LLOYDS BANKING GROUP PLC –2017 RESULTS PRESENTATION

WEDNESDAY 21 FEBRUARY 2018

<u>António Horta-Osório, Group Chief Executive</u>

Good morning everyone. It is great to see you all here. Today we will update you on our strong strategic and financial progress, and provide details of the strategy that will transform the Group for success in a digital world.

We will spend the next hour going through the 2017 results, including time for questions, before moving on to the strategic update. So, turning to the results.

2017 was a landmark year for the Group with the return to private ownership in May. This was the culmination of hard work by colleagues from across the Group, and it is a source of great pride to all of us that we were able to return to full private ownership with the government realising more than its original investment.

We have also made significant strategic progress in the year. We completed the second phase of our strategic journey, making great progress in creating the best customer experience, becoming simpler and more efficient, and delivering sustainable growth.

We have continued to develop our market-leading digital proposition and have the UK's largest and top rated digital bank, with almost 13.5 million active online customers, of which 9.3 million are active on mobile.

We have achieved lending growth in targeted segments within SME, Mid-markets and consumer finance, and increased our corporate pension assets. Our Simplification programme has delivered £1.4 billion of run rate savings, ahead of our original target, and further improving our market leading cost:income ratio.

In June we completed the acquisition of MBNA, which gives us additional scale and a great brand in prime unsecured consumer lending and in December announced the acquisition of Zurich's UK workplace pensions and savings business, which gives the Group a platform to develop the next phase of our strategy for financial planning and retirement, which you will hear more about later this morning from Antonio Lorenzo.

And in July last year we announced the restructuring of the business and the reorganisation of the management team in order to better align the bank's organisational design and capabilities with the changing external environment, and to plan in advance the next phase of our strategy. You will be hearing from a number of the leadership team later.

On the financials, we have again delivered a strong performance, with improved profit and returns on both a statutory and underlying basis. We have also returned the business to growth, with an increase in loans and advances in the year. This strong financial performance, along with the continued de-risking of the balance sheet, enabled the Group to both see its credit ratings increased again, and to deliver very strong capital generation of 245 basis points, above guidance.

In terms of capital requirements, we talked at Q3 about the 50 basis points increase in the Group's Pillar 2A. We are now pleased to announce that the PRA has also completed its review of the Group's PRA Buffer requirement. As a consequence of these and other developments, we are now targeting a revised capital requirement of circa 13 per cent while also holding a management buffer of around 1 per cent. With our strong capital generation we are already at this level.

On returns to shareholders, the Board has recommended a final ordinary dividend of 2.05 pence per share, which means that the 2017 total ordinary dividend of 3.05 pence per share is 20 per cent higher than last year and in line with our progressive and sustainable ordinary dividend policy. The Board also intends to implement a share buyback of up to £1 billion over the next 12 months, reflecting the Board's desire to return surplus capital to shareholders. This represents a 46 per cent increase on total returns to shareholders versus last year, amounting to up to £3.2 billion.

In 2017 we have again clearly demonstrated the success of our business model with increases in both underlying and statutory profit.

Statutory profit before tax increased 24 per cent year on year to £5.3 billion, from a negative £600 million in 2012. And as the below the line charges reduce in future years we expect the gap between statutory and underlying profits and returns to continue to close.

We achieved £8.5 billion of underlying profit, still 60 per cent above statutory PBT, and increasing 8 per cent over 2016, with the improvement a result of:

- Net income growth together with an increase in net interest margin;
- Our market leading efficiency and an improved cost:income ratio;
- Strong asset quality with our AQR being kept at low levels; and
- Our Moody's credit rating improving to Aa- and our S&P outlook improving to 'positive', driving our cost of funds down further.

As a consequence, the Group delivered a statutory return on tangible equity of 8.9 per cent in 2017 and an underlying return after tax of 15.6 per cent, which shows both the progress we have made, and what we still expect to achieve, for our shareholders over the next few years.

Turning to the UK economy. We see an economy that is resilient and continues to benefit from the tailwinds of continuous GDP growth and deleveraging in recent years, with unemployment also at a 40 year low. We expect the employment rate to continue growing in 2018, further supporting consumption. On the other hand, pay growth remains below inflation, which causes pressure on household finances.

Despite the UK continuing to run a current account deficit, exports are now growing consistently ahead of imports for the first time in 6 years, helped by the recent devaluation of sterling, which has also increased the value of earnings from foreign assets, which is positive.

