LLOYDS BANKING GROUP PLC – Q1 2016 INTERIM MANAGEMENT STATEMENT PRESENTATION

Thursday 28 April 2016

António Horta-Osório, Group Chief Executive

Good morning everyone. Thanks for joining our 2016 first quarter results presentation.

I am going to give a short overview and George will briefly cover the financial results. We will then have some time for questions at the end.

Turning to slide 1, for those of you following the website presentation. In the first three months of this year we have continued to make good progress, delivering a robust financial performance with stable underlying profit of £2.1 billion and an underlying return on required equity of around 14 per cent, whilst maintaining our strong balance sheet.

Our UK focused business model continues to deliver and differentiate us in a challenging operating environment, with our cost discipline and low risk approach providing strong competitive advantages.

This cost discipline has allowed us to respond to current market conditions, with the accelerated delivery of cost initiatives driving lower operating costs, which have more than offset the marginally lower income and driven positive operating jaws. These actions have also resulted in a further improvement in our cost:income ratio to 47.4 per cent, which remains the lowest of the UK major banks.

Our low risk business model means that we have very limited exposure to troubled sectors and credit quality has remained strong in the quarter, with impairments down 6 per cent and an AQR of just 14 basis points. In addition, there has been a further reduction in impaired loans, which now represent just 2.0 per cent of our lending portfolio.

This financial performance has resulted in strong underlying capital generation of around 60 basis points in the quarter, however, as announced to the market in February, the ECNs redemption has impacted our CET1 ratio which is maintained at 13.0 per cent, prior to the 2016 dividend accrual.

In the quarter, we have continued to make good progress in our strategic initiatives of creating the best customer experience, becoming simpler and more efficient, and delivering sustainable growth. We have the UK's largest digital bank with 12 million online customers and have now surpassed 7 million mobile digital users. In addition, over the last 12 months we have continued to increase net lending in each of our targeted customer segments.

We also remain focused on delivering on our targets to individuals, businesses and communities as set out in our updated Helping Britain Prosper Plan, and have recently launched our SME charter to help small businesses grow and to provide access to funding.

Finally, we are confident in the Group's future prospects and we are therefore reaffirming our 2016 guidance.
I would now like to pass the call over to George, who will run through the financials.

George Culmer, Chief Financial Officer

Thank you António and good morning everyone. As you have heard, underlying profit was £2.1 billion for the quarter, with a strong underlying return on required equity of around 14 per cent.

Total income for the three months was down 1 per cent year-on-year at £4.4 billion, with a 3 per cent increase in net interest income to £2.9 billion, while other income was £1.5 billion.

On costs, operating costs of £2.0 billion were down 2 per cent, primarily due to the acceleration of our Simplification programme, which has now delivered £495 million of run-rate savings and is ahead of plan. As you have just heard, this has enabled the Group to achieve positive operating jaws of 1 per cent and further improve our market-leading cost income ratio.

On credit, impairments fell 6 per cent to £149m, reflecting the low risk nature of our business model. This equates to a 14 basis points AQR, which comprises around 8 basis points of releases and writebacks, and an underlying 22 of gross impairments.

This is slightly better than expected, although for now, we continue to expect the 2016 full year AQR to be around the previously guided 20 basis points.

Looking at income in more detail. The 3 per cent increase in NII was driven by an improvement in the margin to 2.74 per cent, which is 10 basis points higher than in Q4 2015. Lower funding and deposit costs, including the benefit of the ECNs redemption, continue to more than offset lower asset pricing. In addition, the first quarter margin includes a one-off 5 basis points benefit from credit cards.

And for the full year, we still expect NIM to be in line with our guidance of around 2.70 per cent.

Other income was resilient in the current market conditions and the £1.5 billion for the quarter, is broadly in line with our historic run-rate and our quarterly run-rate expectations for 2016. The year-on-year decrease of 7 per cent primarily reflects lower income from Insurance and continued general pressure on fees and commissions.

Turning to lending. Year-on-year growth trends are broadly similar to those at the full year and over the last 12 months lending across the key customer segments has grown by 2 per cent. Within mortgages, as you know, the market remains competitive and our focus remains on margin and lending within our prudent risk appetite.

In the past year the residential mainstream market has grown by around 1 per cent, with our growth just below that, while in buy-to-let the market grew at around 11 per cent compared with our 3, and as a result our overall growth of 1 per cent compares with the market growth of around 2.

In UK Consumer Finance, which now includes unsecured personal lending as well as asset finance and credit cards, we have delivered UK loan growth of 10 per cent. This was driven by new business growth of 30 per cent in motor finance, which again benefited from our partnership with Jaguar Land Rover, and while unsecured personal lending reduced by 4 per cent due to lower branch sales volumes, we have delivered 4 per cent growth in credit card balances.

Within SME, we have continued our strong performance, outstripping the market once again, with year on year growth of 5 per cent, while we have continued to grow our Mid Markets lending in a challenging market.

Looking at the overall asset position, total loans and advances increased by £1.5 billion to £457 billion, with a similar increase in interest earning assets on a spot basis, while average interest earning assets reduced slightly in the quarter to £438 billion, largely reflecting the timing of asset growth in Commercial.

