to move forward and I think that is based upon the momentum they have got, the investments we have made, the positioning of the commercial bank now within its market and the capability - so I would expect to see that move forward. In terms of OOI, I would expect I think consumer finance to move forward. Again you have seen the momentum, you have seen the balance sheet growth. I would be hopeful that translates into positive OOI. Insurance will stay tough. It is very heartening to see the growth in new business income, it is the future of the business and the stuff we are doing on protection, on planning and the good work we're also doing on corporate pensions. The back book is impacted by economics, predominately the swap rates, the 15 year swap rate in terms of, that is the sort of critical indicator there and that will still be a drag. So insurance could be on the cusp. Retail is likely to be down in 2017 and that is a combination of things through ATM usage, through in terms of lower sales of package bank accounts and value adds within there. So if I jumbled all of those up, I am going to fall short of giving you a precise target, but I think we will do a good job to get close to 2016's total this year.

<u>Question 6: Joe Dickerson, Jefferies</u>

Thank you, it's Joe Dickerson from Jefferies. Just on the matter of interest rates, could you provide us with the interest rates sensitivity at the end of 2016 say versus 2015 because I couldn't find that in the release today?

And then secondly, given your comments on the open book of mortgages, could we expect average interest earning assets to actually grow this year?

Answer: George Culmer

Our sensitivity, I mean I think last year for about 25 basis points it was about £150 million, so I think that is about £600 million for 1 per cent. And it is slightly higher now, about £175 million I think for the equivalent number in terms of sensitivity.

And then AIEAs, you are right, they have been, when you look, I think I called them broadly stable or whatever excluding run-off and within that, as we talked about, you have got growth in CF, growth in SME, all the things that you know. But within that I have also got about a £9–10 billion reduction in the mortgage book. Now within that about £2 billion of that comes from essentially the closed book and you will see that to continue to just run-off, an IF (Intelligent Finance) type book, but the balance, the delta is from the open book. And you would hope that if we commit to what we are talking about in terms of open book participation that should essentially disappear as we move into 2017. So as that is the main drag, we would be hopeful of a small amount of growth in average interest earning assets.

Question 7: Martin Leitgeb, Goldman Sachs

Good morning, Martin Leitgeb from Goldman Sachs. Two questions please. The first one, I was just wondering if you could confirm the share in gross mortgage lending you had during the year? The numbers seem to imply a range of roughly around 16 per cent which would compare to your new open book stock of roughly 19 per cent.

And the second question is to follow-up on your mortgage strategy going forward and if you could just clarify, obviously I understand in 2017 you think, I think you are signalling you could retain the same margin within the mortgage business as you get the benefit of cheaper deposits coming in. Going further out in terms of your strategy, would you focus as previously on maintaining margins rather than stock if competition were to intensify? Or would your focus now go more towards retaining the stock you have? Thank you.

Answer: George Culmer

The mortgage, I think gross sales about £38 billion, so you are right, about 16 per cent is the market share.

Answer : António Horta-Osório

But Martin obviously to see the growth of the open book you cannot look at the gross margin only because as I was explaining previously, you have to look at SVR retention, internal transfers. It is a much more complex book than just looking at gross margin.

On our mortgage strategy, the mortgage strategy is exactly the same. So we did not change any strategy. We have been telling you and I am just repeating the previous answer, that we continue to think that in the current macroeconomic environment and in a market which does not grow, except mainly in the buy-to-let segments, it is prudent to focus on risk, capital and margin instead of focusing on volume growth. That is what we have been doing since around 15 months ago. In order to do that strategy, which we are now doing for 2.5 years, we gave up some growth on the open book as we just discussed and we now think that we can continue to execute the same strategy with a stable, open book. It is as simple as that. And for the future we will consider what competitors do and how to best respond within the same strategy which as long as the macro-economic conditions continue and as long as the growth of the market continues, I think it is exactly the right one.