All these factors considered, the UK faces a period of political and economic uncertainty. But given the fact as well that we are an open economy we also benefit from global growth, which has accelerated recently, and therefore all in all we expect GDP growth in 2018 at similar levels to 2017.

In summary, in 2017 we have made significant strategic progress and our differentiated multi-brand business model continues to deliver, with a significant improvement in financial performance and returns along with strong capital generation.

In 2018 we expect a net interest margin of around 290 basis points, in line with the second half of 2017 and again demonstrating the strength of the Group's margin, given our multi-brand strategy and overall management of pricing and volumes across the whole balance sheet.

We also continue to expect the cost:income ratio to further improve, the asset quality ratio to remain below 30 basis points and capital generation to be in line with our ongoing guidance of 170 to 200 basis points.

We are well positioned for the future and face the next stage of our strategic development with confidence, as we continue to build on our existing competitive advantages and develop new ones. You will hear from various members of the senior management team later this morning and they will provide you with an overview of the key strategic priorities and the initiatives we will be implementing under the next phase of the Group's strategy.

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

George Culmer, Chief Financial Officer

Thank you António and good morning everyone. As you have already heard, the Group has delivered a strong financial performance in 2017, with statutory profit before tax up 24 per cent at £5.3 billion and underlying profit up 8 per cent at £8.5 billion.

This performance was driven by a strong final quarter in which underlying profit was up 7 per cent on Q4 2016 and net interest income up 14 per cent, with a net interest margin of 290 basis points, and in line with Q3. In terms of the full year, net income is up 5 per cent at £17.5 billion, reflecting both higher NII and other operating income.

Operating jaws were a positive 4 per cent and the Group's market-leading cost:income ratio has improved further to 46.8, while asset quality remains strong with a net AQR of 18 basis points and a stable gross AQR of 28. And as you've heard, the Group delivered an underlying return on tangible equity of 15.6 per cent, up 1.5 percentage points and a statutory return of 8.9 per cent, up 2.3 percentage points.

Looking at net income in more detail, net interest income was £12.3 billion and up 8 per cent with lower funding and deposit costs, again more than offsetting asset pricing pressure. MBNA has contributed £430 million of NII for the 7 months of ownership and is performing ahead of our expectations.

The net interest margin for the year was 286, up 15 basis points. And, going forward, while we expect asset pricing to remain competitive, particularly in mortgages, for 2018 we still expect NIM to be around 290 basis points.

Other operating income in 2017 was £6.2 billion and up 2 per cent, with a good contribution from Lex Autolease in Retail and a robust performance in Commercial, offset by reduced Insurance income due mainly to lower bulk annuities. Other income also benefitted from the gain on sale of Vocalink and, as previously stated, we continue to be a seller of gilts and have realised gains of around £270 million in the year.

Turning to costs, cost management continues to be a competitive advantage for the Group and, excluding the impact of MBNA, operating costs fell 1 per cent year on year to £8 billion. Total operating costs including MBNA were £8.2 billion.

Our Simplification programme has delivered £1.4 billion of run rate savings, in line with the enhanced target we set for the end of 2017, and these savings have helped deliver a 19 per cent reduction in operating costs since 2010, with reductions every year and enabling increased investment in the business.

In terms of asset quality, our gross AQR of 28 basis points is in line with the last two years and this is after a large single corporate impairment in the third and fourth quarters, and the consolidation of MBNA in the second half of the year, which adds around 2 basis points to the ratio. Our net AQR is 18 basis points and reflects the expected lower level of releases and write-backs.

Impaired loans for the Group now stand at £7.8 billion, 1.6 per cent of gross lending and down 0.2 percentage points on prior year. The coverage ratio of 45 per cent is up 4 percentage points with a prudent increase in coverage across all business lines, despite the fall in impaired loan ratios. .

Within Retail, the mortgage portfolio continues to benefit from strong affordability and falling LTVs. And the average LTV across our book is now 43.6 per cent and nearly 90 per cent of our portfolio has an LTV of less than or equal to 80 per cent.

In Motor Finance, we continue to take a prudent approach to residual value provisioning and our prime credit card book uses conservative pricing and reserving assumptions, and is performing well.

In Commercial, the book has continued to benefit from effective risk management and the benign economic environment including the continued low interest rates. For 2018, as you've heard, we expect an AQR of less than 30 basis points, although IFRS 9 will of course introduce additional short-term volatility.