Looking at statutory profit, market movements and the redemption of the ECNs resulted in a £790m charge in Q1.

Market volatility and other items were £334 million comprising fair value unwind of £47 million, amortisation of intangibles of around £80 million, as well as negative insurance volatility of £163 million, primarily driven by adverse market movements in equity and credit.

On Restructuring, the £161 million charge reflects the Simplification severance costs related to the role reductions announced in the quarter and the first costs for the implementation of the Group's non-ring-fenced bank.

On conduct, we have taken £115 million during the quarter to cover retail conduct matters. While on PPI, complaints over the three months have been around 8,500 per week on average, which is broadly in line with expectations and no further provision has been taken.

Finally, our tax charge was £123 million, representing an effective rate of 19 per cent. This is below our medium term guidance of around 27 per cent largely due to the impact of tax exempt gains and capital tax losses not previously recognised. We still anticipate the full year tax rate to be broadly in line with guidance.

Finishing then with a few words on capital. As you heard from António, the business continues to be well capitalised and strongly capital generative, with the CET1 ratio maintained at 13.0 per cent, prior to the 2016 dividend accrual of 20 basis points. The underlying capital generation in the quarter was around 60 basis points driven by strong underlying profit which, as in prior years, excluded any capital contribution from Insurance. This underlying capital generation was offset by the ECN redemption charge of around 40 basis points as well as a number of other smaller items including the impact of the prudential valuation adjustment and conduct.

Looking forward, the Group continues to expect to generate around 200 basis points of capital per year, and in 2016 this capital generation is likely to be weighted towards the second half of the year, due to items such as the timing of an insurance dividend and movements in RWAs.

Finally, our TNAV per share increased from 52.3 pence at the full year to 55.2 at the end of March. This increase was again driven by strong underlying earnings but also benefited from positive movements in the cash flow hedge reserve.

So, in summary, the Group's clear strategic focus and differentiated business model has continued to deliver stable underlying profit and strong underlying return to capital generation.

The Group is well positioned for the future and we are today reaffirming our 2016 guidance.

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

End of Presentations

Question and Answer Session

Question 1: Andrew Coombs, CITI

Good morning, two questions both on revenues, firstly on other income. Given what you have seen in Q1 and also your guidance going forward, and that you stated about the quarterly run-rate being broadly in line with expectations. Usually you see an element of seasonality, obviously, in this revenue line. It's clearly a more challenging environment, but are you suggesting you expect that seasonality to be far less pronounced this year?

Perhaps you could also just put a bit more colour on the other income split by the divisions as well?

And then secondly, with regards to average interest earning assets, you have seen another small decline there. Even if you exclude the run-off, 427.8 to 427.2, again I know this has been asked beforehand, but when do you expect to reach a turning point in terms of that average interest earning assets trajectory? Thank you.

Answer: George Culmer

Hi Andrew this is George, I will do OOI first. We delivered £1.5 billion in the quarter and you will recall, I think I said at the full year that we would hope to get into positive territory this year versus 2015. So last year was £6.1 billion so that is the sort of full year number. So that is sort of £1.5 billion. You always want for more. But that is why I say we are sort of broadly in line with where we expected to be. I mean when you look at the comparators, versus Q1 last year we are down what, £115 million. We don't give detailed divisional splits at Q1 and Q3, but within that when you look at the contributors, Commercial is marginally ahead, I think Retail is in line. Most of it is actually Insurance which is about £70 million down and that's as much to do with Q1 last year where we had benefits from longevity and we also had benefits from transferring some assets into Insurance where we were able to reflect the benefits from within that. So that is really why we are down versus Q1 last year.

Versus Q4 it is more spread across the business. And I think we are down about £50 million Q4 on Q1. So that is the position. So as I said, £1.5 billion, it is tough, but Commercial's been resilient, we are ahead on where we were a year ago and we have a great franchise and great business to build on and as markets come back as they will, we will be able to play into that. It will stay relatively tough in Retail. I would hope for more from Insurance, it may be quite lumpy because you have got things like the bulks coming through, but I would hope for Insurance to move forward. And similarly in Consumer Finance where we are growing that business as well. So it does remain challenging, as I said we were shooting to get ahead of the 6.1, we are at 1.5. So it is a reasonable start to the year I would say.

And on the average interest earning assets. We have put a slide in the back, I think it is an appendix to the slide deck, which just shows the reconciliation and just shows you that on a spot basis, the interest earning assets track the growth in loans. So there is an averaging effect in terms of when that actually came into play. And on the averaging basis it was slightly down in Commercial, but as I said, that actually picked up at the end of the month.

I won't give a prediction in terms of going forward. And part of that depends upon how we see the mortgage market, and how we respond to that. So at the moment as you know, on mortgage it's on emphasising margin over everything else. So I am not going to give you guidance. You have seen them stabilise, you have seen that the reduction of run-off is slower than elsewhere, but we are into sort of fine movements. But in terms of tipping points it is dependent on other factors and the average interest earning assets is more of an output than an input.

Andrew Coombs
Thank you.

