Lloyds Banking Group plc – Strategic Review

The Plaisterers Hall, London – Thursday 30 June 2011

Presentation to Analysts & Investors

Sir Winfried Bischoff – Chairman

Good morning ladies and gentlemen. Welcome to our strategy presentation. I am delighted that we are able to update you on the development of the Group and the substantial progress being made towards creating a strong and more resilient bank, and becoming recognised as the best bank for customers and, as a result, the best bank for shareholders.

The Board and I are pleased with the outcome of the strategic review and enthusiastic about its potential for the Group. The executive team has addressed our strategy over the last 100 days with rigour and determination. The Board and I are very confident that this was the right strategy for the Group.

I would characterise it as a 'strategy for our time'. It builds on the assets that we have in our business and the substantial opportunities that we have. It also ensures the bank is in the best possible place to meet the challenging and economic regulatory headwinds that we face.

An essential part of the strategy will be detailed reporting to track against the quantitative and qualitative guidance that we are announcing today. These metrics will also form the basis of executive remuneration going forward. As a board we fundamentally believe that remuneration policy must be aligned to the core strategy of the business. Our management should be appropriately rewarded if they meet the stretching targets which deliver strong and stable growth within our prudent risk appetite. That in turn will deliver value to our shareholders.

Finally, I would say that this is a strategy that will be underpinned by great execution and delivery. The board is absolutely convinced that we have a very credible and focused management team that will deliver on our plans and rebuild the pride in our bank.

On that note, many of you have already met him but I now have great pleasure in formally introducing António Horta-Osório, Group Chief Executive, of Lloyds Banking Group.

António Horta-Osório – Group Chief Executive

Good morning, and thank you Chairman for your introduction. I am pleased to set out today our strategy for Lloyds Banking Group to be the best bank for customers.

In terms of our running order today, I will present on our strategy and guidance. Mark Fisher will describe in detail our simplification programme, which will create a more agile organisation and also savings which we will partly re-invest in the growth of our core business. Tim will then outline the key financial metrics underlying the delivery of our plan. And then I will ask Kate to facilitate a Q&A session.

We already have a strong franchise. We have some of the most iconic brands in UK financial services, including Lloyds, Halifax, Bank of Scotland and Scottish Widows. Through these brands, our high quality, committed people deliver reliable, customer-focused financial services to around 30 million customers. I have been very impressed with the people I have been meeting throughout the bank over the last few months and I will tell you more about this later on.

Today, I will tell you how we will unlock the full potential in this franchise over time by creating a high performance organisation. Our focus will be on our UK businesses and the UK economy, significantly streamlining our International presence and creating a simpler, more agile organisation, which will be more responsive to our customers' changing needs. This simpler organisation will result in significant savings. We will reinvest part of these in additional value-for-money products and services for our customers. And in doing so, we will grow our core business and deliver strong, stable and sustainable returns for our shareholders. To explain in detail how we will achieve this, I would like to go over four main blocks with you; starting with the first 100 days.

We have made significant progress since March. We have strengthened our Executive leadership team, both internally and externally. We have created a new, more agile organisation, that brought the senior team closer to the customer by delayering one level at the top of the organisation, and centralised all control functions. We have accelerated the pay-down of the remaining government and central bank funding, so that today we have only £37 billion outstanding compared to £97 billion at the end of last year. This is £60 billion in six months.

We have continued the disciplined reduction of non-core assets, which stood at approximately £173 billion at the end of the first quarter. And we have accelerated the disposal process of the branches we are required to sell given the tight EU mandated timetable we need to work towards.

In our core business, we have renewed our focus on customer satisfaction and publicly committed to reducing the level of complaints we receive. We are revitalising Halifax as a leading challenger brand on the high street, offering greater, value-for money products, and a simple, efficient and fair customer experience.

We are playing a key role in the UK's economic recovery through actively supporting SME lending. Following our strong performance in the first quarter, our lending grew 2 per cent in the first half of this year, against a decline of 3 per cent in the market as a whole.

We have provided clarity on the costs relating to Payment Protection Insurance. We are on schedule to substantially complete our integration programme in the third quarter of this year. And, simultaneously with this quite challenging and intense start, we have completed our 100 day strategic review which was in itself a thorough and meticulous exercise.

Before I move on to the context for our strategy, I'll turn briefly to the important organisational changes we have made.

As you can see on the slides, our old management structure was siloed, like a 'Federation', resulting in too much duplication of roles between businesses and functions, acting on its own and in an uncoordinated way and too many layers between senior management and our customers.

Our new organisation brings a number of significant benefits. It is a flatter organisation, with one layer already removed between the leadership team and our customers giving higher visibility to our key businesses, internally and externally, and centralising our control functions, such as Risk and Finance. As a result, in Retail, the leadership of our Lloyds and Halifax community banks, and our newly created Products and Marketing area, now report directly to me.