In terms of divisional performance. Retail has put in a strong performance and benefitted in the second half from the consolidation of MBNA. Underlying profit of £4.4 billion increased 9 per cent, with the net interest margin improving by 14 basis points, while other income was up 3 per cent, largely driven by Lex Autolease.

Lending is also up 3 per cent, including year on year growth of around £1 billion in the open mortgage book.

Commercial has seen a 5 per cent improvement in underlying profit to £2.5 billion and a market leading return on risk weighted assets of just over 2.8 per cent, well ahead of our target of 2.4 per cent. The net interest margin has improved by 18 basis points, driven by 5 per cent improvement in net interest income, while other income has remained broadly stable.

Underlying profit in Insurance and Wealth is down 3 per cent on 2016 due primarily to lower new business income from bulk annuities and a lower contribution from wealth. The business though continues to generate strong returns and capital generation, with an underlying RoTE of just over 16 per cent and a full year dividend of almost £700 million.

Finally in the Centre we have seen increased income and profits due to the £146 million gain on the sale of Vocalink and the £274 million of gains on sale of liquid treasury assets, primarily gilts, that I mentioned earlier.

Looking then at statutory profit. Statutory profit after tax is up 41 per cent at £3.5 billion, reflecting the higher underlying profit, lower below the line charges and a lower effective tax rate. Market volatility, at £82 million is significantly lower than 2016, primarily due to the £790 million charge for the ECNs in the prior year.

Restructuring costs of £621 million are in line with 2016 and include the final costs of the Simplification programme, as well as our investment in our non-branch property rationalisation, the Group's ring-fencing programme and the integration of MBNA.

PPI costs of £1.7 billion include £600 million in the fourth quarter, reflecting an increase in expected weekly claims through to the time bar, from 9,000 to around 11,000, which is the average received over the last 9 months. Other conduct and remediation charges were £865 million and included £325 million in the fourth quarter for Packaged Bank Accounts, arrears handling and other legacy issues. Going forward we expect remediation costs to reduce significantly.

Finally, the effective tax rate of 33 per cent is lower than prior year due to the impact in 2016 of writing-down deferred tax assets, but is still adversely impacted by the non-deductibility of conduct charges and is above our long-term expected rate.

Turning then to the balance sheet. Loans and advances stand at £456 billion, up £6 billion in the year and up £11 billion since the low point in Q1.

As guided, the open mortgage book finished the year slightly ahead of 2016. And as you have heard, the SME portfolio continues to grow ahead of the market while motor finance continues to grow strongly and within the Group's conservative risk appetite.

The acquisition of MBNA obviously completed in June and contributed around £8 billion of credit card balances and £7 billion of risk weighted assets.

However even after allowing for MBNA, RWAs are down £5 billion in the year at £211 billion, reflecting the portfolio optimisation and model approvals and ongoing RWA reduction, predominantly in Commercial.

Finally then, in terms of capital. The Group has generated 245 basis points of CET1 in the year. Underlying banking operations and the insurance dividend delivered 250 basis points, RWAs a further 80,and 40 basis points came from market movements, all offset by around 120 basis points for conduct.

As you've heard, this strong capital generation has enabled the Board to recommend a total ordinary dividend of 3.05 pence per share, up 20 per cent on 2016, and our CET1 ratio after the ordinary dividend was a strong 14.4 per cent.

We also intend to implement a share buyback of up to £1 billion over the next twelve months which gives us a pro forma CET1 ratio after the buyback of 13.9 per cent.

In terms of capital requirements, as António mentioned, the Group's PRA buffer has now been agreed and after including the coming systemic risk and countercyclical buffers, the Board will now target CET1 of circa 13 per cent and a management buffer of around 1 per cent.

On pensions, we have taken significant steps in recent years to de-risk the pension fund and we have now agreed the latest actuarial valuation and a new deficit contribution plan.

On IFRS 9, the day 1 impact before transitional relief was a reduction of 30 basis points, which will be phased in over the next 5 years.

And the impact of both pensions and IFRS 9 is fully factored in to our ongoing guidance of annual capital generation of 170 to 200 basis points.

And finally on net assets, after adjusting for MBNA, TNAV increased 3.1 pence per share before dividends, driven by strong statutory financial performance offset obviously by a deduction of 3.2 pence for dividend payments.