<u>Question 2: Michael Helsby, BAML</u>
Morning. I have got two if I can. First one for you George. In the past you have given us very helpfully the SVR balances by brand, the movements that you are seeing and also the yields. But on top of that you have given us your fixed rate deposit balances and those yields. Have you got that data again please?

George Culmer
I do, but do you want to give your second question.

Michael Helsby
Yes one I guess more broadly for Antonio and I am sure the questions that follow will probably focus on a similar theme, but it is clear that the revenue environment is getting a lot tougher in the UK. You know competition is clearly very fierce and the rate environment isn't helping. So the performance that you demonstrated in Q1 was very good. You maintained your costs and doing everything that we would hope you would do. But revenues are down 2 per cent excluding the card benefit that you referred to. Costs were down 1 per cent. So I guess the question is, if the revenue environment gets tougher, to what extent, what levers have you got to pull on costs that you can still maintain that cost:income ratio improvement? Thank you.

Answer: George Culmer
Yes on the asset side, on the mortgages, I mean the SVR book is about £148 billion which is down from about £153 billion at Q4. But within that, I mean the Halifax at 3.99 per cent is at £51 billion and that compares with £52.5 billion. The others are all down sort of a billion or so in terms of things like the Lloyds etc, Bank of Scotland. So Lloyds is £37.8 billion compared with £39.1 billion. In terms of attrition rates. I mean it has picked up slightly so I think we were sort of 8 per cent, we are up to about 9 per cent and we would expect it to be that, if not tick slightly higher and one of the things that you are seeing here as people come out of fixed, you have got quite a large number of maturities, some are on lower rates and they now fit into SVR which is a step up. Okay, you get a behavioural response to that. So it has picked up a bit and I think we would expect to see it continue in that direction. Not a dramatic shift, but that is what we are seeing.

On the other side of the balance sheet, on the liabilities side, I mean first up talking generalities, we do have a great advantage of being able to manage the entirety of the balance sheet and manage between brands and products and divisions and as a simple example, Retail savings are £182 billion, which compares with £185 billion in Q4 and about £194 billion a year ago. And when you look at the Commercial equivalent to those, Commercial is now £129 billion and it was £126 billion at Q4 and £122 billion twelve months ago. And in terms of comparative costs, if Commercial deposits cost me 50 basis points and Retail at 1 per cent plus, you can see we have got the ability to flex within the balance sheet so within the divisions in terms of sourcing the cheapest bits of funding.

And within the Retail bit, my aggregates and my savings balances are now about a percent in terms of costs and that compares with about 106 at Q4 and north of 130 about twelve months ago. And the movement between the 106 to the 1, you know it is just shaving a few basis points. So the fixed, where we have got about £26 billion average rate of about 210 and that was £27 billion and 213 in Q4. Fixed ISA £31 billion and that is 201 and that was 207 at Q4, when the balances were £33 billion. And similarly instant access with £94 billion, just down from £95 billion in Q4, but the rate we are paying 50 and we were paying 54. So it is more of the same in terms of themes, in terms of flexing within the divisions as I say, within the types of deposits and then looking to shave in terms of the costs of those funds. And it's the advantage we have in terms of being able to manage costs across the piece.

Answer: António Horta-Osório
And Michael to your second question. The way I see this is very similar to the way we have been discussing in the last few quarters and we discussed at year end. And we see the economy in a good place. We see interest rates lower for longer as we discussed at year end results, so we see a translation of the economic environment and at the same structure and in the same direction. And therefore as interest rates are lower for longer as you said, there is more pressure on income and income is not growing as we thought it would grow 18 months ago. On the other hand, impairments are also lower which is related also to lower interest rates for longer. And our impairments are better than we thought and our NPLs given our prudent risk position, our NPLs went down again to 2.0 per cent of our total loans. So you have a natural offset on impairment and there is a

difference which we are acting on in an accelerated way through costs and simplification of the business at an accelerated pace. And to elaborate a little bit on the several points.

On the economic environment, we continue to see the UK growing well on average, so depending on exceptional items, depending on what happens with the Referendum. The UK economy as we saw yesterday, continues to grow at a reasonable pace, 0.4 per cent quarter on quarter and 2.1 per cent year on year which is in line with expectations. Therefore the economic environment is quite benign. It is growing with less debt, which I re-emphasise is a very important thing. Because obviously more debt stimulates GDP in the short term and the fact that the UK economy is growing with less debt on the household sector which needed it, the corporate sector that did not need, was already at a healthy level. And now in the public sector, I think it is very positive and will ensure a longer economic cycle than otherwise.

And second, the fact that house prices are growing throughout the country and that the mortgage market is not growing very much, that also has a positive impact on the quality of the balance sheet of banks in terms of mortgages. We attract new business at higher prices but most of the business which is the stock, gets lower and lower LTVs given house price movement and that is quite positive for the banks as a whole and for us as the leading bank in the mortgage sector.

Therefore what we are doing in this environment is now going into the cost line. As we said at year end, we have accelerated our cost plans last year and as George mentioned we are ahead of plan. This year we have continued acceleration and I would say we have intensified it since the beginning of the year, it was clear, given the market turmoil in the beginning of the year that things are even lower. And we are ahead of the plan and when we finish the plan which will finish before the three years, we will give you more news and more initiatives about what we are going to do next. We are strongly committed to providing positive jaws as we have provided in Q1, where we decreased the cost:income again to 47.4 per cent which is much lower than our other UK peers.