Similarly, given our focus on support for the UK economic recovery, Commercial, comprising our business supporting our SME customers, also now reports directly to me. And we are now able to make faster decisions, with new, cross-functional weekly committees for the key areas of pricing, costs, investment, and the non-core portfolio, which I personally attend. None of these committees existed previously to March which means that key decisions are now taken at a higher level of the organisation, faster and in a coordinated way.

We will be focusing the strategy on supporting the UK economy and we are therefore reshaping our international business, halving the number of countries where we operate, and splitting the remaining operations between our Wealth and Wholesale divisions.

Turning now to our strategy, and the trends that have shaped its formulation.

Firstly, our marketplace is changing, and with it the expectations of our customers are increasing. We need to regain our customers' trust, by offering them products that are simple to understand and transparent in what they offer, and designed from the customer's point of view. We need to offer them advice to plan and save for their retirement which we foresee as an increasingly important trend for the future as the population ages and state support diminishes. And as technology evolves, customers increasingly want to be able to access our products through multiple channels. And of course, they want better value for their money, especially in difficult economic times.

Second, we are seeing greater clarity on regulation. Our regulators' focus is both on ensuring stability of the financial system, and on promoting competition. They are therefore demanding that we meet stringent capital and liquidity standards. We also expect detailed recovery and resolution mechanisms and are awaiting clarification on the ring-fencing of retail operations with the publication of the ICB's final report in September.

And, in an already competitive market, we are seeing new challengers, and increased customer switching between providers.

And finally, we see a continuing challenging macro economic environment. As you will hear from Tim, we remain cautious on the outlook for the UK economy.

In our main scenario, we expect a slow and long recovery, with continued deleveraging and high inflation for some time to come. On the other hand, there are non-negligible scenarios of additional macro economic risks such as double dip or contagion from a sovereign debt crisis.

In this environment, our decision to accelerate the implementation of the actions we have taken to control costs and simplify our organisational structure are key to mitigate these risks and adapt our business model to be more resilient to any future volatility in the markets and therefore protect the sustainability and predictability of our earnings.

But despite these challenges, we see the opportunity to earn strong, returns in the medium term, albeit at lower levels than before the financial crisis.

We also face a number of internal challenges, such as the EU mandated State Aid sales, and other challenges relating to our legacy including the limited amount of investment that has been available for growth opportunities in the past few years.

Our structure, organisation and processes still remain slow and inefficient, as I said, resulting in higher costs than necessary. Despite good progress so far, we still have much work to do on our non-core exposures, and our funding structure.

However, in facing these challenges we are fortunate to have a unique set of assets with highly recognisable and trusted brands combined with a valuable customer franchise and market position. We are the number one retail and commercial bank in the United Kingdom.

We have high-quality, committed people, who have impressed me very much, as I told you at the beginning of this presentation, as I have been meeting them throughout the Bank: for example, in the convention we organised in March with 5,000 people; in my branch visits every month (to Edinburgh, Birmingham, and London so far); in the call centres; in my SME breakfasts with clients; in the Corporate Bank; and at Scottish Widows.

And we have proved our change management capability through the success of our integration programme, which is about to complete in the third quarter. The completion of integration will create the springboard for our simplification initiatives. It will release people with experience of undertaking large-scale projects, and operating with a single platform, to further transform the Group into the next stage of its development.

Finally, we have the advantage of having aligned our senior leadership team behind our plans through the strategic review with a clear mandate to support our customers, increase efficiency and invest for growth.

Our new strategy through which Lloyds will address these challenges and maximise its potential is focused around being the Best Bank for Customers. We can only succeed as a bank if we succeed in the eyes of our customers. Having long-standing, broad based relationships with our strong customer base is a privilege that allows us to bring the whole Group to serve them in an integrated way, in a simplified manner and starting from their point of view.

This is an evolutionary process, not revolutionary, which will be developed day-by-day, client by client, brick-by-brick, but over time we will make a real difference to our customer service proposition and the value we can generate from it.

We need to focus on a simple set of products that help our customers meet their needs:

- For financing, handling routine transactions, saving for the future, and managing uncertainty. Fewer products, each one delivering better results in a simpler way

- We also need to deliver good value for money, for example through using the cost savings we achieve by enhancing the challenger brand opportunity in Halifax or rewarding loyalty for Lloyds and Bank of Scotland customers.

- We need to provide trusted advice and quality service. A trusted advisor through the cycle for businesses and SMEs and stepping into the RDR "advice gap" for retail with product offers only an integrated manufacturer/distributor can deliver, and getting service right the first time in a way that we can be proud of.

- We need to serve our customers how and where they want to be served. We have an industry-leading internet offering in Galaxy and we will launch in Q3 a state of the art solution for businesses for foreign exchange transactions and money market deposits called Arena. We also know there is a valuable role for branches and we are committed to keeping them open and well invested.