So, in summary, our low risk business, cost discipline and targeted growth continue to provide competitive advantage. We have delivered on our October 2014 strategy and in 2017 we have achieved further significant improvements in profit and returns on both statutory and underlying bases.

As you've heard, we have set strong targets for 2018 with a net interest margin around 290; further improvement in the cost:income ratio, an AQR of less than 30 basis points; and we continue to expect ongoing capital generation of between 170 and 200 basis points. Trajectory of the statutory ROE is clear and we are on track to deliver our targeted 14 to 15 per cent return on tangible equity in 2019.

Over the last three years we have made significant strategic progress and we are well positioned for future growth to face the next stage of our journey with confidence.

That concludes today's results presentation and we now have 30 minutes for questions on the results. There will be plenty of time and plenty of opportunity later to discuss the Group's new strategy. I should also say that Antonio and I will be around during the coming breakouts for any of those we don't get to during the shortened Q&A session. Thank you.

Question and Answer Session

Question 1: Chris Manners, Morgan Stanley
Good morning Antonio, good morning George. It's Chris Manners from Barclays here.

Reply
Welcome back.

Chris Manners
Thank you. So just two questions if I may. The first one was looking at your strategic update and I suppose if we look at your cost target, your cost:income ratio target and what you are saying about a resilient margin, it does actually look like we need quite a punchy other income and loan growth expectation to deliver that. Could you maybe tell us a little bit about how you see the growth outlook for the loan book? And I have got one more as well.

Answer: António Horta-Osório
Okay I will tell you as I usually do segment by segment to give you an idea of what our targets and intentions are. So in terms of the open mortgage book our intention is to do exactly the same that we did last year. We expect the open mortgage book to be slightly above the position which it reached at the end of the year and in the mortgage market given the low growth of the market, historically high house prices, uncertainty in general, we think the right thing to do for our shareholders is to continue to privilege margin and capital and low risk so we will continue to focus on margin but we will grow the open book in mortgages slightly this year, but over the plan to your question, we think there will be growth in the open mortgage book.

In terms of consumer finance in general, so including UPLs, credit cards and car finance, our intention is to grow reasonably in line with the market over the next 2–3 years. It is an area where we are still under represented, excluding credit cards where we are where we want it to be and therefore my best idea is to grow in line with the market.

SMEs where we have consistently grown above the market in the last 6 years and which is a critical area we think given the huge importance for employment and exports in the country, we have always focused a lot on SMEs as you know. Our expectation is to continue to gain market share in SMEs. That is why in our Helping Britain Prosper plan, we put out a target of growing net balances in SMEs and mid-markets by £6 billion by 2020. So this is an area we expect to grow and gain market share.

And finally on large corporates, we don't target as we always did, it depends on how companies want to access the market through capital markets securitisation as you name it. We don't target global corporates. We expect the Commercial bank as a whole to increase its lending and its RWAs.

And finally the closed book, which is getting smaller and smaller, will continue to run-off. That gives you the coverage of all the segments I think. You had a second question?

Further question
Yes I just had, I suppose one more question which was on competition in the mortgage market. If we are seeing TFS coming to an end, if we are seeing, maybe that puts a bit of pressure on the challenger banks. I am just trying to think about how you see mortgage market competition at the moment? Thanks.

Answer: António Horta-Osório
Right. What I continue to see over the next say 6–12 months and the foreseeable future, I am going to be a bit boring on this. But I continue to see very similar behaviour to the past three years. I continue to expect on one hand as you said, I continue to expect TFS ending to have an effect on funding for players in the market in general especially the ones that took the most of TFS, the smaller players. And therefore that is going to pressure their cost of funds, that would be a reason for prices to go slightly up. On the other hand, some other players have said that they want to increase their presence in the mortgage market.

So you have two contradictory factors there. I continue to expect the leverage ratio to be announced in the second half of 2018 by the PRA on the ring fenced bank to have a significant effect on the equity that will have to be allocated to mortgages given it becomes a restricting factor so it almost doubles and therefore to be another pressure for prices to go slightly up. But all in all as I have been saying now for three years, I expect the trends to be the same over the next 12 months so some pressure in mortgage prices which we will continue to offset given we have higher costs on our multi-brands approach in certain brands and also given our improved and continuing improving credit ratings, our lower wholesale cost of funds and that is why we are targeting a NIM of 290 basis points for the year which is in line exactly with what happened in the second half of last year.