It is a very different strategy to what we do for example in car finance where given we are underrepresented, the return on risk weighted assets is the highest of all of our portfolios, within prudent risk appetite, we are growing significantly market share and are decreasing somewhat the margins, exactly the opposite strategy because it is a very different environment.

Question 8: Fahed Kunwar, Redburn

Hi, it's Fahed Kunwar from Redburn. Just a couple of questions and following on from that, a consumer finance point. I mean your growth is very strong at 11 per cent, but the margins are down 75 basis points year-on-year. So I mean is the answer much like we have seen over the last few years that it is either margin or growth, but the end product is NII is flat to modestly down going forward unless asset prices start to rise? We have seen other market participants, competition is very tight in unsecured and capital keeps flowing into it as well. So I was wondering what is the outlook on NII rather than margin and growth on the consumer finance book?

And the second question is on your ROTE target for 13.5 to 15 per cent. I mean you did an underlying ROTE of 14.1 per cent in 2016 and you have got I think a base rate rise of about 75 bps out to 2019, so why is your overall ROTE target so low considering the current ROTE and you have got base rate rises in your numbers? Thanks.

Answer: António Horta-Osório

George will take your second question. I just like your point, 'so low'. If you compare to general guidance it does not look to me so low! But anyway, George will take the second question.

On the first question, I mean I think you are right on what you said, but I think there is an important point which happened in 2016 which we do not anticipate in 2017 which is we fund the consumer finance portfolio partly with German deposits. And given what has happened with interest rates in Europe in the past year, where they went very negative, there was an especially negative impact there. That is also why we have a substantially reduced book during the year, that is part of the tactical brands and as you saw in George's slide that was where we reduced most of the portfolio. So that was a bit of one-off effect which is not related to the consumer finance lending side if you want. It is related to the way we fund it. So I would not expect that to happen in 2017. You were right on your considerations. I repeat it is our highest return on assets portfolio with prudent risk, we are growing very much because of the Jaguar Land Rover representation which we consider prime business. Until this year all gross business is new business, because there are no redemptions in the first four years, so I would expect the net interest income to increase in 2017.

Answer: George Culmer

The second one, I mean the comparison between the underlying returns that we are currently posting versus the target that we have got, I suppose there are two things to that. One, is again the delta between the underlying and the statutory and I think if you look out, hopefully PPI will be but a memory by then. Other conduct; it is disappointing this year that other conduct has gone up. We expect it to trend down, it will trend down. I do think other conduct will continue to be a feature, but at a much diminished rate, but it will come down. There will also continue to be a number of small items below the line. I am not pre-empting any big below the line charge, anything that people don't know about. It is just the amortisation stuff. So there will be a few things that go through.

In terms of the underlying result though, I mean it is also worth bearing in mind, yes we assumed a very modest amount of base rate increases as we flow through, but also I think it is fair to say, and again, the AQRs that we are seeing, you know I think when we did our last strategy update, we talked about a through the cycle of sort of 40 basis points. Now we would be inside that now, but I think our sort of long-term run-rate certainly would not be 15. So yes there will be a slight pick-up in terms of income, but I am factoring in a higher AQR when I put that number out as well.

Further question:

So just to be clear, is it a 1 per cent base rate in 2019 in that ROTE guidance?

Answer: George Culmer

It was just below 1 I think. We assume nothing happens until about 2018.

António Horta-Osório

So it's within a much more prudent interest rate environment.

Question 9: Andrew Hollingworth, Holland Advisors

Morning, Andrew Hollingworth from Holland Advisors. Just one quick one on this whole return on tangible targets. I get the fact that it is a different interest rate guidance and that is very useful that you have given that and it makes the situation more realistic from where we start today. But squaring the fact that your capital generation points, it does feel like the return on tangible target is an underlying number, not a reported number and I know that is not what you have said in the past, but on the basis that you, is it realistic to have a situation that is a clean bank in 3-4 years time with no restructuring charges, with no write-down charges on sort of mis-selling? And therefore do you not end up with a return on tangible target that will never be at the reported level and actually the reason why your capital generation is lower than people are expecting in this room is because of the fact that your return on tangible is actually at the underlying level?

