LLOYDS BANKING GROUP PLC –Q3 2017 INTERIM MANAGEMENT STATEMENT PRESENTATION

Wednesday 25 October 2017

António Horta-Osório, Group Chief Executive

Good morning everyone. I am going to give you a short overview of the results and the progress being made in delivering our strategic priorities. George will then briefly cover the financials before we take your questions.

So turning to slide one for those of you following the Presentation. In the first nine months our differentiated business model has continued to deliver, with a strong financial performance and improved profit and returns on both underlying and statutory bases. Underlying profit increased to £6.6 billion, driven by income growth, positive operating jaws and a continued low AQR. We have also delivered a 38 per cent improvement in statutory profit before tax to £4.5 billion.

Performance in the third quarter was particularly strong, with income at 8 per cent, driven in part by organic growth and in parts due to the acquisition of MBNA. Statutory profit was more than double the same period in 2016 due to the better underlying performance and the absence of conduct charges.

Across the Group, we continue to grow in a number of our targeted segments, including the open mortgage book, SMEs, and Consumer Finance, and as a result Group loans and advances at £455 billion are up £2 billion on Q2 and £5 billion on year end 2016.

On capital, in the quarter we have seen improved capital generation and some upward pressure on capital requirements, as George will explain in more detail. The Group’s capital generation continues to be very strong, with 85 basis points generated in the third quarter, meaning that the Group has now generated 185 basis points in the year to date. This has enabled us to increase our 2017 guidance to 225 to 240 basis points.

Finally, the UK economy remains resilient. Over the last few months we have seen the impact of inflation on consumption through pressure on real wages; however the economy continues to benefit from record employment levels, as well as private sector deleveraging and rising house prices in recent years.

As you know, we are now approaching the conclusion of our current strategic plan, which focused on three strategic priorities: creating the best customer experience, becoming simpler and more efficient, and delivering sustainable growth.

On creating the best customer experience, one of the main areas of development for us has been in digital. We operate the UK’s largest and top-ranked digital bank, with 13.2 million customers active online, of which 9 million now use the mobile app, an increase of 15 per cent in the last year. We have a market-leading digital proposition and will continue to invest significantly in our digital capabilities.

We have invested in our customer journeys and complaint resolution processes in order to better meet our customers’ needs. As a result, complaints in the first nine months are down 17 per cent compared to the same period last year (excluding PPI), whilst the Group’s Net Promoter Scores has improved again, and is up by around 60 per cent since the end of 2010, having improved across all brands and channels.

Significant progress has also been made in becoming simpler and more efficient. We remain on track to deliver our Simplification programme target of £1.4 billion of run rate savings by the end of this year, having delivered £1.3 billion to date, but further opportunities remain. Our market-leading cost:income ratio of 45.9 percent gives us a competitive advantage in enabling us to invest for the benefit of our customers whilst generating superior returns for our shareholders.

Our third strategic priority is delivering sustainable growth, and as you have seen, income is up 8 per cent on the third quarter and loans and advances are ahead of prior year. This has been delivered through organic growth in targeted segments and our acquisition of MBNA. On MBNA, integration is ahead of schedule and is expected to complete by the end of Q1 2019, a quarter ahead of our original two year target.

You will also have seen that we recently announced the acquisition of Zurich’s workplace pensions and savings business which brings in almost £20 billion of assets under administration and 500,000 customers, and accelerates the development of our financial planning and retirement business.

Finally, and in terms of value and returns for shareholders, as you’ve heard, capital generation remains strong. Underlying returns after tax continue to be around 15 per cent while we are now delivering a year to date statutory return of 10.5 per cent, and 15.3 per cent for Q3, ahead of most of our peers and in line with our existing guidance for 2019.

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 had a strong Q3, with net interest income up 12 per cent year on year and underlying profit up 9 per cent.

Given this strong performance, year to date total income is now up by 6 per cent at £13.9 billion. While operating costs continue to be tightly managed with positive operating jaws of 4 percent.

Credit quality also remains strong with a net asset quality ratio of 16 basis points, and a stable gross AQR year on year.

Within income, both NII and OOI are up by 6 per cent.

The increase in net interest income to £9.1 billion was driven by an improvement in the margin to 2.85 per cent and supported by the income from MBNA. The margin has again benefitted from lower funding and deposit costs, which have continued to more than offset asset pricing pressures.

As rates have increased we have also continued to build the structural hedge and, with a balance of £165 billion, we are now effectively fully hedged, with an income benefit in the first nine months of around £1.4 billion over LIBOR.

Going forward, and irrespective of any rate changes, we expect the Q4 margin to be stable on Q3, at around 2.90 per cent, and the full year margin to be around 2.85 per cent.

On other income, Q3 OOI of £1.4 billion is flat year on year and up 6 per cent year to date at £4.8 billion. OOI has benefitted from the sale of VocaLink in Q2 and better underlying business performance in Commercial Banking, which was up 6 per cent driven by Mid-markets and Global Corporates, and continued growth in Lex Autolease which offset pressure elsewhere in the Group.

As we said last year, in the current environment we do not expect to hold all gilts to maturity and in 2017 we've sold around £9 billion of gilts and other assets, with a gain on sale of £200 million, compared with about £100 million of gains in the first nine months of 2016.