Being the Best Bank for Customers is only possible if we first re-examine everything we do and ask "if this does not help our customers, why are we doing it?"

- we need to reduce extra management layers and internal bureaucracy that creates complacency and distracts our attention away from the customer and act as a single management team.

- we need to simplify the way we do things – constantly changing cumbersome processes, convoluted systems, complicated products, and confusing policies

- in this manner we can re-invest the benefits – providing greater management focus, more time for customers and investing part of the cost savings we deliver – to provide the experience customers want.

Most importantly, as we address the issues I have just raised, simplifying the way we work and investing where we can make a real difference, we will enhance value for our shareholders

In delivering value for our shareholders, we will target positive operating jaws, customer-driven low-volatility earnings based on a prudent risk appetite and high returns on core investments, supported by a strong balance sheet and funding position. And in seeking to improve our returns, we are committed to reinstate dividend payments once our regulatory capital requirements have been defined and prudently met. And with improved returns, we aspire to return to full private ownership over time.

Turning now to our action plan to deliver our strategy.

This has four elements, each with its own target outcome. First, to drive sustainable, predictable returns on equity above our cost of equity, we will reshape our business portfolio and concentrate our core business in the UK economy, to fit our assets, capabilities and risk appetite.

Second, we will simplify the Group to improve our agility and efficiency, and drive significant cost savings and positive jaws.

Third, we will invest to grow our core customer business, to deliver stable, strong, high-quality earnings streams over time.

And finally, we will continue to strengthen our balance sheet and liquidity position, ensuring we have a robust Core Tier 1 ratio and a stable funding base.

Dealing with these in more detail:

Our core businesses are those which deliver strong returns, are liquidity and capital efficient, and have attractive growth prospects. They are businesses where we have sustainable competitive advantages and fit with our core customer strategy. These include our core retail businesses, including bancassurance; in our commercial and wholesale businesses, they include our transaction banking, rates and foreign exchange offerings; and in Wealth they include improving our penetration of the mass affluent, affluent and high net worth segments.

We have defined non-core businesses as those which are outside our risk appetite, are distressed, or where we have a subscale market position. They have a poor fit with our core customer strategy and an unclear value proposition, delivering below-hurdle returns. Examples include our Irish assets, shipping and aerospace portfolios, and retail self-certified mortgages.

I want to emphasise that we have undertaken an extensive review of core and non-core assets, as Tim will detail later on. We have made significant changes to non core where we exited around £15 billion of Treasury Assets to repay our Government assisted support and reclassified around £14 billion of assets to non core in line with our international repositioning. Likewise we have reclassified around c£15 billion of assets to core including the social housing business and the Agricultural Mortgage Corporation (AMC) which we believe are at the heart of the UK economy and its communities and Lex Autolease which is a sound UK business with significant growth potential.

We will take a disciplined approach to managing and reducing our non-core portfolio, which comprised approximately £173 billion of assets at the end of the first quarter. Firstly, we will continue to ensure we have adequate coverage ratios for all non-performing assets.

In terms of organisation, and given our non core assets are mainly assets, not legal entities that are included in different business areas we will be managing them in two separate ways, to avoid unnecessary complexity:

- non-performing commercial real estate and commercial loans, as well as Ireland, will be managed by a dedicated workout unit, which will be centrally managed under our Risk function.
- other activities will be managed within Wholesale, Retail and International until being run down or sold.

All of these activities will be overseen by the Group Asset Review Forum, chaired by our CFO, ensuring we have a single point of responsibility for maximising value in the non-core, and which meets on a weekly basis. And these sales will no longer be part of BAU, as we will have dedicated leadership and experienced transaction teams focused on these asset sales which will be motivated through specific balanced scorecards and appropriate incentives.

Turning now to our plans for our core businesses, and firstly our operations focused on personal customers in Retail and Wealth Management.

In Retail banking, our approach will be two-fold. We will revitalise the Halifax brand to be a leading challenger on the high street. Halifax will deliver a simple, efficient and fair customer experience, and will be a leader in value-for money and market-changing products, like the very successful ISA Promise product we launched earlier this year.

I will talk in more detail about Halifax's role as a challenger brand later in this presentation.

As you know, Lloyds and Bank of Scotland are leading relationship brands in UK retail banking. For these brands, our approach will be focused on deepening our relationship with our customers through rewarding their loyalty. We will deliver a high-quality customer experience by investing behind branches, new channels and services like our very successful Money Manager product. In seeking to meet more of our customers' needs, we will also further develop our Wealth business. Our goal will be to become a wealth advisor to our existing UK customers in the mass affluent, affluent and high net worth segments.

With the Retail Distribution Review, we believe we are uniquely placed to build a compelling proposition in these segments as independent advisors re-focus on a fee-based market. And we will refocus our International business, on UK customers, expats and other clients with UK connections, where we can bring added value.