Answer: George Culmer

No, it is definitely at that reported level. To your point and going back to some elements to the earlier question, I would have thought there would be a feature of some element of conduct. I mean conduct is just when you know we treat our customers, we do things wrong and we make them whole. It is part and parcel, we have to minimise those occasions, we have got to make sure we address them as quickly as possible. But it isn't pre-empted ongoing restructuring charges, all those sorts of things. It is a genuine, at the reported level. Now I am never going to see, you are never going to see 100 per cent flow through of underlying down to statutory, there will be a small element of dilution, but compared with what we have shown on the charts with what you have seen in prior periods, I would expect a much, much, much more reduced element in terms of that dilution.

Further question

I suppose implicitly then, the other way to look at it, is in that target you have long-term, there is some ongoing, the type of restructuring that a bank, such as your nature requires on an ongoing basis, that is in the target?

Answer: George Culmer

That is correct.

Answer: António Horta-Osório
Not restructuring. In terms of ratifications to customers, which you were calling mis-selling. It is not mis-selling. In the same way that we lend money to people expecting to get it back, but sometimes they don't pay and you have impairments. We try to do the right thing every time, but sometimes clients have not been exactly, the commission has not been right or something and you have to do ratifications to customers which are part of normal business. So as George was saying, we are assuming there will be some ratifications, some customer redressing permanently like there is some impairments permanently. It is part of business.

Further question
But surely restructuring is part of normal business as well in the bank?

Answer: António Horta-Osório
Yes but restructuring, we are not assuming anything in particular because if we did then we would assume additional cost cutting measures as a consequence so the two go together.

Andrew Hollingworth
Thank you.

<u>Question 10: Rohith Chandra-Rajan, Barclays Capital</u>
Morning, it's Rohith Chandra-Rajan from Barclays. Two quick ones please. One just on the AQR guidance. I appreciate that the 25 basis points is gross 28 stable on this year so sort of suggesting a fairly stable economic outlook. I was just curious, into the medium term about the sensitivities of that AQR number to unemployment, property prices, GDP etc, if you could give any guidance around what you see as the key sensitivities?

And the second one was just on the margin where you are little bit more confident now than you were in December when you reiterated the around 270 basis points and now saying above 270 basis points. I was just curious about what has changed there please?

Answer: Juan Colombás
So in the retail portfolios, the main sensitivities, unemployment as you say and HPI in the mortgage book and secured is basically unemployment I would say is the main driver of future impairments. In the corporate book what we are seeing today is related to unemployment as well. What we are seeing in the corporate book, which is a special feature is the low level of the corporate gearing, so the interest rates are very low so the capability of repaying debt is very strong. We see corporates in the UK also with big levels of cash and so this is a very sound position, very different. The best in the last 30 years. So that is a special feature we are seeing today.

Answer: António Horta-Osório
And just to complement what Juan said and George alluded to that, we have in our opinion now, a much lower AQR through the cycle than what this bank had 6 years ago because it is a very different bank. So to start with £200 billion of toxic assets which now are reduced practically to zero. The low risk approach that we took for 6 years in terms of new cohorts etc, we think that AQR through the cycle, to your question as well, is much lower than what it used to be 6 years ago.

And on your second question about our confidence on margin. You are correct, we are forecasting a higher margin than what we said in Q3. We have said around 270 basis points, we finished slightly better, on the upper side of 271. And we now think that the margin will be higher than 270 basis points in the year. This is mainly due to two factors. First because we had a very good quarter in terms of, as I was answering before, in terms of managing the liabilities of the bank as a whole. And through mix and great management in several divisions we were able to go back, as I said, to the target loan:deposit ratio with a lower cost of deposits, we look at margin as a difference of the two so that has enabled us to be more optimistic about margin this year. And at the same time to invest more and keeping the open book of mortgages flat as we discussed before. So that is the first one. It is not a market driven point, but it is a bank specific point.