Question 2: Raul Sinha, JP Morgan

Good morning, it's Raul Sinha from JP Morgan. Can I have two please as well, maybe first to start off on NIM and the debate. Can I ask what you are assuming in terms of rate sensitivity please? And the trajectory of rate hikes? Obviously I think what is quite important today is you have talked about resilience in the NIM beyond just the 2018 guidance as well so to try and understand a little bit as to what is the driver of the resilience in the NIM beyond the suggested 12 months? That is the first one. Then I have a second one on M&A if you want if now or I can wait.

Answer: George Culmer

These questions are straying off the results aren't they? Look, in terms of sensitivity, if I look at the Annual Report, buried in there I think we talk about now 25 basis points is £80 million or something like that and previously I think it was £175 million or whatever the numbers were, which is a number we have to calculate but it is a bit misleading because it depends to the extent to which you are invested and liquid. And you know the easiest way to short circuit that and show the sensitivity of the business is to look at things like the structural hedge which we talk about and my £165 billion of invested assets and say a percent on that which will come over time is an easy bit of maths to do and the £1.5 billion, the £1.6 billion. So without dissing some of the numbers that are in my Annual Report and Accounts, that one is not the most meaningful number. And it is more important to look at that.

Our outlook is, and what we are seeing for the plan is I think rates gets to about 1.25 per cent or something by 2020 and you know our original planning assumption was one rate hike this year. So we have assumed a steady rise in rates over that period.

In terms of what gives us confidence, you know the backdrop. If I start by looking back, you know the story of how we manage the business. You know the story of how we manage the NIM. You have seen that in the results, you have seen that in what we have done over the years. We will continue with that operating model in terms of how we manage the spread and in terms of how we manage the detail of this. There is still more that we can do in terms of some of the retail liabilities. We have probably got most of the biggest gains out of the wholesale funding, those that have come through, although we will still be very keen and rating upgrades are fantastic and help in those respects. Structural hedge is big in size and whilst I am at my limit at the moment in terms of £165 billion, let's see where balances grow and we are very good at growing current account balances as we have in 2017. If those continue to grow those will add to the volumes. Also whilst I am at that £165 billion in terms of maximum. I am short as we said before, so about three years versus four and a bit. So that gives me ability to extend and play into rate rises as well. So I can deploy that to generate. So it is a mix of how I manage the book. The structural advantage in terms of things like that structural hedge and our confidence that those will continue as we go forward.

Answer: António Horta-Osório

Just to add one point. You were very thorough! As we have been repeatedly saying, a multi-brand strategy that gives what customers want in terms of segmentation, coupled together with total integration of all back office systems and everything the client doesn't see has been for a long time my strongest belief that provides the best cost:income advantage if properly done. First point.

Second point, as George says, these estimates are being given with what I think is quite a prudent estimate of interest rates. Because of the huge uncertainty which faces the UK economy on a three year view. And therefore we are only forecasting interest rates to increase to 1.25 per cent with one base rate this year increase, while inflation is at 3 per cent. So rates would normally be significantly higher. Why am I saying this? Because with this very low and gradual increase of interest rates is what joins the guidance. Should interest rates be higher as George very clearly explained, we are very positively exposed to rising interest rates if they rise beyond the plan. Second question?

Further question

Thanks very much, a very comprehensive answer. On the second one, I mean what is very clear is there is going to be a significant step up in cash flows, you know statutory profit was up 40 per cent. And going forward it looks very likely that you are going to have a lot more cash generation underpinned by your 200 basis points capital generation target. In the past obviously you have been very clear about returning capital back to shareholders while clearly if there is an exceptional opportunity like there was with MBNA you will look at that. Could you address the question of what you would do with the capital generation you know because now you are already at 14 per cent, if you generate 200 basis points of capital per year, even after paying what dividends you have there is substantial room I would argue to return capital back to shareholders. And what is your framework to decide whether you should be returning that capital or reinvesting it?

Answer:
Well I think you are completely right and we have been very clear as you said about that. We have presented what I think is an ambitious plan, but it is exactly as in the previous plan, a plan based on organic growth. If there is an opportunity like MBNA was a unique opportunity in credit cards that came up that contained risks with a 17 per cent expected ROE, it is in our shareholders' interests that we take it. And by the way it is going better than planned.