To achieve this, we will invest behind new service models, and enhanced electronic capabilities. This will include a new investment platform which will carry both Scottish Widows' and third party products, offering our customers significant choice.

In serving our business customers

We will invest both behind Commercial Banking and Wholesale Banking to be their best through-the-cycle banking partner.

In Commercial, we are a leader in fuelling the economic recovery and play an integral role in our customers' communities by delivering on our SME lending targets, consistently sustaining our application approval rates at 8 out of 10, holding over 200 charter events and providing more business mentors than any other bank. We will seek to deliver a much wider range of Group products and services to our SME customers, including our Retail, Insurance and Wealth offerings in an integrated manner.

To support this, we will increase efficiency and deliver better value for our SME customers by investing in a new relationship and service models and better on-line and phone based support. In so doing, our Relationship Managers will double the time they spend with customers and as we significantly improve the speed of processing applications, customers will receive their funds in less than half the time.

For our larger corporate customers, who are served by our Wholesale banking business, our goal is to be their trusted advisor, serving a wide range of their banking needs. To broaden and deepen our product scope, we will therefore be investing behind our transaction banking and our debt capital markets, fixed income, and rates capabilities. And we will concentrate our activities in the UK by restricting our international presence and products to support UK connected corporates.

Our insurance business has been a significant and stable contributor to the Group's profits through the cycle and provides strongly attractive diversification benefits. Our life business is industry leading in its cost performance, and our general insurance business has one of the lowest combined ratios in the industry with sophisticated underwriting and claims management. And the business is also capital efficient and produces liquidity-free earnings.

And although we are a top 3 provider in the UK, both in Life, Pensions and Investments, and in General Insurance, we only have 10 per cent and 5 per cent market shares respectively, which represents a very significant opportunity to increase our customer penetration. Also, as a result of the Retail Distribution Review, we expect Independent Financial Advisors to consolidate, as regulation increases. This provides us with a unique opportunity to leverage the potential of this business, by selling more products directly to our customers, particularly in the mass affluent and affluent segments, through our branch network.

These are the investments and changes we will make to each of our businesses.

Let me now turn to the savings we will make to fund our investments in core business growth and service improvement.

As our integration programme completes this year, we now have the opportunity to deliver further cost savings from the simplification of the Group. Our new programme will use the strong change management skills we have developed under the integration programme that gives us the confidence to deliver on the next phase of the Bank's transformation. We have identified further cost savings, which we expect to amount to £1.5 billion per annum in 2014. These savings are additional to the £2 billion of run rate cost savings we will have delivered by the end of this year from integration. They will come from better and simpler operations and processes, lower cost distribution and a simpler product offering, and further improvements in procurement.

We will also create a simpler, de-layered organisation, bringing our top team closer to our customers and front-line staff and also centralising control functions. Wherever possible, we will use the experience we have gained during the integration process to limit redundancy and effectively manage this process via naturally occurring attrition rates and use of internal redeployment.

And, as a signal of our focus on delivery to the customer, we are also committing to keeping total branch numbers at the same levels (excluding the EU mandated branch sale) through the period, and to maintain the present policy of no further off shoring of UK operational full-time roles. Mark will describe this simplification programme in more detail later on.

At its heart, our strategy will create headroom for us to reinvest one-third of these savings in growing our core businesses. This will mean around £2 billion of cash investment, corresponding to an annual P&L cost of around £500 million by 2014, equivalent to reinvesting the one-third of the simplification benefits, which will be incremental to our ongoing investment in the business. Our particular focus will be on growing capital-efficient non-interest income, which we expect to account for around fifty per cent of our income by 2014.

We will be very disciplined in assessing the investments we make, and they will be subject to rigorous tests. These will include their fit with our overall strategy, their financial returns, and their fit with our new risk appetite. Our focus will be on the investments that make a tangible difference to our customers.

We have pre-selected around twenty growth initiatives based on these rigorous criteria which will be re-assessed continuously based on their business plan progression in the context of a strict and centralised capital allocation process.

As you have heard, they will be targeting products and services that our customers need, designed from their point of view. They will include creating a simple product portfolio for our retail customers; and
new transaction banking, financing and risk management products for our business customers.
Overall, we will look to deliver fair and simple to understand prices and services.

We will build on our reputation for trusted advice and service by taking a holistic view of customer needs, by creating new and integrated models for bancassurance for affluent and mass affluent retail customers, and by being a through-the-cycle partner to business.

And we will develop multi-channel access, including an e-portal for SMEs, and an electronic platform for transaction banking and markets for larger corporates.

This will be mirrored in our Retail business with the integration of multi-channels and further development of mobile platforms.

I'll now turn to five case studies highlighting the actions we will take in specific areas of our business.

First, Halifax.

Halifax shook up UK High Street banking in the early 2000s with its sometimes-irreverent, always good-value new approach to banking as usual. A few were shocked, but many more were drawn to Halifax, which became the leading share gainer during that period.