Turning briefly to asset quality. As you have already heard, we continue to see no deterioration in credit quality. The UK housing market continues to be resilient and we have seen no change in the credit performance or risk indicators in the mortgage book. The motor finance book continues to benefit from conservative residual values and prudent provisioning. The credit card book has also continued to perform strongly, with reductions in persistent debtors, and benefiting from our conservative risk appetite and modelling assumptions.

The gross asset quality ratio for the first nine months, which includes MBNA, is 26 basis points and in line with previous years despite taking a single large corporate impairment in the third quarter.

For the year to date, the net AQR is16 basis points, and slightly up on prior year, reflecting the lower releases and write-backs and we continue to expect a full year AQR of less than 20 basis points.

The impaired loan ratio has improved in the quarter from 1.8 to 1.7 per cent of closing advances and the Group's coverage ratio excluding Run-off has increased from 43 to 45 per cent.

Finally, the Group's IFRS 9 implementation is in the final stages of completion, and it is currently expected that before any transitional relief, the CET1 impact will be a reduction of between 10 and 30 basis points after taking account of regulatory expected losses. As a consequence, the initial move to IFRS 9 is not expected to have a material impact on the Group's capital position.

Turning now to statutory profit which, after tax, has increased by 50 per cent to £3.1 billion, due to the strong underlying business performance and a reduction in below the line items. Market volatility and other items of £13 million are much lower than prior year, largely due to the £790 million ECN charge in 2016.

In Restructuring, the £469 million charge reflects severance costs from our Simplification programme, the cost of non-branch property rationalisation, building the non-ring-fenced bank, as well as now the integration of MBNA which has cost about £30 million to date and, as you've heard, is progressing ahead of schedule.

On PPI, we have taken no further charge in the quarter and have an outstanding balance sheet provision of around £2.3 billion. Whilst net claim volumes increased, as expected, after the FCA's recent advertising campaign, reaching around 16,000 per week at their peak, they have fallen quickly and are now running at about 11,000 per week, a bit above our assumed run rate of 9,000.

Finally, our tax charge was £1.4 billion, reflecting an effective rate of 31 per cent. We continue to expect a medium term effective rate of around 27 per cent, but remain above this currently due to the non-deductibility of conduct provisions.

Turning briefly to the balance sheet. As you've heard, loans and advances were £455 billion at the end of September and have increased by £5 billion since 2016 year end and £2 billion since Q2, driven by growth across targeted business segments, in particular the open mortgage book, SME Consumer Finance and, of course, the acquisition of MBNA, which brought-in almost £8 billion of prime credit card balances.

Risk-weighted assets are £217 billion, down 2 per cent on a year ago, even after the addition of £7 billion of risk-weighted assets from MBNA. We continue to target and optimise capital efficiency and returns, and this is clearly seen in the growth in our higher-returning businesses in Consumer Finance and SME offsetting reductions in the lower-returning Global Corporates and Run-off, and so enhancing overall returns and RWA efficiency.

Finally as you've heard, in the quarter we've seen both improved capital generation and some upward pressure on capital requirements. Capital generation in the quarter was a strong 85 basis points, with 60 basis points from underlying profits, 5 from movements in RWAs and 20 basis points from market and other movements. As a result, the Group now expects to generate between 225 and 240 basis points of CET1 this year.

On requirements, as you know, the Group's current view of the appropriate level of CET1 to meet regulatory requirements and, a buffer, grow the business and cover uncertainties is around 13 per cent. During the third quarter, however, the PRA has increased our Pillar 2A requirement from 2.5 to 3 per cent of CET1.

As a consequence, this additional Pillar 2A capital will be held at year end and there is upward pressure on the Group's overall current requirement of around 13 per cent.

As we are currently awaiting guidance on the PRA buffer, we will provide an update on requirements with the full year results.

The Group however still expects to deliver a progressive and sustainable ordinary dividend and the Board will give due consideration at the year end to the distribution of surplus capital through the use of special dividends or buy backs.

On net assets, TNAV increased by 1.1 pence per share in the quarter to 53.5 pence. Statutory profit after tax of 2 pence and favourable net reserve movements of 0.1 pence were partly offset by the payment of the 2017 interim dividend, of 1 pence per share.

Net reserve movements included the fall in the cash flow hedge reserve from changes in interest rate expectations, offset by favourable movements in the defined benefit pension schemes.

Finally, our strong capital position, stable profits and strong asset quality have all been recognised in the recent credit rating upgrade by Moody's, in which Lloyds Bank was upgraded to Aa3.

So, in summary, our differentiated business model continues to deliver, with a significant improvement in financial performance, returns and capital generation. As a result we have enhanced our guidance for capital generation and margin, while maintaining our AQR guidance of less than 20 basis points.

We are well positioned for the future: the integration of MBNA is ahead of schedule, we have acquired Zurich's workplace pensions and savings business and we have implemented the Group's new organisational structure. These changes prepare us well for the next stage in our strategy which will be announced with our full year results next year, and give us great confidence in the future of the Group.

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

End of Presentations

<u>Question and Answer Session</u>

<u>Question 1: Raul Sinha, JP MORGAN</u>
Morning Antonio, morning George. Can I have two please, two areas. To the first one, on OOI and the second one on capital. On OOI, if I look at your earlier guidance, that full year OOI would be up ex-VocaLink, that implies that Q4 would be up on Q3 and I was just wondering if you might be able to give us a little bit more detail on why that might be the case?