The same thing happened on a smaller scale, Zurich's pension and savings business, it gives us a good platform, helps a lot with corporate pensions. The plans that Antonio has in insurance, we could build it or buy it, it's a small amount of capital, but it shows how we consider the framework. So we don't have any as I said in the previous plan, this would be the same, we don't have any special acquisition in sight, our framework is exactly the same. Our plans are to grow organically. We want to grow where we are under-represented. Should specific opportunities present themselves in areas where we are under-represented, we will look at it with the same eyes that we have on the second strategic plan, main target to grow organically. And therefore the Board will consider as it is very clear on our dividend policy at the end of the year with all available information what to do with excess capital that we will have at that time. And now we have very clear capital requirements post clarification from the PRA in terms of the buffer and in terms of the stress test which is 13 per cent plus around 1 per cent management buffer. So exactly clear as you describe it.

Raul Sinha
Thanks very much.

<u>Question 3: Andrew Coombs, Citi</u>
Good morning, it's Andrew Coombs from Citi. Perhaps one follow-up on capital and then one on your loan loss guidance. On the capital, I think you were clear, but just to clarify. The 13 per cent plus 1, is assuming stable Pillar 2a, stable Pillar 2b and embeds in the D-SIB and the counter cyclical that is coming in. Is that correct?

Answer: George Culmer
You ask a lot. Look that is our guidance and we are confident in that guidance and that reflects the counter cyclical of about a percent. That reflects the systemic risk buffer coming in. That reflects the capital conservation coming in. And we have got a current Pillar 2a of about 3 per cent. You will find out what that is as that moves. As we go forward we think as we continue to de-risk the business that actually there could be some opportunity in there. We will come to that. The Pillar 2b as Antonio said, we had our review completed in January. We were pleased with the review. We are not allowed to tell you the consequence of that review, but it certainly is reflected in the numbers that we are talking to you today.

Further question
You are not relying on a reduction in the 2a or 2b to absorb the D-SIB, it's all factored in?

Answer: George Culmer
We are very confident in our numbers.

Further question
And just following on from that, buy-back versus special dividend. The rationale there and then my final question after that on loan loss.

Answer: George Culmer
You squeezed that one in. Look you know previously we weren't 100 per cent privately owned, the numbers were smaller etc. The ordinary dividend was smaller. So I think special as a supplement suited that time. Now we are fully privately owned, the ordinary dividend is at a more significant normalised level, it doesn't need the buttress of a special dividend alongside it. So we think a buy-back is more appropriate to where we are now and just brings a bit more flexibility as well.

Further question
And then on the loan loss point. If you look at your second half, loan losses Q3/Q4 23-24 basis points. You are guiding to sub-30 for 2018 but you are also guiding to sub-30 for 2019 and 2020. You are not looking for much of an incremental uptick in loan losses at all despite what you are saying about a higher rate trajectory, admittedly small increases but nonetheless.

So what gives you the confidence given the point we are at today, unemployment is very, very low. Rates are at record lows, or close to record lows. What gives you the confidence that you are not going to see any form of real uptick in loan losses?

Answer: António Horta-Osório

Well I think you have to look at our guidance holistically. There is a small uptick in interest rates but as I just answered in the previous question, very small with 3 per cent inflation, you would expect a loan bond to yield 4 per cent in normal conditions. So we are expecting the base rates to increase from 50 basis points to 125 basis points in three years. As I said, that is quite mild. As you know with low interest rates normally you have an association of low impairments. And on the other hand, we are at 18 basis points net this year. So we expect some increase. We think that the Bank is continuing to de-risk. So the 40 basis points through the cycle that had been 60 basis points in our first strategic review, 40 in the second, will now be lower, 35 basis points, we continue to de-risk the Bank. But given the outlook we have for the UK economy, so holistically speaking, what we see is you have the tailwinds that I mentioned to you.

We see pressure on consumption given disposable income is growing less than inflation. But employment is going up so we have more people consuming. You have exports being positively impacted by the devaluation of the pound, given we continue to have complete free trade with Europe. Earnings from foreign assets are increasing in pounds. The world growth has increased. We are a big open economy that helps the UK economy. So for me it looks quite clear subject to any major political problem in the world that the next 12 months will be very much like the past 12 months. When you ask, and beyond that, obviously that is more difficult to predict. The holistic guidance we give is coherent with the following view. The Government agree the transition with Europe in December, which we welcome like all businesses. That should be in writing in March. By the end of the year it will be clear what the agreement with Europe will be. And we will have as businesses, two years to plan for that transition which I think for most businesses is critical. For us as you know it does not impact anything, given that we are completely positioned in the British economy. But for the economy itself it is very important. So people from year end, they will have two years to prepare for whatever the agreement will be. And therefore for the next three years our holistic guidance I think it is very coherent. With that assumption and given the tailwinds in the UK economy and the world economy we see a continued resilient economy going forward.