Michael Helsby
Got it. Thank you.

<u>Question 3 : Ian Gordon, INVESTEC</u>
Morning, can I have two please. Firstly, just following up on the cost point. It feels like your positive jaws guidance is consistent with a small absolute reduction in costs and you have delivered that in Q1, can you just talk a bit more specifically on the tail wind you may get in Q2 with relation to the FSCS charge? Can you quantify the amount you charged in Q2 2015 about £0.2 billion I think? And what is your expectation for the time line of the decline of that charge? I appreciate it is dependent on a number of factors, UKAR etc.

And then secondly, can you just talk a bit more on your thinking on front book pricing in the mortgage market, it certainly looks like given where swaps have moved you have actually been achieving some useful expansion in front book asset spreads. Can you comment on a) how true that is and b) how sustainable you see it given the very strong approvals data we saw again for April taking us to the second quarter? Thanks.

António Horta-Osório
George will do the first, I will do the second.

Answer: George Culmer
Look I mean, first of all I will repeat some of the things Antonio said around the costs. We do have the ability as I was saying earlier about managing the balance sheet and rates, simply to respond and react to what we are seeing. And we are moving more speedily in terms of expense action within our original plan than we envisaged. So you know branch closures targeted 200 and we are up to 150, in terms of heads we talked about 9,000 and I think we are just over 6,000 now. So we are moving more speedily and will continue to do so. There is a seasonality step up in Q2 and that is the FSCS which I don't have the precise number, you are right, it is round about the 200 there, although it depends upon rates and other matters and it can be lower this year. I am not going to explicitly talk about what income might come along to offset that tick-up, but just to reiterate the point, we do target these positive jaws and we target to maintain that over the year, but I'm afraid I can't divulge into any particular detail as to what income there will be to offset that step up in costs as we move through, but it is a seasonal thing from year to year.

Answer: António Horta-Osório
And Ian reverting to your second question on the front book prices and margin. I would say that the trend in front book prices relating to mortgages has been similar to what we have watched over the last 18 months. There is a progressive pressure, downwards on prices based on lower impairments, given the benign economic environment. And also on lower deposit costs. And I think that that trend is not very different to what it was six months ago. It depends from player to player, but overall I don't

see it very different. And we are assuming as we said at year end results that it will continue. I think we have a competitive advantage in terms of margin management because we follow a multi-brand approach to the market where we have very different customer segments with different needs. And we manage the margin together and it is the difference between assets and liabilities. It is important to address the difference between assets and liabilities and we do it together, we do it on a weekly basis at the top of the organisation and together we use this multi brand approach and I think this is a very powerful element of our strategy which I think shows in the differentiated behaviour of our NIM versus other banks.

So continuing to the next one or two quarters which is now only the time that we can foresee given competitors behaviours, I would expect Ian that this downward movement on mortgage prices continues, this slight downward movement, but I continue to expect deposit prices to go down and the UK is in a very good position in terms of liquidity and we continue to aim to balance the difference of the two and that is why we are keeping our guidance at around 2.70 per cent for the full year.

Ian Gordon
Thanks very much.

<u>Question 4: David Lock, DEUTSCHE</u>
Morning everyone, three for me please. First on deposits. Thanks for the colour on the rates you are getting on the ISAs in particular. Certainly when I look at my own ISA and I look at the ones quoted on the Bank of England, I am getting nowhere near 2 per cent. So I just wondered if you could explain the duration of those balances and why you are so much higher than the market average on that?

Second question is on the restructuring charge. It was a little bit higher. Is that just because of the redundancies that have come through this quarter or should we expect a little bit of lumpiness in the rest of the year?

And the third one, I just wondered if you could comment whether since the beginning of April you have seen any change in pick up in terms of mortgage volumes following the buy-to-let changes around tax? Thank you very much.

Answer: António Horta-Osório
I will take the first one and George will take the second and third on buy-to-let. In terms of your question, I think as I was saying to Ian Gordon before, I think deposit prices are on a downward trend and I am sure that in terms of our ISA prices as the season went very well for us, we generally speaking, we did not increase our ISA prices, they came down slightly. On the other hand as you pointed out and especially through the Halifax brand, we still have higher funding costs, given the heritage of Halifax the Building Society. And it is an opportunity for us to continue lowering those prices. So I hear both your comments, I think the answer is that, I think deposit prices continue to go down and in our case as well. And specifically in the ISA season, we still have higher prices in the Halifax brand than in the market in general which is in my opinion an opportunity to continue to lower them as time goes by.

Answer : George Culmer
On the restructuring yes, a couple of things on restructuring, as we called out in the Presentation, you have got around about sort of £30 million or so of the first of the non ring-fenced build, that is coming through, we are in build phase of that, now we know what we are doing and we are constructing that. And then with the severance, yes we have announced in the quarter 2,000 or so redundancies so that relates to that. Those costs are slightly higher, it is a consequence of going faster that we are probably spending more in terms of exiting people etc, less attrition and we are having to take more direct action. So we will have plenty more, so that is the reason for that.