During the crisis, while Lloyds and Halifax were busy with integration, another challenger saw the opportunity to gain share. I am quite familiar with the approach they took and I am quite confident Halifax will again become the leading challenger brand in the UK.

Today, we are enthusiastically re-launching Halifax with the aim of being the UK's top switcher brand – the bank that UK customers turn to first as an alternative to the "Big 4". Halifax will compete head-to-head with Lloyds and Bank of Scotland. You will see a major new marketing campaign for Halifax in September this year.

Here's our plan:

We will challenge category norms with radically new products. As I have already said, we have changed the game with recent products such as the Reward Current Account, ISA Promise and the Clarity Credit Card. Our new Halifax Savings offer is just around the corner.

We will challenge the value offered in the market. In both our new and existing product range we will ensure that cost advantages of our simple, no-nonsense offer translate directly into financial benefits for our customers. We will change the game in offering the kind of convenient, available banking that our busy customers need. Beginning in August all our Halifax branches will be open on Saturday.

Finally, we will continuously challenge ourselves to make banking as straightforward as possible for our customers. Our Halifax colleagues think like their customers – they are quick to call out signs of inefficiency or bureaucracy and they will let me know exactly what they think during my regular branch visits. And I am quite confident as a result of these changes, we expect big things from our Halifax brand.

Turning now to our plans in Bancassurance.

Lloyds Banking Group is already the most successful bancassurance provider in the UK.

Yet we believe that there is still an untapped opportunity for us to meet more of our customers' investment and protection needs. Of our 17 million eligible customers, only 2.1 million are our bancassurance customers today. Our overall market share confirms growth potential as well – today we capture only 10 per cent of new business in our Life, Pensions and Investments, with only 43 per cent coming from existing customers, and only 5 percent of General Insurance business.

We think we can dramatically improve our performance in this market, as the graphics on the left hand side of this chart show. We are targeting an increase in bancassurance customers of 50%, from 2.1 million currently to 3.2 million by 2014. We are equally confident that we can increase bancassurance revenues and profits by 100% by 2014.

Why do we think we can do this?

First, RDR is creating an advice and distribution gap – our mass market and mass affluent customers may not be able to access or afford IFA advice. We see these customers every day and we can offer them affordable, relevant advice.

Second, we also observe a manufacturing gap in UK insurance as other providers have adopted niche product strategies. Our Scottish Widows manufacturing platform – which produces products for our own customers and intermediaries – enjoys industry-leading costs. Our unique position as a vertically integrated provider enables us to provide a wide range of products to our customers in an integrated manner both in terms of product innovation and development and in the actual delivery to our customers.

Third, we have a clear execution plan and are investing behind it, including:

- New specialised advisor models for both protection and investments
- Simple self-service propositions with integrated planning tools,
- A wide range of channels – branch, e-commerce and telephony – to meet different customer segment needs.

Fourth, our new, more agile organisation will enable us to break down divisional silos that may have got in our way in the past. Our new leadership in Insurance and Retail Banking is committed to working together to realise this tremendous potential for the bank. And in terms of other opportunities for us to lever cross-Group opportunities, I would now like to discuss our Commercial business.

Lloyds is deeply committed to our small and medium-sized business customers. We are leading the market in meeting SME lending commitments – since the start of 2011, we have grown our commercial loan book by 2%, year on year, while the market has shrunk by 3%.

We are much more than a lender to our SME customers - we are their primary bank and business partner. To illustrate, 96% of our Lloyds' heritage commercial lending customers have their current account with us. We have a major impact on the success of our UK commercial customers. A good example is the long-established aluminium processing company who moved to Lloyds from another bank at the end of last year. With a loan to help them move to a larger factory, they have now increased production by 90 per cent, taken on 9 new employees, and are set to double their turnover this year.

And we are helping new businesses, giving them practical guidance to help get them up and running, like the new children's play centre that opened in Wiltshire this year, where we are already helping them on expansion plans including a crèche and after-school clubs.

Lloyds is a wonderful foundation bank for our small and medium-sized customers. But we are not yet satisfied with what we offer to them.

When we compare our business model to best-in-class, we think we're still a bit old-fashioned. And we are not doing as much as we could to help our customers with their full range of product needs -- financing, risk management, insurance, pensions and wealth. We aspire to provide a comprehensive suite of products and services to our Commercial customers using our unique customer insights with a much more flexible and effective service model. Key changes to our commercial business include:

More thoughtful, multi-product propositions matched to customers' life cycle stages.

Launch of our new Direct Relationship Bank, which provides an alternative based on customer needs and preferences. A re-engineered commercial lending process, which will dramatically reduce our time-to-cash for loans. Better product skills and more customer-facing time for our relationship bankers. Using sophisticated customer insights capabilities to deliver products from the whole Group – Retail, Wealth and Insurance

Turning now to further developing our corporate relationships.