Andrew Coombs

Thank you very much.

<u>Question 4: Ed Firth, KBW</u>

Thanks. Hi, it's Ed Firth here from KBW. I just have a couple of quick detail points actually and one slightly broader one. Can you just update us on the back book of mortgages again? You normally give us a sort of quick run-down on where it has been and how it is progressing during the year? The SVR book?

And then the second one was you mentioned you revised your actuarial pension deficit. It might have been in the numbers, I apologise. Could you just tell us what that actuarial deficit is now?

Answer: George Culmer

Well I will start with the pensions, yes it is in the numbers, but previously it was £5.4 billion and now I think it has gone to £7.2 billion which does not sound like a good result, but that is a good result in terms of what has happened to interest rates etc, inflation expectations. And it reflects the significant de-risking that we have done over the last few years in terms of hedging ourselves for rates and inflation. So in terms of capping and managing that. We also talk about it in the RNS in terms of the deficit contributions which we have agreed with the Trustees. And as I said in my presentation, all that is factored into our ongoing capital guidance.

On the first bit, in terms of the mortgage back book. With the pick-up in rates we have seen a slight pick-up in the attrition levels so I think at Q3 we were talking about 11 per cent. It is now around about 13 per cent attrition rate and I think it will probably stay around about that level, it might touch up to 14 per cent. And it is just the other side in terms of the pick-up in rates which is going to cause some great attrition there but it is obviously going to help me in terms of things like reinvestment rates on structural hedge. So it has ticked up to about I would say about 13 per cent in terms of the attrition rate.

Further question

Is that annualised 13 per cent?

Answer: George Culmer

That is Q4, on Q4.

Further question
And then I guess my final question was just on tangible book. Your TNAV per share continues to be down/flattish which I guess is the reverse of the rising rate environment and the re-pricing of your hedging broadly speaking, is that a fair analysis? And secondly have you got some sort of idea of what you expect TNAV per share to do as you look going forward? You are obviously factoring in these rate rises into your margin, should we expect the TNAV therefore to be somewhat disappointing as you re-price the hedge?

Answer: George Culmer
[laughing] The re-price of the hedge is going to be an adverse impact upon it and you will see that. Rates rising is a good thing, what is the immediate impact of rates rising in terms of my balance sheet? Well two things happen actually. In terms of the Group balance sheet it hits TNAV as I re-price the hedge. Actually it helps me in insurance and helps the capital position of insurance which you don't get visibility of, but it is a big plus from a capital perspective. That outweighs that. So that will, as rates rise up, that will be a headwind. But going the other way, I have talked about and we will talk about more today and later, the strong statutory profit growth that will obviously feed in. And obviously the big counter to that will obviously be what the distribution policy is. But I should expect to see in terms of TNAV going forward with that strong Stat profit, which states the obvious, that will drive the TNAV offset by what we determine in distribution. But you are right, in terms of rate rises you will get a headwind as I re-price that hedge.

Answer: António Horta-Osório
And just to comment. Last year we had an impact from MBNA, given the high profitability from MBNA, there was some goodwill. So if you do a pro-forma as George showed in the slide for MBNA, the TNAV increased by 3.1p and we basically are distributing 3.2p. So basically what we create we distributed with RoTE of 8.9 per cent. Our target RoTE starting in 2019 is 14–15 per cent.

Answer: George Culmer
You will get, in terms of IFRS tick over, whilst we talked about the capital and it is more limited because you get EEL offset and then you get transitional rules, it will hit your sort of TNAV from an accounting basis as you step up provisions as you move into an IFRS 9 world as well.

Ed Firth
Thanks very much.

<u>Question 5: Claire Kane, Credit Suisse</u>
Hi, it's Claire Kane from Credit Suisse. A couple of questions from me. Firstly on the CET1 capital calibration. You have moved back to kind of plus one per cent buffer. And just to ask if we are sitting here at the Interim and we have another half a per cent counter cyclical capital buffer and your PRA, and your Pillar 2a buffer doesn't go down, will we be then looking at a 14.5 per cent CET1 or should we consider that your management buffer would adjust to accommodate a higher capital stack? First question.