And the second one, to be very frank, is that time has gone by and those good results allow us to do other things and therefore as time goes by and we keep improving the performance of the bank, we obviously feel more comfortable to do additional things and be able to continue improving performance. We are closer to the year, we are now more comfortable that the good work done in the second half is producing sustainable results and that is why we are giving you better guidance. But it is all based on this great work at total balance sheet level from various divisions in terms of mix and deposit acquisition.

<u>Question 11: Tom Rayner, Exane</u>

Thanks Antonio, it's Tom Rayner from Exane. Can I just come back to your mortgage strategy please because you mentioned it a few times and given your appetite for unsecured growth it suggests you are not overly concerned by the macro environment in the UK, yet the strategy, I would have looked at the new business rates in the market and on required equity and would have thought they would still be quite attractive returns on capital.

António Horta-Osório

On which segment?

Tom Rayner

Well maybe on buy-to-let as well, but the mortgage market. The new business rates, obviously a lot lower than the back book, but still possibly giving you good returns on required equity. So I am just trying to get a sense for your fairly prudent approach. Is it that you really don't like buy-to-let and you don't really see the mainstream market sort of recovering? Or is there an element of protecting that back book, so you don't want that 9 per cent attrition rate to start moving higher perhaps if you start pricing more aggressively? Is there any competition angle?

António Horta-Osório

A lot of questions!

Tom Rayner

It's all the same question, I am giving you potential answers. I am just trying to understand your thought process.

Answer: António Horta-Osório

There is no big mystery about this. I mean I think I have been quite open and quite constant and I would say quite firm on this belief. I think the mortgage market as I told Jonathan sitting next to you, that the mortgage market is much more complicated than people might think versus other segments because it is not a direct equation between new business margin and volumes. You have to take into consideration internal transfers, SVR attrition and the impact of price movements in any of those on the others because they are correlated. And therefore taking that point into consideration, plus my prudent macroeconomic assumption where I think we should be prudent, given the uncertainty out there. And thirdly the fact that the market grows very little and the main sector that grows is buy-to-let where we are even more prudent. Everything points to privileging risk, capital and margin instead of volume. We don't have any doubts about that for us.

On the unsecured market, although rates have been coming down as we previously answered, we think that it is still the highest return on risk weighted assets adjusted for over the cycle AQR. We think where we are growing primarily in the Jaguar Land Rover representation business, is prime consumer finance. We don't do subprime anywhere, but we particularly like the Jaguar Land Rover brand which we consider prime prime if you want. And we are growing there at appropriate returns. We are underrepresented and that is why we have a different strategy than in the mortgage market.

The final comment I would make is that when you consider margins you have to consider in my opinion the difference of the two margins and not just versus a base rate or whatever. You have to consider every asset you give, every loan you give, you have to fund it. That is why we like to see the difference of the two and not just the margins individually.

<u>Question 12: Chris Cant, Autonomous</u>

It's Chris Cant from Autonomous. I just wanted to ask two please. One on non-banking NII. It has been running around negative £100 million per quarter during the course of this year. I was just wondering what guidance you can give us for next year in terms of understanding how to interpret your NIM guidance, will it remain that negative and should we just put in £400 mllion again?

And to follow-up, something you said in response to a previous question related to that. You said NII would be up in absolute net terms next year. Is that a pre MBNA comment or a post MBNA comment? Because it makes a difference.

And then secondly, you made some comments about your capital position, the PRA buffer reducing but sticking with the 13 per cent because you view that as a buffer against future potential regulatory action. I am just wondering if the thing that squares the circle between your guidance there and your capital generation guidance is that you are expecting significant RWA increases? So when you are looking out to the 2018/19 point and you are talking about this 170-200bps, do you have an assumption that you can share with us about the quantum of RWA inflation you are receiving? Thanks.

Answer: George Culmer
So the non-banking NII, which you are right, it has been bounced around. I think we want to stop that. So we will take a longer look at that and I would expect it to be a smaller number in 2017.