On capital, I was just wanting to explore whether or not this rising pressure on your capital requirement actually means anything for the dividend and for the expectations, given that you are already at 14.9 per cent now pre-divi. If we take your new capital generation guidance, you are 15.3 to 15.5 by the end of the year. And even if you assume you have to adjust your PPI provision for the 11,000 average claims, you know that still means you have got a potential dividend, including a special of around 4.3 for the full year.

So I was just wondering if any of my maths there is incorrect and if I am missing something? It seems to me that even if you held yourself to 14, you would be able to meet, or even maybe slightly exceed, consensus DPS expectations?

Answer: George Culmer
Hi Raul, it's George here. I will answer the capital one first and then come back to the OOI one. As you know on capital, we have talked about it a long time of around 13 per cent being our guidance and you know that within that, we are fully cognisant obviously with additional buffers that were coming in and the expectation that we would offset those through reductions in some of the PRA, Pillar 2A and Pillar 2B buffers and we have seen that in reductions that we have seen in the last couple of years. Remember that, and that around 13 provides the regulatory requirement and a healthy buffer that we put in for management purposes. Obviously it is disappointing to have to be able to report that Pillar 2A, rather than going slightly down as you might have expected, has gone up by the 50 basis points. So I am going to have to hold that additional 50 basis points for a bit at the year end. And also that I am not able to announce what we think the target will be because I have to wait for my Pillar 2B buffer at the end of the year. But to your central theme around dividend affordability and to your sort of numbers, I must admit, if I just look at it in a slightly different way but probably come back to, which will confirm your maths, I mean we talk today, we have got strong capital generation of the 225 to 240. Let's take the 240 - the top end of that range. So, we are going to go for 240. If I say I am going to put aside 50 basis points for that Pillar 2A, okay I have still got 190 left to spend. I think you talked about 4.2. Look, this isn't a prediction, my own consensus is something like 4.5p or something like that. That's 150 basis points of capital. So you know that would still give me 40 or 50. So look, this isn't a prediction or anything like that, but if I generate 240, to your point and I'm not saying this will happen, you could increase capital by a per cent and still meet those consensus expectations around divi and total distribution. So that is how I would see it and that is how I see the numbers and I take great comfort from that.

So Raul that is how I see it. I think I am confirming what you said in terms of how you come back to that maths.

In terms of OOI, the first thing, yes I think we said that ex-VocaLink we would expect OOI to be slightly ahead of prior year. And I would still expect that. I think if you look historically, Q3 I think, we are flat on prior year but Q3 is always I think about the weakest quarter as we move through the year. So I would expect Q4 to be stronger. Why would I expect it to be stronger? There's always a slight downturn in things like Commercial Banking during the summer period; Insurance always has the strongest quarter in terms of Q4. We do true ups on assumptions and all those sorts of things within our numbers. So I would expect Q4 to be stronger than Q3 and I would still expect OOI ex-VocaLink to be slightly ahead of OOI in 2016.

Further question
Thanks George, that is very helpful. Can I just have one clarification on the capital. Obviously there are lots of moving parts here, but as I understand it, the phasing in of the higher requirements as well because your counter cyclical buffer only goes up to 1 per cent at some point in 2018. So for full year 2017 would it be fair to assume that the counter cyclical buffer requirement actually only goes up by 50 basis points? And so the requirement at end 2017 is probably slightly lower as a binding constraint than it would be in 2018 anyway?

Further answer: George Culmer
You are absolutely correct. So things like counter cyclical at the back end of 2018 and things like the systemic risk which comes in is I think at Q1 2019. So those are out there. You are absolutely correct in that statement.

Raul Sinha
Thanks and apologies - that was not me buying two million of Lloyds. Apologies! [laughter]

<u>Question 2: Fahed Kunwar, REDBURN</u>
Hi, morning. Could I just ask a couple of questions? The first one was on the increase in the hedge portfolio by about £20 billion in the quarter. Can I just ask why that has increased? My basic understanding was that the current account balances around £100 billion, you have got around £40 billion of equity. So £140 billion hedge balance, which was what it was at Q2, is about right. Should we infer from that this has been an additional switch in the current accounts from what it was in this quarter, which has led the hedge to be increased? That was my first question.

My second question, on the Pillar 2A buffer. Just so I understand it, in 2016 I think you moved from a surplus to a deficit which has moved back to a surplus in 2017. So will that hopefully put downward pressure on the Pillar 2A buffer for 2017?

And a third question was on car finance. So Pendragon recently were quite bearish on residual values coming through particularly on luxury cars. So I was just wondering obviously on your 10 odd billion cars on the balance sheet, 4 is Lex and 6 roughly is Black Horse. Could you give an idea of what the residual values are doing on the Black Horse component but also what they are doing on the commercial vehicles in the Lex Autolease component of that as well? Thank you.

Answer: George Culmer
Hello, it's George again. So yes three quite detailed questions. If I take them in order. So the hedge, yes you are right. We came into this year, I think we were £111 billion and we have basically put on about £66 billion allowing for offs in the period and we are now at about £165 billion and obviously, I think as previously discussed, we exercise discretion in how we deploy that hedge and with the pickup in rates we have sought to go back to reinvested, which is our natural state and we have sought to be slightly short though so we are not on the wrong side should rates pick up. So we have gone to effectively fully invested.