Lloyds is well-recognised as a leading UK corporate bank. We are a reliable, through-the-cycle business partner for our customers – in their Excellence Awards, British FDs have named Lloyds ‘Bank of the Year’ for the last 7 years running. It is not unusual for our bankers to have 20+ year relationships with the CEOs and CFOs of our customers. Yet we lag our banking peers – other corporate banks in the UK and other markets -- in meeting our customers’ broader corporate banking needs.

As we can see on the right side of the slide Lloyds has a strong and focused positioning with corporate and commercial customers. But the data on the left shows, Lloyds’ business with customers is concentrated in lending and our share of wallet of fee based capital light products is relatively small.

Investing to change our wholesale banking business mix is a top priority for us. We have no desire to become a complex, risk-taking investment bank with equity activities. Nor do we want to chase global Multi-national Corporations around the world – in fact, we are streamlining our international wholesale footprint. Rather, we will invest in low-risk, capital-light product capabilities to serve our existing UK-centric corporate and commercial customers better. We plan to:

Build our debt capital markets, interest rates and fixed income sales capabilities. Introduce our new Arena electronic platform, which will enable on-line customer transactions and more efficient end-to-end trading processes. Improve our research offering to reflect our unique insights into the day-to-day performance of the UK economy.

Put more product expertise into our dialogue with corporate and institutional clients. With our improved product suite, we will be able to reach our Trusted Advisor aspiration with more large corporates. We will also become more relevant to UK financial institutions as they seek to invest in our corporate customers’ debt offerings.

Moving on to our plans for Wealth.

Our strong market shares with our Retail customers are not currently replicated with affluent, mass affluent and high net worth individuals in our Wealth business. As the chart on the left shows, we have existing relationships with more than 20% of the UK’s mass affluent customers, but only a 9 per cent share of their investable assets under management and our shares of affluent and high net worth customers and their assets under management is even lower.

Many of our wealthier customers would like to do more with Lloyds, but they need a more compelling proposition than we have offered in the past. Our goal is to meet our existing customers' demand for better wealth propositions from us. Importantly, we do not aspire to take on the sophisticated global wealth management leaders to compete in the ultra high net worth market. We will also scale back our international operations significantly, closing many of our locations. These areas simply do not fit with Lloyds 'Best Bank for Customers' strategy. And we are well aware of how expensive the wrong wealth management proposition can be for shareholders.

To achieve our aim, we will:

Segment our customers in a more granular way, paying particular attention to our Main Banker affluent and mass-affluent customers

For our affluent customers, we will focus on premium banking services, a simplified advice model, financial planning, and packaged investments. Our affluent customers will also benefit from an improved on-line offer, including more self-directed options.

For our high net worth customers, we will significantly enhance our investment platform. We will offer standardized risk profiling, model portfolios, and dedicated relationship managers for advice. We will offer selective customized banking products. We will also improve the quality of their experience across channels.

Given our current position in Wealth Management, we think our aspirations are ambitious but achievable:

We aim to increase in-proposition customers by more than three times by 2014. And we aim to grow income per wealth management customer by at least 50% over the same period.

Turning now to guidance on our financial targets. First, let me re-emphasise that this will be a 3 to 5 year journey. It will take time to create a high performance organisation in retail and commercial banking. We are nonetheless giving you guidance for 2014 to increase clarity and to provide an objective sense of direction and metrics on which you will be able to measure us on over time.

Secondly, our set of targets for growth, efficiency and capital, as I have highlighted, are fully supported by a comprehensive and detailed set of simplification plans and growth initiatives.

As described we are targeting around £2 billion of cash investment, corresponding to an annual P&L cost of around £500 million by 2014, equivalent to reinvesting a 1/3 of the simplification benefits, which will be incremental to our ongoing investment in the business. With this investment, we expect income growth in our core business to exceed UK nominal GDP growth. We forecast that this will be primarily driven by growth in other Operating Income, which we expect to represent approximately 50 per cent of total income in 2014, as a result of the initiatives I have described to you.

And we also expect to increase our net interest margin to between 2.15 per cent and 2.30 per cent over the same period. This takes into account both our macro economic and customer behaviour scenarios as well as the likely evolution of our cost of funding. Importantly, over time our core margin will be higher than our Group margin.

Our cost saving programme is expected to deliver positive operating jaws and £1.5 billion of annual savings in 2014, resulting in cost income ratio of 42 per cent to 44 per cent by 2014, equivalent to 39 per cent to 41 per cent excluding operating leases.

And in ensuring a disciplined allocation of capital to core businesses, we will, compared to the end of 2010, more than halve our non-core asset portfolio by the end of 2014, and target net capital generation from the non-core portfolio in the 2012 to 2014 period.

Turning now to our targets for risk, funding and returns.