Answer: António Horta-Osório
And to your second question, I did not say I was expecting NII to go up this year. I mean and I am not saying the opposite. What I said was I expect NII, to the question, for the consumer finance area which was the question.

Chris Cant
I mis-heard you, okay.

Answer: António Horta-Osório
And I said nothing about the total NII, we were discussing the consumer finance and NII which I related to the German deposits which we partly used to fund it, but that was the conversation. And on the capital, 13 per cent?

Answer: George Culmer
A number of things. I know we said in the presentation, but it is worth repeating. So it is good news, it is reflective of the de-risking that we have undertaken that we have had this reduction in the PRA buffer. Again as we have said, we are going to stick at 13 per cent and this is about regulatory developments Chris, this isn't about any foresight we have about RWA inflation, whatever happens to Basel 4 etc, who knows at the moment. This is about the position of systemic risk buffer overlays in 2019 so it is not about RWAs, it is about changes in capital rules.

Answer: António Horta-Osório
What happened on the PRA buffer is not a surprise to us, we were expecting that. Like George has said, we also know there are some known headwinds out there like the systemic risk buffer domestically which taking everything into consideration we have told you before, we expect our capital to be around 13 per cent. Now the buffer has been reduced as expected, we know the others will come in the future, we continue to expect the 13 per cent.

Question 13: Robert Noble, RBC
Thanks, it's Rob Noble at RBC. I was just wondering on the margin drivers in the consumer finance book, but split by the different products. So what is the difference in the margin between the cars, the cards and the personal finance and what are the drivers between the three of them?

And then on TFS, how much TFS funding did you take? And your average interest earning asset growth, do you expect to fund that with more TFS funds over the year? Thanks.

Answer: George Culmer
The TFS, taken about £4.5 billion and I think total capacity would be expected to be around £20 billion and I would expect us to be drawers of the TFS, so it is an appreciated development and we will make full use of that.

In terms of the first, we will come back to you on the specifics in terms of the relative attractiveness in terms of cards, car finance etc. So apologies to sort of push off, but as Antonio said, this is an attractive part of the business and we look at the returns we are making when we look at the economic profit it generates. We are big supporters of the sector and hence the capital we are deploying. So we will come back to you with some of the specifics.

Answer: António Horta-Osório
We manage it together because we think from the client point of view they are a substitute of each other and that is why we manage them together, but we can come back to you with specific points if you want.

Question 14: Diarmaid Sheridan, Davy
Good morning, it's Diarmaid Sheridan from Davy. Just a question around AQR please. Interested in your thoughts around IFRS9 and maybe on day one impact firstly, but also then through the cycle how you think that could impact you? Thank you.

Answer: George Culmer
Okay so IFRS9, it's a January 2018 impact. We are not going to say anything now. We are obviously working on it and all those sorts of things in terms of what the numbers might be. Part of that is obviously because you have got to determine your view of the future when you arrive at that particular point. So we will probably give some more update as we move through the year. As

you know from a capital perspective, there is the proposal out there to apply a transitional basis to smooth over 3-5 years which then would be welcomed and would make it much easier to deal with.
I am not a big fan of IFRS9, I mean it is going to produce more volatility I think it is going to make it quite impenetrable for users of the accounts to understand what is going on. And the variables in terms of views of one's book and views of the future and how the two interact with each other. You will get greater volatility, nothing obviously will change over the life cycle of an asset, but you will get something that is harder to understand, it is more volatile, but so be it, sorry.

Question 15: John Cronin, Goodbody
Thank you. John Cronin from Goodbody. Just to come back to the consumer finance piece. I appreciate that you are going to come back with more granularity on that, but just ask the question in a more broad style perhaps. You have called out that there has been some asset yield compression over the course of 2016 owing to the surge in motor finance lending. You talked very positively about growth in that book. So I suppose how in broader terms should we be thinking about the asset yield progression with respect to that specific book?