The components are the current accounts which has been building which is good through the period; the capital, but also there is the rate insensitive elements of variable accounts as well which I think, common with our peers, we invest that element. So it is the rate insensitive element would be the sort of missing element of your piece. So we're up to fully invested and that gives us great stability around our NIM as we go through this year and into 2018 I would say as well in terms of that hedge and the volumes that we have now got in place.

The Pillar 2A, you are right. Pillar 2A – it's a slight frustration – as you know, I can tell you the delta in that, but I am not allowed to talk about the whys and wherefores, but to your point entirely, it captures those risks not captured by Pillar 1 so I have got operational risk, I have got interest rate in the banking book, within there I have got concentration. But I also have pensions, and precisely to your point, it does move around. So the increase that we're seeing is basically derived from the balance sheet at the start of the year, whereupon, I am going to agree with everything you said, that the pension has gone from a surplus to a deficit and to your point now, we are actually calling out that the pension scheme has actually returned to a surplus position and I can say that that is a good thing in terms of Pillar 2A construction. So I would agree entirely with your central bit.

Car financing, look we continue to remain comfortable. Yeah we have about, you know, on a sort of £10 billion of residual value of which half is Lex and then I have got about 2 or 3 JLR and 2 or 3 through PCPs within Black Horse. That sort of amortises down to about a £6 billion exposure. We monitor the hell out of this, still selling cars for profit. We still carry our excess provisions. We still discount new pricing to allow for drop-offs in terms of guaranteed future values over and above where the market would place that 3 years out. So as I said, units still being shifted at profit. We feel comfortable with our exposures and I suppose that is all there is to say.

Fahed Kunwar
Perfect, thank you very much.

<u>Question 3: Claire Kane, CREDIT SUISSE</u>
Hi good morning. So a couple of questions: Firstly on the PRA buffer which you have referenced as being one of the final components to determine what your capital target will be going forward. Given you have completed the stress tests, how confident are you that you would have a binding constraint on Pillar 2B or how that might change for you going forward? You stepped away from your previous target which was your known capital stack plus a 1 per cent buffer. And given you have had some volatility in Pillar 2A, do you expect to return to that framework of adding on a buffer like some of your peers do?

And then my second question is around the mortgage market. So, just really if you could provide some commentary around the competitive landscape and what your outlook would be for volumes into Q4? Is it running ahead of expectations or not? And how the pricing is coming through in the market, given yourselves and some peers have upped rates recently? Thank you.

Answer: George Culmer
Okay, shall I do the first one. Hi Claire. As you know, well actually let's start with - you know, our previous capital guidance as you said, if you went back a couple of years, used to be around 13 and within that we used to say that was roughly around about a 12+1. And then during 2016, we were pleased to be able to announce that within that 12, the PRA buffer or Pillar 2B buffer as it was then, had come down significantly, representing the de-risking of the business. But that we would stick to around 13, but it was now significantly less than 12 and a bigger number than 1 in terms of the buffer that we held. And again we had to express it in that slightly clumsy way because of what we could or couldn't say to the market. But the key thing is that it came down significantly because of de-risking. We would always expect to hold a form of management buffer, what size would depend upon circumstances. So we stuck to the around 13, despite the regulatory requirements to the Pillar 2B coming down significantly because we obviously know that there are capital requirements to come. But that came down.

So as I look forward, look all I can say is it has come down significantly in the past, reflecting our de-risking of the business. We continue to de-risk this business. I would make that point. Now, how that gets played out in the buffer, I don't know. As you say, the stress tests have been completed, but I won't be informed until January or March time. So that is coming down. We will have to wait until then to see what actually happens in terms of the buffer itself.

Answer: António Horta-Osório
Okay and Claire relating to your question on the mortgage markets, I would say that overall we don't see a significantly different picture from previous quarters. But to give you some flavour, we see some of the smaller banks increasing prices, probably because of TFS coming to a close and for LCR considerations. On the other hand we also see some other banks investing more on intermediaries for example. So overall, not very different. We continue to expect, as I have said previously, in other calls, asset prices to continue to come slightly down given AQRs are at extremely low levels. And in our case we continue to expect our deposit prices to also come down given we have higher overall deposit prices than the sectors as you know, very much because of the heritage of the Halifax brand as a savings and mortgage building society, which we have progressively changed over time being part of the Group.

And of course my answer to you is based on rates not moving. So there is an expectation in that market that rates might move in November. Of course that will be a change, but apart from that which I am not going to comment in this question. Apart from any change in rates, I would continue to expect a similar behaviour between asset prices and deposit prices in the following 1 to 2 quarters.

Claire Kane
Thank you.

<u>Question 4: Robert Noble, RBC</u>
Good morning. Well I will just pick up on that interest rate reference you have just made there António, what sort of benefit would you see from 1 or 2 interest rate hikes from the Bank of England in general?

And also if you could just give us the breakdown as usual of the deposit prices by book that George you normally give? Thank you.