The buy-to-let, as we said, markets are running 11-12 per cent, you know there is a tax element to that and we do expect the market will calm down after tax changes come in. We are at 3 per cent so we are well inside that from the market share perspective, but we do expect it will calm down.

Answer: António Horta-Osório
And David it’s interesting, if I could just add a point of colour here. It is interesting that not only we notice as you were asking a significant increase in buy-to-let due to the stamp tax that was implemented in April, which as George says now we expect it just to be a translation of volume, so it should be lower now going forward. But we also saw a significant increase in the purchase of second homes which was both buy-to-let and second homes but we see that as a mere translation of volume from later in the year into the pre-stamp duty tax changes.

David Lock
Okay, thanks very much.

Question 5: Martin Leitgeb, GOLDMAN SACHS

Good morning. I have two questions please and the first touches on the point from George on average interest earning assets. If I look at your domestic retail mortgage book in the UK, the balance there has been extremely stable, pretty much since fourth quarter 2013, obviously excluding TSB at a level of roughly 300 billion sterling. And I am just trying to square up the comments earlier that you are not going to give any guidance in terms of how we should think of this average interest earning assets going forward with obviously having strong growth in some of the other segments, are you essentially hinting that you would be willing to accept some form of contraction in the total residential mortgage book in order to sustain and protect your margin there?

And the second question is with regards to your branch footprint. I think it is now 1.5 years ago since you announced the current branch reduction target. Just looking at what the competitors have done in terms of their branch footprint over the last two years, average cuts of between 13-19 per cent, you seem to have done less in terms of the branch reduction at this point in time. I am just trying to think going forward, is that an element where you could tweak substantially more in order to address the cost base in case the revenue environment would remain challenging? Thank you.

Answer: George Culmer

Look, I think when you look at the trends, I don't think we break it out by division, but the trends over the last years have been, in terms of average interest earning assets, in Commercial has been coming down as we have looked to improve the efficiency and returns of that business, have been growing in Consumer Finance. And you are right, mortgages has been relatively static, it has been round about the £300 billion mark for a while. I think our strategy on mortgages is quite clear in terms of this is margin over volume. And you know my reason for being hesitant here, that has been the policy and the trade-offs between volume and margin on mortgages I am not going to elaborate on, because it is dependent on the circumstances that we are seeing. There are other volatile items like things like large corporates and stuff which bounces around, but would I be prepared to sacrifice a bit of mortgage volume for margin, of course I would. And you see that in the stats that we give today. I'm staying out of Buy-to-let, there are prudent risk appetite reasons, mainstream, I am closer to the market, but I am still inside that. And so I am effectively reducing market share and I am emphasising margin over the volume.

Answer: António Horta-Osório

And Martin we think that is absolutely the right approach in the mortgage market when you have have the following characteristics. First the market is only growing around 2 per cent but all the growth is in buy-to-let. So residential is only growing 1 per cent. So given the market is not growing very much, for us growing a little bit less in the market in terms of market share of the stock is not very relevant. And in terms of risk appetite, we think as the leader in the sector we should set the standards, the Regulator is worried about buy-to-let, we should listen to it and we should set the standards as we are doing.

Secondly, in terms of margin and given internal transfers movements, SVR retention, this is a much more complex game than any other product in terms of new business versus margin and this is clearly the best approach to preserve capital and value for shareholders. And therefore as a whole we think all the directions point for us to keeping this trade-off which also preserves capital. So we will continue to do that of course, the extent to which we will do that will depend on competitive behaviour and on future interest rate movements. And as George was saying, the reason why we don't want to lead to total guidance in AIEAs is more also due to the fact that large corporates can either borrow or go to the capital markets and they are big so there could be significant movement and as a consequence we don't target credit growth on large corporates as we have never targeted and therefore we don't give overall guidance on the total AIEAs, but we gave you guidance on the different segments and will continue to do so on the different target segments.

Martin Leitgeb

On the branch network footprint, should we see more optionality here going forward?

Answer: António Horta-Osório

Yes I think you will. Our strategy in terms of the branch footprint as we have discussed last year, when we presented the Strategy about 15 months ago, our plan is that we still think that this has to be carefully considered because still more than 50 per cent of current account openings are done in branch, so client acquisition is still more than 50 per cent through branches and this is mostly due to AML regulation which asks people to go to branches to verify identification. So that is something which will continue for some time. Secondly, we think that the better margin sticky deposits are mostly in branches. And therefore the branches are at a minimum value in the cycle given the level of interest rates, where interest rates will eventually increase, the value of the deposits in the branch will substantially increase. But thirdly, given that our competitors have been closing aggressively and we have been gaining market share just by standing still. To give you an example, the Lloyds brand was five years ago the fourth of the big five. And now it is the second just by size, all the other closing branches aggressively. So we have decided to close 200 branches by the end of next year and that would mean that we would at least keep our market share of branches.

We think that the competitors are closing more. We have accelerated our plans as well. So as we said before, we are going to finish this plan ahead of time and then we will present to you additional initiatives and they may include branches as well, given what is happening in the competitive environment.