And my second question is just to come back to the capital guidance again. I appreciate your point around the system risk buffer being the key driver in terms of the retention of that guidance. But just to put it to you, if we were to find out later today for example that all of the Basel 4 so called regulatory proposals were dropped, would you think 13 per cent is the optimal or appropriate target for your investors?

Answer: António Horta-Osório
George will take the second question, while he thinks, I will answer the first one. You are right about asset compression, but it is not really an asset compression as it has a big impact from the mix. Because where we are growing the most is in Jaguar Land Rover and as I told you Jaguar Land Rover is what we consider prime prime car finance and as prime prime, it has lower margins than the rest of the segments. So it is a segment where we are growing the most. It is true that margins in general are going slightly down as I previously answered, but through mix given we are growing more in Jaguar Land Rover than the rest, it looks to you a bigger compression, it is a mix effect. It has much lower AQRs and as I said, it is our highest return on risk weighted assets over all the portfolios.

Answer: George Culmer
In terms of the capital, I mean if Basel 4 does get torn up, be sure to let me know. For us as a business we think 13 per cent is about the right number. Now we will, as Antonio said, the move on the PRA isn't unexpected because we have been de-risking the portfolio and we would expect to see that come through and you will see that in our stress test results etc. So perhaps as we move forward and Basel 4 did hypothetically disappear, we might come up with a slightly cuter number, but it is all hypothetical and look, you can over complicate these things. We manage the 13 per cent, assume 13 per cent.

António Horta-Osório
So we are coming up to 11 o'clock so I will take one or two final questions.

Question 16: Ian Gordon, Investec
Hi, Ian Gordon from Investec. Two quick ones. Firstly apologies if I have missed it, but if you haven't disclosed it, can you spoon feed me on the planned phasing of your TFS drawings?

And then secondly, probably a statement of the obvious, but in the old days, someone always used to ask the dull question, are you happy with the consensus? And the answer was always sort of yes. Listening to your comments in your usual understated way, you have already told us that relative to your own consensus compilation NII is wrong, volumes are probably wrong. The cost:income ratio is wrong and impairments are plain nuts. So I assume that you are very unhappy with the consensus?

Answer: António Horta-Osório
That was a very British and elegant way of putting the question! Those easy questions always go to my CFO!

Answer: George Culmer
TFS, no we haven't said. I mean we assume a sort of relatively equal drawing through the year. So I think that is how we will actually draw on it. So in terms of the undrawn element, assume that that is drawn equally through the quarters of 2017

Further question
Of the £20 billion?

Answer: George Culmer
Of that order and we have already done about £4.5 billion something like that. And do you know I have never commented on consensus before. So I would rather not start now, actually.

<u>Question 17: David Lock, Deutsche</u>
It's David Lock from Deutsche. Just a couple of quick ones please. The first one is on the restructuring charges. I just wanted to check I think there are three outstanding programmes you have got. You have got the simplification, the ring-fencing and then the MBNA and it is about £750 million to run I think on those?

Answer: George Culmer
Yeah so we had about £600 million in the year to date and there are 3 actually. There is simplification which is about £400 million of that number. We have got the non-branch property portfolio which I think is about £50 million of that number and then I have got my ring-fencing which is about £150 million of that number. And in terms of sums to come, ring-fencing I think we said around around £300 million, could be slightly north of that, but as I say another £150 million and a bit to come on that one. On the non-branch I think it was £300 million so about another £250 million between now and I think 2019 and on the simplification one, on the restructure and redundancy costs essentially I think we said at the half year there would be round about £350–400 million of that order and I think since that point, we have taken about £150 million of that I think.

Further question
And the MBNA £200 million to come?

Answer: George Culmer
That will be in excess of that, that is correct.

Further question
And the other quick question was on the fair value unwind line. Do you expect it to continue to tick up in the coming year?

Answer: George Culmer
It drops away. I think it drops away in about 2018, it drops away quite markedly.

David Lock
Thank you.

End of Q&A