Answer: António Horta-Osório
Okay, so George will give you the breakdown. So just to give you some flavour on that Robert. We have said before, we are very positively exposed to rising interest rates. Our expectations on interest rates from the start of this second strategic plan was to have interest rates slightly lower than 1 per cent by 2019. It looks like now the expectations on the market are aligned with our previous expectations. So the market expects an interest rate movement in November as I just said and one more or two next year. And that a slow rise in interest rates is, as you know, beneficial in general for retail and commercial banks and we are significantly exposed to rising interest rates as George has detailed before.

Answer: George Culmer
Yes that is right. And then Robert in terms of some of the savings rates and stuff. So I think we talked of an aggregate savings rate of about 51 basis points at Q2. That has dropped down to about 47 basis points at Q3. And within that you have probably seen a main step down in things like the fixed book which is sort of 132 plays 142 at Q2. That has probably been the bigger mover. Fixed ISAs also down about 9 or so basis points. So we continue to show you that. And you see that in the, if you look at the NIM walk from Q2 to Q3, I think you have got about 4 or 5 off from assets, 4 or 5 back from liabilities is what you are seeing there. And then obviously a 3 month benefit from MBNA versus we have had only one month in Q2 and that's what is driving that NIM forward.

Robert Noble
Great, thank you very much.

<u>Question 5: Rohith Chandra-Rajan, BARCLAYS CAPITAL</u>
Hi good morning, I have got a couple as well please. One clarification actually on George's comments on capital earlier - just to check that I heard it correctly - on the potential dividend paying capacity. I think essentially what you are saying is even if you are working to a 14 per cent CET1 ratio at the full year you would be able to, there would be sufficient capital to pay the current consensus expectation of around 4.5 pence dividend. So I just wanted to check that was right. And if that level is 13.5 rather than 14, then I guess the dividend paying capacity would be more like 5.5 to 6 pence. So that was the first one.

And then the second one was just on credit quality, which I guess all the indicators you have pointed to have been strong. There was a pick-up in the quarter which you ascribe to a single corporate exposure. I just wondered if you could talk about that a little bit? And also the reducing level of write-backs that you are seeing, I think they were 12 basis points of write-backs in the first half falling to 7. Is that a trend we would expect to continue? Thank you.

Answer: George Culmer
Hi Rohith, it is George again. Yes to your first point. Look, first up, you know we remain, and the Board remains, committed to our progressive and sustainable dividend policy and the Board will make its usual determination at year end in terms of surplus capital and special buy-back etc. So that's a decision at a further point. But to confirm, the maths that I gave is the maths that I gave. So that is to show in terms of, if I generate the 240, if I put away the 50, just going to consensus in terms of capacity then your maths is correct, so the 4.5 is 150 and you are right, there is 40 left over etc. So there is nothing wrong with your maths, and that is entirely what I said. But again as I say, the Board will make its determination at the end of the year in terms of what the commitment to the progressive and sustainable ordinary dividend and what we do around surplus capital. But you are absolutely right in terms of capacity and in terms of capital generation and potential uses. So to confirm that.

And then your last question about impairments. So yes, a step up in Q3, and that reflects, and I am looking again at prior year, I have got about £40 million or so coming through from MBNA which is in their prior year. And that is entirely in line with our expectations. And then sorry, no on the single large corporate it would be inappropriate to give any further detail. The key point we would want to make is that this is absolutely not a trend or a deterioration in terms of credit quality. We are not seeing anything in terms of credit quality coming through.

Answer: António Horta-Osório
And Rohith this is António, this is not what George just said, it is something we have been repeating over the last few quarters. I mean you have record numbers of employment. Unemployment would be the indicator that could start rising non-performing loans, especially on the household sector. We have record employment numbers – the highest since 1975. Second, you have very low interest rates and very negative at the moment, given inflation went to 3 per cent. We have left that in the economy, especially in the household sector that needed it, but also in the corporate sector that did not need it. And you have, as I have mentioned before in previous calls, you have had a significant recovery of house prices throughout the country which has put a lot of equity in the pockets (of households). To give you an example, we are the largest mortgage lender in the country with around a £300 billion portfolio. Average LTV of around 45 per cent. So it means our retail customers have more than £300 billion of equity in their homes. And that is very important not only in terms of equity there, but in terms of confidence.

So as I said before, in several calls, the fact that we have these tailwinds to the UK economy, in light of Brexit uncertainty which is high and exists but which outcome we will only know probably next year to work in another year or 2 or 3 years. These tailwinds on the economy will provoke a longer cycle as we have been repeating. And that is what you are seeing. So we don't see in any of our portfolios, not only any sign of impairments, but any sign of increase on non-performing loans. And as George said, we still have write-backs which also shows how prudently we provision across the cycle as well.

Answer: George Culmer
And you asked a question, if I recall, about the future experience of write-backs. I forgot what the precise question was Rohith, but you know we have said that we would expect to see, but at a lower level going forward. That was the guidance. That's what we said. We would stick to that. As we move beyond this year into future years, you know we would expect to see write-backs etc. and releases, but just at a lower level than that which we are currently seeing.

Answer: António Horta-Osório
Write-backs it is a very good indicator of the prudency of provisioning policies over the cycle.

Further question
Okay, thank you. So the write-backs I guess were 12 basis point in the first half of the year, they fell to 7 basis points and it sounds like you are kind of thinking that maybe that might be a new level or certainly trending down from the 12 anyway?