Martin Leitgeb
Thank you very much.

Question 6: Joseph Dickerson, JEFFERIES
Hi, good morning guys. George could you just comment firstly on bulk annuity deals, if there is a pipeline, what it looks like? When such deals might complete so we can think about the trajectory of fee income over the coming quarters?

Secondly, Antonio, I looked at the credit conditions survey from the Bank of England a couple of weeks ago and if you look at the loan pricing commentary in the credit conditions survey, they were talking about spreads on secured lending to households widening significantly in the first quarter of this year after 13 quarters of narrowing and how lenders expected these spreads to widen further in Q2. Further when I look at your own pricing, in non buy-to-let areas, it seems to be going up. So could you just square those data points versus comments on pressure on front books spreads? That would be very helpful to me. Thanks.

Answer: George Culmer
Okay, on the bulk annuities, obviously transactual in nature. There is a large market out there, multiples of billions and the largest significantly come to market each year. We recognise them when they are transacted. We have an active pipeline you know, we have secured no deals in Q1, but I can say that since Q1 we have actually won a number of deals. They will come through. But it will be, I am afraid, lumpy in nature. We are targeting a significant financial in a number of bulk annuity deals as we move through this year. And as I have said, we have already actually in Q2 succeeded. So I am afraid I can't be more specific, but they will depend on when deals are actually won. So sorry on that.

Answer: António Horta-Osório
Joseph on the question about the prices, I think you are correct that in Q1 spreads were a little bit better in terms of the Bank of England data. In terms of our prices, you are correct as well, as I was saying, we are the leader of this market and therefore we set the policy that we think is correct. But as I was saying previously, I would not extrapolate too much quarter on quarter because you have to see the whole picture in terms of applications to approvals to completions. You have to see the swaps movement which is very extreme and in terms of Q4 versus Q1. And now up again. So I was answering my previous question more on a forward looking view for the next two or three months and taking into consideration if you want the last four or five quarters. And I think that the general picture which may have small changes from quarter to quarter, but I think the overall picture is the one I was describing, i.e. gentle, progressive pressure on the assets prices given lower impairment levels and benign economic conditions and gentle and progressive downward pressure on deposits given the situation in the UK market is quite rich in terms of deposits.

And again as I was saying, the importance is the difference of the two which we manage quite tightly, quite carefully on a multi-brand context and at the top level of the Bank.

Question 7: Chris Manners, MORGAN STANLEY
Morning Antonio, good morning George. So two questions if I may, both on capital and capital return. The first one was you have accrued twenty basis points of capital as the dividend in the quarter. By my calculations that gets you to about 0.65p. How should we think about that dividend accrual? Would that be your accrual rate for the interim dividend or what you think you will be paying for the full year? Would that include a special component to it? What should we read into that pace of dividend accrual?

And the second one was on your 13 per cent go-to capital ratio. When I add up your stack I get Pillar 2A of 2.6, systemic risk buffer of 2.5, countercyclical buffer of 1 and 7 per cent baseline getting you to 13.1. And then I would assume you might have a PRA buffer or management buffer on top of that. To get down to your 13, are we assuming that Pillar 2A comes down? And if so just trying to understand what the moving pieces there might be? That would be great. Thanks.

Answer: George Culmer
Hi Chris . So in terms of capital ratio and capital build, yes the accrued dividend and how to think about it, I think the short answer is, not too deeply. It is essentially a quarter of last year's ordinary dividend and as I am sure are aware, we are required, once one has a dividend policy you are required under PRA rules to accrue to that policy. So at the moment we have just accrued one quarter of last year's dividend, but I would not read anything into that. Last year's ordinary dividend, there is

nothing around special. There is nothing so please, please don't think too deeply about that. We will obviously talk more about dividends at the half year.

And then in the capital stack, obviously you know Basel continue to produce CPs etc. Always heartened by the last line they talk about no desire to increase capital and all those sorts of things and I know that is very much the stance, not just the words at the bottom of the page, but the stance of the UK Regulators and we have that confirmed and reconfirmed. And our expectations going forward is that there would be offsets and I would look to manage down things like Pillar 2A within that. So as it stands today, stick with our 12 to around 13.

Chris Manners
So am I to take that to mean that you think Pillar 2A is going to come down as that happens when you get inflation from some of the Basel papers. So you would actually have an RWA increase when your Pillar 2A comes down? Is that fair to say?

Answer: George Culmer
That might be one bit, but there are other elements in Pillar 2A that aren't RWA related. I have got you know IRBB, I have pensions in there. So I don't think they will get pushed into the RWA calculation.

Chris Manners
Got you, okay.

<u>Question 8: Jonathan Pierce, EXANE BNP</u>
Thanks, good morning. Three quick ones. Firstly on margin. There is quite a big gap this quarter between banking net interest income and the reported net interest income looks about 90 million quid which I guess is this insurance and trading deduction. Why has that gone up? That seems to be quite a lot higher than what we have seen in the past. So that is the first question.

The second one is on the restructuring charge again. Could you maybe just give us some feel for where you think that number is going to come out through 2016 and how much you now plan to spend on ring-fencing and structural reform over the next year or two?