My second one is just on the buy-back. Historically you have assessed surplus capital at year end. Do you think now this could be more of an interim assessment given your pretty steady capital generation?

And then finally, sorry just the last one, on Insurance. You paid a much larger insurance dividend this year, I think £675 million. Just what is the outlook there please?

Answer : António Horta-Osório
George will take one and three. On the second one, the answer is no. The Board will continue to assess the capital at the end of the year when we have all the relevant information. We decide a buy-back with a 12 month horizon so we will continue with the cycle of addressing capital surpluses at the end of the year with all available information then.

Answer: George Culmer
And on the Insurance, without being sort of too vague about it, it is a balance between opportunities we see in terms of writing new business, market rates etc. And £700 million is probably at the sort of top end of what you would expect. Benefits from both, it is sort of counter to some of the things you see in OOI and I have talked about the lower bulk annuities. If I am not putting the capital to work there then that feeds into the surplus position we have distributed it. We also benefited from market movements at year end. We also benefited from market movements subsequent to year end in terms of what you have seen. And something like the 15 year swap rate is probably the key thing to look at and as that grows up that will help my capital position. But £700 million is at the top end I would have said in terms of run rate type expectations.

And then asking me for the future in terms of what the Board might do, I always find these questions a bit tricky. You know, I am not going to commit to what we might or might not do. And we currently assume around a 1 per cent in terms of the counter cyclical within our 13. If it goes up 50 basis points we will have to assess it in the circumstances at the time. So I know it is not a definitive answer to your question Claire, but I can't answer in terms of what we might do in a future circumstance. You know but 13 assumes the 1 per cent.

António Horta-Osório
Any more questions, one more question.

Question 6: John Cronin, Goodbody
Thank you. John Cronin from Goodbody. Two questions from me. One in relation to the Pillar 2a again and I suppose going in the opposite direction to the last question, to the extent that you mentioned de-risking from a P2a perspective but potential reduction from the current circa 3 per cent level in the future to the extent that everything else were to remain equal, would you pump up the management buffer or would you reduce your minimum target CET1 capital ratio were that sequence of events to unfold?

Secondly on the PPI, you mentioned that the average over the last 9 months now was 11,000. So if you could give us any more information in relation to how that has evolved since the third quarter that would be helpful, thank you.

Answer: George Culmer
I will deal with the PPI before coming to the hypothetical one. Yeah so PPI we have gone up to 11,000 I think as we disclosed. The extent to which if it has to go up again to 12,000 or whatever. For every 1,000 now it is about £200 million and obviously the closer we get to the time bar, the penalty if you like for being wrong or the benefit for being wrong diminishes. So 11,000, it has moved around a lot as you might expect. What we assume is a completely static, every week of the year, 52 weeks of the year I am going to get 11,000 now. And the most previous experience, you know that includes December and early January which are fallow periods because not much happens so you have got loads there. The most recent we have seen is slightly above that, the most recent week was about 12,500, that was what we saw last week. So that is the most recent.

We will remain susceptible you know to what comes through the door. If you look at the go forward, the FCA had those, the Arnold Schwarzenegger ads or whatever. Unfortunately something is going to follow that. So we have one large campaign and two small campaigns to come so there will be increased publicity. At the same time we have got the PPI CMC fee cap that comes into play in 2018 so it will be interesting to see what impact that has. So there are still a number of variables out there and there is the behavioural consequence as you get near the closing time. So those are still out there. We have budgeted for what we have seen, or we have provided for what we have seen, but there are still uncertainties around that.

And then unfortunately a bit like Claire's question, I can't give you hypothetical's. I mean the Pillar 2a, which again I am restricted to what I can say to you, but it reflects those risks that aren't captured. You know look at the things we are doing. We talked about the early question to pensions. As I put money into my pension scheme and make those deficit contributions then theoretically your charge in terms of Pillar 2a should go down because you are actually mitigating that risk through contributions. I have been a seller of things like gilts etc. You get charged for things like asset swap risk, if I've got less gilts, there should be less of that. So I can give you the reasons why as I de-risk you should see a smaller amount. I can't guarantee that and I am afraid what I can't do is tell you that if that happens what the response to the business will be because it will depend upon the circumstance at the time. But it is certainly an area of opportunity.

António Horta-Osório
Okay, thank you very much. We have to stop now for the break-out sessions. Any remaining questions we will take at the end of the break-out sessions and the strategy review. So you have time to address the remaining questions.

End of Results Q&A