Answer: George Culmer
Yeah, that is a slight over precision in your question. We would just expect a slightly lower level to that which we have seen.

Rohith Chandra-Rajan
Okay, thank you.

Question 6: Andrew Coombs, CITI
Good morning. Two questions please. The first is a follow-up on capital, more specifically the 50 basis points increase in the Pillar 2A. There was previously a discussion about your move from a surplus to a deficit, back to a surplus again on the pension position. But that was already known to you and yet you previously expected Pillar 2A to fall rather than increase. So I was just trying to get a feel for what is driving the increase? What can you tell us about the reason behind that hike? That would be the first question.

Second question would be on PPI. You did see an initial spike you said 16,000 per week, that has now dropped back to 11,000 already. But even in that scenario it is running above your 9,000 assumption. So why did you elect not to take an extra charge or provision for PPI this quarter? Is it just a case that you want more evidence of where that run-rate ends up? Thank you.

Answer: George Culmer
Hi Andrew, George again. So on PPI yeah as we sort of said in the Presentation, I mean we came into this quarter, Q3, around about the 9,000 level which is what we assumed through to the time bar. The most significant thing in the quarter, I will come back to your question in a moment, is actually that the Courts reaffirming that time bar in the quarter, I think that is the big call

out. And in terms of the appeal to judicial review has been turned down and given us the certainty which I think is the right thing for everyone. And I think that is the big callout. And as we said in the Presentation, we still have something like £2.3 billion so I have £100 million a month in that provision which is kind of what I have been paying out over the course of Q3. But we came in round about 9,000. That 9,000 as you know, we always have a sort of gross complaint. That is the sort of total we get which is around about 15-16,000 a week in the undisturbed, giving us 9-10,000 of net complaints. As we went through the quarter with the FCAs advertising, that 16,000 effectively at its peak doubled up to, it got to about I think 36,000. The net got to about 16,000 as I said in the Presentation at its peak, mainly because you know what you were seeing was a whole load of, while conditional activity, a lot of that was of low quality with not having PPI. As I said, that 16,000 has dropped down to 11,000.

So sort of to your point, I am assuming I am going to get 9,000 every day of every week for the next 23 months in the provision. So that is a big number and that is a big assumption. At the moment, the monitoring of the excess that we have seen. You know to give an example, the sensitivity we give is that if it is 1,000 more, so i.e., 10,000 each day, each week, each month, it is something like £250 million. So to me the big event of the quarter was the reaffirmation of that deadline. Yes there is a sensitivity around if volumes exceed the 9,000 or 10,000 and we will continue to monitor, etc. And if we have to act, we will act to top up. But to me, look I don't want to sound complacent or anything like that, but that is very manageable, etc. And we will continue to monitor that as we move forward.

On the 2A, I am afraid I am going to have to frustrate you a bit, because you know I am not allowed to talk about components and movements or drivers. So I appreciate the question and I appreciate why you are asking the question, but I am not allowed to give you detail as to the whys and wherefores of 2A increases. So I can't say more than I have said I'm afraid and I am sorry about that.

Further question
That is understandable. Can I just ask a supplementary in that case about the Pillar 2B and given the PRA's, or given the stress test on consumers, talking about an extra 50 basis points for the system. Lloyds, obviously one of the banks with the larger consumer finance portfolio. Is it a case of going into the year end, do you expect an offset from other parts of the stress test declining, or is it a case of your embedding an extra X-per cent into your targets already?

Answer: George Culmer
Look. As I said previously, we have historically seen a reduction in the Pillar 2B buffer, the PRA buffer, because it reflects the de-risking of our business. Now with the consumer finance bit that comes out, let's see how that plays through. We absolutely stand by the prime quality nature of our consumer finance and our credit card book and we would like to think that that would be reflected in any current view. But we have previously come down because we have de-risked. We continue to de-risk. You know the other one for example, things like conduct. That is why things like PPI are helpful etc., as well in terms of de-risking the system, de-risking the outlook and we would probably be more than hopeful that, as I said, the quality of our credit card book would be reflected. And also how we performed in the stress tests would be reflected in terms of the PRA buffer to come. But I won't find out until January.

Andrew Coombs
Understood, thank you.

<u>Question 7: Jonathan Pierce, EXANE BNP</u>
Good morning. Two questions, I'm sorry the first is back on capital. I think talking about capital stack in terms of transition or position is maybe not quite as helpful in some respects as thinking about where we will be at the start of 2019. And obviously we know most of the components of your stack with decent accuracy now. And I add them all up and I am getting to slightly over 13 per cent without any PRA buffer at all and without any management buffer. So I am trying to marry that up with, it seems the suggestion this morning that 13.5 per cent is going to be the new right number. Is what you are saying that you feel you can get away without holding very much in the way of a management buffer at all on top of all of these other buffers that we know about that will be fully phased in in 14 months' time? So maybe give us a little bit of help on that to start.

The second question is just really to understand these gains that are being taken as you sell down the AFS portfolio. Presumably the bonds that you reclassified last year are now fully fungible with all of the other Government bonds within that AFS portfolio. So should I think about this as whenever you sell a billion pounds worth of sort of £50 billion of Government bonds you now have in AFS, you are going to take sort of 2 per cent or something of the total gain on that portfolio? Or are the gains ascribed to individual bonds there? Are you able to pick and choose what you can sell to create the gains at any one point in time? Thank you.