And then the third question, I think George you alluded to a PVA adjustment within your initial comments, effective capital in the quarter and I think you said it was something to do with conduct. Could you just flesh that out a little bit? That would be really useful. Thank you.

Answer: George Culmer
Yes okay, so banking, I don't have the numbers to hand in terms of banking numbers. So there is nothing that I am aware of in terms of the sort of non margin related NII. So we will get back to you but there is nothing I am aware of in terms of that that I would particularly want to call out. The restructuring charge, I guess I am not going to be very helpful here because the restructuring charge, I expect it to increase and there will be more, but I am not going to give a number because of what people can infer from that and all those sorts of things. That is something we are going to work on and develop as we move forward. So apologies for being unhelpful on the second one as well.

The third one, PVA. So prudential valuation adjustment and it sort of goes into the whole sort of capital volatility point in the sense that what we have applied this time is the new rules have come out from this which we have to apply which essentially, I have got my balance sheet values which are a best estimate. I essentially have to overlay for regulatory purposes a prudential adjustment on top of that and it has cost me around about 5-6 basis points of capital in Q1. So it is a sort of one-off but I have applied that adjustment and that is what it actually relates to.

Jonathan Pierce
Okay, so it is not actually that material. I was just going to say, on the restructuring charge, are you able within that just to update us on ring-fencing costs because that is obviously an element of this in the quarter?

Answer: George Culmer
Yes ring-fencing is about £30 million in Q1, I would expect over the course of this year that would probably be around about £70-80 million I suppose of ring-fencing type costs that I would expect to come through. And overall, it would be about £300 million or so of ring-fencing and that would incur over the next three years, if that is more helpful.

Jonathan Pierce
Yes that is useful, thank you.

<u>Question 9: Raul Sinha, JP MORGAN</u>

Morning, can I have a couple of clarifications and then a broader one on the balance sheet. The first one George, just going back to the discussion on other income that you have had previously. Can I just clarify that you still aspire to get to positive territory for this year or are you sort of backing away from that? If I and apologies if it is a little bit semantics but if I do 1.5 times 4, that gets me to a little bit short of last year's run rate, so if you could clarify that, especially with some of the bulk annuity stuff coming through I would have thought you still have a chance of getting there. That is the first one.

The second one is on the NIM, could you tell us how much more ECN benefit there is still to come on the NIM? And the two basis point underlying pick up in NIM in the first quarter, is there any significant moving parts we should think about the next quarter or quarters going forward where we should actually expect NIM to come down significantly because of any step changes? Or is it just a sort of general run-off from here? If I square the 2.70 per cent guidance or 2.74 per cent, appreciate you don't want to get drawn into quarterly NIM dynamics, but if you could give us a little bit more colour on how you expect that, that would be useful?

Third one is, I saw that your wholesale funding picked up a little bit on the balance sheet as well and can you tell us if you are going to be running a higher LCR ahead of the Referendum and will that have an impact on NIM in the second quarter? Thanks.

Answer: George Culmer

On the first point on OOI, yes you are being semantic I think. Look you are right, as I said at the full year, I expect to move into positive territory and I still hope to move into positive territory, i.e. being in excess of. So you are right, I am at sort of 1.5 and to your point and to the previous question, I know I have got no bulks in there, I know there will be a contribution from bulks, just to pick one example as I move through the year. I am hopeful of Commercial building on their base and developing. It will stay tough in Retail I think, but I am hopeful of Consumer Finance moving forward as well. So that is not coming off guidance. It remains tough and obviously we will update you as we go through the year, but we are not coming off what we aspired to.

On the NIM, a couple of things, ECNs will be about four or five basis points on the full year. So actually when you look to the 2.64 per cent which was last year to the 2.70 per cent most of that was actually ECN so ECN will be five/six basis points coming through. The underlying that is relatively robust. So if I strip out ECNs and I strip out this credit card adjustment we talked about, you will see that the sort of quarter on quarter Q1 vs. Q4, I think we got about three basis points from Retail and Commercial deposits, two or three basis points from wholesale and in offset about three from Asset Finance. So that was the underlying trend. And going back to some of the earlier discussions, we still think there is more we can do to manage that. So we still remain relatively robust about NIM progression and I don't want to get into one basis point here or there, but we are still confident of delivering the 2.70 per cent.

And then on wholesale funding, yes couple of things going on there. We have done a bit of early issuance, so sort of to your question around market disturbance, we have been out early into the market. FX is a factor as well in terms of the pickup in terms of the valuation and where we have a slightly higher LCR, it doesn't have big NIM impact you know. We are north of 100 and we are slightly higher than we would normally be, but it does not have a material impact on the NIM.

Raul Sinha

Okay got it, thanks very much.

<u>Question 10: Arturo de Frias Marqués, SANTANDER</u>

Hi good morning, two quick questions from me please. I think you have been very clear and very helpful in what you see in terms of pressure of asset yields, versus deposit cost reductions. You have mentioned pressure on the asset side being offset by reductions on the deposit side. I think you have also said that you think the next couple of quarters are going to be pretty much more of the same for what you can see now. So my question is, how many quarters you think you have before you find yourself unable to offset the yield pressure with the additional deposit cost reductions? Because we all know it is more difficult to keep cutting deposit costs versus asset yields. So how many quarters do you think you have?