Given our prudent risk appetite, we expect our average asset quality ratio to improve to 50-60 basis points by 2014. We will measure the robustness of our funding position firstly through our loan to deposit ratio, which we expect to be less than or equal to 130 per cent for the Group as a whole, and less than or equal to 120 per cent in our core business, by 2014. And we will ensure that we meet Liquidity Coverage Ratio and Net Stable Funding Ratio requirement ahead of the regulatory implementation dates.

We are currently targeting a core tier 1 capital ratio prudently in excess of 10 per cent by January 2013 when the Basle III transition period commences. Tim will give more detail on the transition to Basle III rules in his presentation.

And with our disciplined approach to investment, we are targeting a sustainable statutory return on equity of 12.5 per cent to 14.5 per cent by 2014 over a higher required capital base. As I said to you we believe we will be able to achieve healthy returns over time but these will be lower than before the financial crisis.

And I would like to emphasise that these targets may look similar to others you have seen, but they will be achieved in a very different way based on simplification which will drive efficiency and savings and therefore will enable investment in growth initiatives targeting OOI. And all of these plans have a very high degree of granularity behind them.

So, to conclude. Our strategy will unlock the potential in our franchise over time. In turn, this will deliver strong, stable and sustainable returns for shareholders. There are three principal elements behind delivering these improved shareholder returns:

First: enhancing our earnings. But also delivering better quality, lower volatility earnings. As you've heard, this will come both from simplifying the business and lowering costs…
and from carefully managing our appetite for risk and focusing our investment for growth on less capital-intensive activities.

Second, we will build a strong capital position. This will, further reduce both regulatory and economic risk. And over time, we expect this will also mean that we can resume our payment of cash dividends.

Third, we will further improve our funding profile. Reducing our reliance on wholesale markets will make our funding position more sustainable. Over time, it should also improve our competitive position by reducing our wholesale funding spreads.

These three key elements are reflected in the financial targets for 2014 that I have just described. I believe the execution of our strategy will deliver on them. This means we will create a high performance organisation. This is a big undertaking as it will stretch the Group in several areas but we have great people and a senior leadership team firmly behind these plans.

And in executing our strategy, we will create the best bank for customers
and the best bank for shareholders.

Thank you very much.

Now, I will hand over to Mark, for more detail on our simplification programme.

Mark Fisher – Director, Group Operations

Thank You Antonio and good morning everybody. I'd like to spend about 15 minutes or so giving you an insight into what we are actually be doing under the heading of Simplification.

Antonio described Integration as the springboard for Simplification so I'd like to say a few words about that start point. As you have heard, Integration is well on track to deliver the promised £2bn of run rate synergies by the end of 2011.

We are in the final stages of the core systems integration which will give us a single platform supporting Halifax, Bank of Scotland and LloydsTSB brands, across savings, current accounts, mortgages, loans, general insurance and life & pensions for our personal, clubs and societies, small businesses and medium to large corporates. But whilst that gives us a single platform, the platform itself is broadly what LloydsTSB had circa 2009 with a few improvements since that time. Like the curate's egg it's good in parts. The opportunity now exists to **transform** that platform to a world class standard. And that is what Antonio meant by integration providing the springboard for simplification

The goal of Simplification is to improve customer service and improve efficiency. These aims go hand in hand, as reducing errors, speeding up service, limiting manual inputs, achieve both goals simultaneously.

Despite its size the business does not capture all the operational scale benefits because it lacks the technology and linking mechanisms to act as a truly scaled entity.

Transparency may seem like an odd word here, but what I mean by this is both transparency to customers in terms of the completion of their service request, and transparency to the organisation on controls and on costs.

Crucially the cost savings to be delivered will provide the cost headroom to allow investment in growth initiatives. And this is not just a programme of technical change aimed at a few technical processes, this is an holistic change to the way that Lloyds operates.

So integration delivers great progress in a number of areas. For example, the number of non branch buildings was over 450 at the start of 2009 and by the end of this year we will be at around 170. But we have been working since late last year to try and understand the gap between our post integration state and the best in class. And working with benchmarking groups on a European basis, we have identified that there is huge potential for improvement. If I take my example of non branch buildings, the best in class would probably have around 20 major buildings, so even at the 170 at this year end, we have a long an awfully long way to go. In terms of IT applications within the platform, we would probably need to halve those to get into a best in class territory.

Crucially, in terms of end to end processes, benchmarking reveals very substantial opportunities to improve error rates, rework and manual input. Overall we believe that for most processes, the improvements in the range are 30-50% improvement of all their metrics is possible. I will explore a couple of examples of this in a few minutes. Finally, we have hugely complex front and back book product sets and we see great opportunity there, we have very bureaucratic committee structures in areas like Risk, and these are some way from world class.

To seize this opportunity we have developed well over 100 initiatives which we estimate will deliver cost savings of £1.5bn in the year 2014, with an exit run rate of around £1.7bn at the end of 2014. We will invest around £2.3bn in processes, people and systems to achieve these targets. For ease of analysis we have grouped the initiatives into four broad workstreams. The largest of these, and it shouldn't be a surprise is

Operations and Processes and we estimate these will deliver around 35% of the total benefits. The next largest workstream is Sourcing delivering around 30% of the total benefits.