Answer: George Culmer
Okay. Right, Jonathan. Okay, in terms of the gains then. As I said in the Presentation and as we said last year. In the current environment, low returns, the capital I have to hold against them, gilts are not an overly attractive asset and so we have been selling off, and we have continued to sell off. And we are at around £200 million as I said in the Presentation of gains. That was like 70 each in the first two quarters and so I think it was £51 million in Q3. And actually that compares with about £45 million in Q3 of 2016. So in the in quarter it is not a very big distorting factor.

In terms of you know do I look at gains on an individual credit basis or do I look at gains on a sort of portfolio basis? I am not sure it really sort of matters. What I am saying is that, as a class, they are not particularly attractive to us. We clearly flagged this last year that we would step away when we did that accounting change as we moved out of HTM into available for sale. And we have sold out and have continued to do that through this year in terms of de-risking. So I am not going to sort of tell you or project to you what you should put in or expect going forward, you know that would depend upon markets and how we view our internal positions. But we have made very substantive progress in coming out of assets that we don't see as attractive.

In terms of capital - sorry going back to your very first comment. I mean let's be clear. The position is as we said, we currently expect to hold around 13 and we are saying that with what has come out today, that around 13 is under pressure. So that is what we are saying about our capital position. And we will have better information on that at year end, going back to earlier questions when we get the PRA and the Pillar 2 buffer.

In terms of the look ahead, you are absolutely right. By the time we come to 2019, of course we have got the capital conservation step up, the systemic risk comes up as well. But again I would be hopeful within that period, as I continue to de-risk, as I continue to take actions, as I continue to make contributions to pension schemes etc. etc., that the discretionary buffers would come down. Now where we end up, we will know better as we move forward. But for the immediate position as I said, we are currently around 13, and that around 13 comes under pressure given that I was expecting to go down a bit, a few basis points in terms of Pillar 2A. I have had to go up 50 basis points. Let's see what they say about the Pillar 2B buffer, but going back to the earlier questions, what is important is that capital generation and the affordability of actually paying for those steps.

Jonathan Pierce
Okay, thank you very much.

Question 8: Joe Dickerson, JEFFERIES
Hi, good morning. I think we have laboured the capital thing enough, but I guess if you could just clarify that the Pillar 2A buffer has an element of conduct risk in it and presumably over time as things like PPI roll-off and maybe there is something in there for I don't know what happened with HBOS but I am sure you can't comment upon that. But assuming that there is nothing major on the conduct front that we don't know about coming off, if I was a reasonable person I would assume that any element as I say conduct on a forward basis in the Pillar 2A buffer should improve. If you could confirm that, that would be helpful.

And then you referenced that the capital level comes under pressure at 13 per cent. I guess if it comes under pressure you know how come you are confident enough in reiterating that 13 per cent CET1 is the right number, the right CET1 level with which to operate the bank from a returns standpoint? If you could comment on those two things I would be grateful.

Answer: George Culmer
Okay, so yes first up you are right. Pillar 2A as you say covers those risks which are not picked up in Pillar 1 and so within that you have got concentration, you have got interest rates, you have got pensions. But to your point, you also have operational risk and within operational risk there is a conduct element and I would subscribe to your thesis that as I look forward, and this comes back to things like importance of the PPI time bar, that the conduct element should diminish. And I would also go back to the last point that the Pillar 2B buffer, the PRA buffer, also has a conduct element of that. So there is conduct elements in both the PRA buffer and the Pillar 2A buffer and, as I look forward, I would expect conduct to come down and I would expect that to flow through and be reflected in.

Then in terms of your capital position again, just to sort of clarify. We talk about currently requiring around 13 and, you know, that's our current position. It has been our position in terms of capital requirement. And again as I said, we talk about, I am repeating myself now, coming under pressure because of assumptions deviating from what we were assuming happens to things like the Pillar 2A etc. which I just talked about.

There is also, again, going back to some of the earlier questions, you know the current requirements of today differ from those requirements of the future. So things like the counter cyclical doesn't come in full until 12 months' time. Things like systemic risk doesn't come in until Q1 2019, so a number of those step ups don't come on until subsequent periods. But look, currently around 13 is where we think is appropriate, but we do say it is under pressure given, as I said, what has happened on 2A and as we look out. We will have more information and be able to update better at the year end.

Joe Dickerson
Thank you.

Question 9: Martin Leitgeb, GOLDMAN SACHS
Yes good morning. I have two questions please. The first one is just the usual data on the back book if you could just share what the current balances there are?

And I was also wondering if you could tell us what the share in gross mortgage lending you had during the third quarter, as I remember in the first half that was around 15-16 per cent and in June it increased or spiked at around 20 per cent. I was just wondering what kind of number should we look for in terms of gross mortgage lending share going forward?

And the second question is more broad on Brexit and impact of Brexit and you elaborated on the risk side of things - that you don't see any signs of deterioration in any books yet, if I understood that correctly. I was just wondering if you could shed a little bit of light on what you see on the demand side, is there anything you notice in terms of lower demand from, say, corporate clients' investments being postponed and so forth and similarly, is there anything you see already on the consumer side, whether that is unsecured loan demand or anything? From the report and your data it doesn't seem like anything has appeared so far. Thank you.