And the second is very related question.

Answer: António Horta-Osório

Arturo that is a very good question because I have to admit we have been going on for more quarters than what I said three years ago! We have been progressively managing this better than we felt, and sustainably. But the reason why we said in the previous answers Arturo, for the next two or three quarters is not at all related to any difference on the future, it is just related to the fact, as I think I mentioned as well, that obviously all of this is how we manage this Bank. All of this is dependent on what competitors do and how the market environment changes and it is much easier to tell you how we see competitors acting and in the light of the present interest rate environment, what is going to happen in the next two or three quarters, than to forecast on a longer horizon. So that is the only reason why I said two to three quarters and you will recall I have been saying two to three quarters for the last five years because of the horizon that we can tell you about and we want to be as always very transparent and very frank with you. And beyond that it may be dependent on things people do tomorrow or in a week. So we will have to continue to keep discussing this every quarter and we will continue telling you how we see the following two or three quarters, but don't expect anything in any direction in terms of our horizon. And I repeat the only reason is to be as accurate as possible in telling you how as the largest UK Retail and Commercial Bank we see the interaction of the environment and the different competitor strategies folding out.

Arturo de Frias Marqués
Yeah thanks for that. But am I right in thinking that if competitors continue to behave more or less as they have been doing so far. I mean this gradual and gentle erosion that you mention continuous more or less unchanged for the next few quarters, am I right in thinking you would not be able to offset that with deposits for more than these two or three quarters?

Answer: António Horta-Osório
I think the answer to your question is no on both grounds. i.e. you are absolutely right that I said maybe a year ago I said if the environment would continue with low interest rates for much longer there would be a progressive erosion on our margin, you are absolutely right, but as we have been commenting at each quarter, we have been able through active management and our multi brand approach to counteract that. And actually the progressive gentle erosion never happened and as George just said, we gave you the guidance of the 2.70 per cent which shows an uplift of the ECNs if you extrapolate the impact of the ECNs out, you have the same margin as last year. So that gradual and gentle erosion that I told you would happen in the future. We have been through active management and multi-brand as such has been able to avoid that from happening, first point.

And to your second point which is no as well, I don't think if competitors continue to behave as they are that you will see the margin erosion after these two or three quarters I mentioned to you and that is why we were robust when we gave you the 2.70 per cent margin guidance in February and that is why George has told you that we are I would say even more robust now after one quarter, that we will achieve that target.

Arturo de Frias Marqués
Okay, that is clear. Thank you. The question on costs you have said also that you will for now execute on that 200 branches reduction by the end of next year, whether you come back with more as you said you might do depends squarely on this NIM performance, i.e. if NIM can be defended we should not expect additional branch closures? And if NIM cannot be defended, we should expect original branch closures? It is the right way to think about this?

Answer: George Culmer
No that is a bit narrow. Look we are through 150, I think we did say end of next year, but as I said, we are moving more quickly and it will be done this year, but as Antonio said, there are a number of factors in terms of usage, the embrace of technology, growth in digital, etc. So it is too simplistic to say.

Answer: António Horta-Osório
I would add Arturo, our branch strategy as I was answering in a previous question is more driven by being still more than 50 per cent of client acquisition, second the value of deposits being higher in branches, they are more sticky and I repeat at a low point in the cycle. And thirdly on what competitors do. And given that competitors have been closing many more branches than they had announced and what we thought, our market share has increased by going slower. As George was saying, we will finish the current 200 planned this year and given everything else including especially the fact that competitors are going quicker, and by the way that customers are also going digital at an exponential pace. We now have passed the seven million mark in terms of mobile banking users and twelve million in terms of digital users. All the conditions are united apart from our continuous efforts on wanting to be simpler, more efficient in following customers' behaviours, for us to have additional activities in terms of branch closures, which as George said, we will tell you when we finish the current plan. But they are independent from the margin considerations.

Arturo de Frias Marqués
Okay, thank you very much.

<u>Question 11: Robert Sage, NATIXIS</u>
Thank you. I have two questions. The first was with respect to Brexit. If you do have any comments about any impact in the first quarter I would be interested. But my question is more really whether you sense that there might be any pent up demand, possibly among some of your corporate client base or SMEs who might have been delaying investment decisions in advance of

the Referendum result and whether that could actually lead to some sort of improvement in demand post Brexit, if we vote to remain in?

And the second question was just a very quick one. In terms of the conduct charges in the first quarter, could you just give a little bit more colour in terms of what they are and perhaps what the outcome for the rest of the year might be?

Answer: George Culmer
Okay I will deal with the second one first. It is just a number of items within the Retail Division and I can't say what the full year might be. These things when they happen I deal with them and there is no line of sight in terms of how you go forward.

The Brexit comments, you know as well as I do, I mean you see some impacts in the market in terms of people not participating in the markets etc as you move down the various hierarchies of corporate and SMEs and all those sorts of things. SMEs continue to trade and continue to act and transact and drawdown etc. If you go further up, maybe some people are standing off, but that is broadly what we are seeing.

Robert Sage
Thank you.

End of Q&A