Answer: George Culmer
I'll do the first couple. So yeah on the back book, again it's the same old story in terms of SVR attrition. So we still are looking around sort of 11 per cent in total and within that the sort of Halifax, just a shade under 10 I think, with the 3.74 book at now I think it's about £44.3 billion in terms of size. So again we are not seeing any change in trends in terms of SVR attrition, I would make that point very clear.

In terms of front book, in terms of volumes, yeah we talked at the half year. I think we said it was about £18 billion. So in Q3 we are now at a year to date up to about £30 billion, £30.1 billion in terms of new business. So that is just over 11.5 in Q3. Market shares, I think we are down about sort of about 15 per cent in the first half. I think in Q3 we were about 17 per cent share of new business. So that has picked up as we alluded to I think at the, as you say, at the Q2 Presentation.

Answer: António Horta-Osório
And Martin relating to Brexit, I mean, to give you some colour. So in terms of the household sector, as I said previously, we see some impact on real wages because inflation, at now 3 per cent, makes real wages growing negatively as you know and consumption is two-thirds of GDP. So we see people saving a little bit less, borrowing a little bit more and holding off some purchases. Which is normal when they have an inflation shock. And as I have said in previous calls, that behaviour is a normal behaviour when something changes, but it is also allowed by the fact that households have significantly deleveraged in the previous 10 years so since the crisis.

And in terms of corporates we see some impact as we have said previously. Our SME net lending is growing at 2 per cent while previously it was growing at 4-5 per cent. So some impact, but not much. Some companies, given the uncertainty, are holding some investment projects, but we are still growing 2 per cent instead of the previous 4-5 per cent. So as a whole, not much. That is why GDP I believe was growing 2 per cent and is now growing around 1.5 per cent. So some impact, but not very much.

Going forward to your second part of the question. Obviously it will depend on the agreement that the UK will get with the EU where we export and import around 50 per cent. So 50 per cent of our trade is with EU. Normally in my opinion, agreements only come close to deadlines, so probably we will only know the agreement next year. Businesses, as you know, are asking for a transition period and the Government is minded to try to agree that. So if we have a 2-3 year transition period we will know the agreement next year for an implementation in 3-4 years down the road. And that is why I have been saying that for the next few quarters, which is the normal time span where we can reasonably see what is going to happen, we continue to expect GDP to grow around these levels.

Martin Leitgeb
Thank you very much.

Question 10: Chris Cant, AUTONOMOUS
Hi thanks. I just had two questions please following up on previous comments. The management buffer. You referred back to your previous guidance of needing 1 per cent over 12 as a management buffer. With the advent of IFRS9, the increased volatility that will create, I was just wondering if you could update us on your view on the right level of management buffer for the business please? Obviously, that's not something the regulators can prevent you from disclosing.

And then you also made a comment George about greater stability on NIM into the fourth quarter and into 2018. Just thinking about the comment around 2018 and what I can infer from that. Are you talking about greater stability year over year there, or greater stability on your exit run rate of 290 please? Thanks.

Answer: George Culmer
Just greater stability I think Chris. Look yes you are right, the management buffer, but, you know, the amount you hold as a management buffer will depend upon circumstances. So you know, at the moment as it stands today, we hold the management buffer significantly in excess of the 1. And that goes back to comments we were making earlier about the reduction in the Pillar 2B buffer that we weren't allowed to talk about, which brought down the regulatory requirement. But we expanded out our management buffer because we knew there were changes coming. Now as you go through those changes, you won't need to hold such a big; if you look at how you distribute capital, you might not need to hold such a big management buffer. So it will depend upon circumstances. So I am going to be slightly frustrating, I am not going to give you a number, but you know at the moment it is significantly greater than that, but as you move through, and you know as capital uncertainties disappear, then the management buffer could flex accordingly.

And then in the NIM, we are not giving formal guidance today and all those sorts of things, but go back to my point you know, we have got a very strong contribution from the structural hedge as we have built the volumes and locked into some of the higher rates that we are seeing. I would expect that very strong contribution from that hedge to continue into 2018, which will underpin whatever we say about NIM when we get to the year end.

Further question
If I could just push you a bit more on that management buffer point. I mean I appreciate there are capital uncertainties, but there always was. Other banks were able to guide on what they think the right level of comfort buffer, I mean this is a discretionary buffer you are holding to ensure you don't have to cut a dividend or whatever. You previously framed that as being equivalent to one year's worth of ordinary dividend that you wanted to have in the tin in case there was a bad year. Is that the right way to think about it still? Does IFRS9 change your view on the necessary size of the buffer? Other banks do give numbers for this, but I can understand why you can't talk about Pillar 2B yet because you don't know your stress test result. I can understand you can't talk about the components of Pillar 2A because the regulator won't let you. But this is a decision for you as a management team so I don't understand why you can't give the market some guidance and we can see from your share price reaction this morning, concerns around capital are very real. I don't think you are doing us any favours by not telling us.

Answer: George Culmer
Thank you for that Chris. We will. I have said what I wanted to say and I hear your reasons why you think we should say more, but we will talk more about it at the year end when we have all the pieces, I think that is the right time to talk about this.

Operator:
Ladies and gentlemen we have now run out of time so this concludes the Lloyds Banking Group Q3 2017 Interim Management Statement Conference Call.

End of Q&A