The balance of benefits comes from a workstream centred around Organisational initiatives with a fourth workstream based around Distribution and Channels.

I will now take you through each of these now in more detail.

The biggest opportunity for our processes and operations is to automate. So whether customers choose to use self service, or whether they choose to interact with a member of branch staff or telephone centre staff, all of them will use simple entry screens that collect the relevant data and when the "OK" button is pressed at the right hand corner of the screen, the transaction is finished with no more intervention by human hands. That has got to be the end target for many of our high volume and complex processes.

Where this is not possible we build an enterprise wide image and workflow infrastructure which will allow us to take work from the point of input to new multi skilled centres where the task is completed by what I like to refer to as the "expert mark one human eyeball" so one of our great employees. And ideally no further hand offs beyond that point. This will reduce error rates, dwell times and manual effort, It will improve the customer experience and reduce costs. I would use the analogy of an iceberg here. It is not just the direct effect of the improvement but the way it ripples through the organisation. Fewer errors mean less rework, mean less complaints, mean fewer complaint handlers, mean less complaint outcome testing, mean fewer referrals to the FOS and so on.

For colleagues we will eliminate many highly manual tasks and effectively move them up the value chain with better opportunities to develop skills. You will have seen the announcement this morning included an estimated reduction in jobs of around 15,000 in addition to the 28,000 jobs released by Integration. I would stress that this is jobs not people. In Integration we have managed to use natural attrition and redeployment to offset the impact on our people meaning that to date less than half the announced job losses have resulted in redundancy.

We will be taking the same approach here in Simplification. I would remind you that due to normal attrition in the next three years the Group would expect to need to recruit around 35,000 additional people.

As I said earlier, we believe the scale of the opportunity to improve the end to end processes is generally in the range 30-50%. This slide gives two examples where we started detailed design work already. The first example is about account switching so new customers joining the Bank. The second Antonio has already referred to, about our commercial lending fulfilment process. You can read the percentages for yourselves - but the key issue is all of those percentages are **at least** of the order of magnitude that the benchmarking suggests.

In the case of our commercial lending process it is not only cost benefits but freeing up relationship manager time to reinvested in time with the customer. Now these are only two early examples but serve to give us confidence that the scale of the opportunity is there.

Move onto the second workstream Sourcing. As you know, Integration has delivered great benefits in this space already. At the start of Integration we had around 29,000 suppliers, and by the end of this year that will be down to around 18,000 with the top 1000 suppliers accounting for over 94% of the spend. That is good progress but we believe the opportunity is there to go materially further, to around 100 lead suppliers reducing the total number down to around 10,000. I keep saying to my procurement guys that 10,000 is still a very big number so we'll see where we can get that one to.

Now this is not just about getting "steely eyed purchasing managers" doing tough deals with suppliers. It is more about managing the whole demand life cycle. This starts with the realisation that the absolutely cheapest way to procure anything is not to buy it. So reduce demand to the absolute minimum. Then, when you have unavoidable demand, the next step is to simplify the specification of what you want to its minimum appropriate level and have a uniform specification across all brands, geographies and businesses. Then comes the " steely eyed purchasing manager" bit, but here it's not just about tough negotiation but about structuring the supply chain so that we want to buy from suppliers what they are easily and cheaply deliver. Our ability to do this whole approach is greatly improved by the new structure Antonio showed you, with all the lateral functions and units supporting business lines in a "One Group" basis. We have already implemented a new structure of a cost board and so called cost management units to manage this process at a granular level of detail. Now you may be sat there thinking, that doesn't sound like much fun and you'd be right, it isn't fun but it is necessary and it is working.

A good example of this is Training, we have identified over 1300 training suppliers. By the end of Q3 this year we will reduce that to 10 lead suppliers and achieved over 20% cost reduction and no diminution in training quality. Coming back to my iceberg analogy, just think about the complexity in the organisation in deciding which one of 1300 suppliers you actually wanted to use and then think about the complexity in accounting and accounts payable of dealing with thousands of very small invoices.
Antonio referred to a flatter more agile structure. Some of you may recall that in Integration we aimed to implement what was called an "8x8" structure. So each manager having at least 8 direct reports and no more than 8 layers from the Chief Exec to the Cashier. The new organisational design pushes this a significant step forward to a "7x10". So there is, one less layer for faster communications and shorter decision making lines, and each manager has a wider span of control forcing each subordinate to take more personal accountability and promote a high performance culture.

Now these two Christmas tree charts, as I like to call them, are representative rather than mathematically perfect. But they do show that the front line staff are largely unaffected, the real changes in middle and senior management, and savings here are, of course are very high cost. These restructurings are now underway and will be largely complete by the end of this year.

Delayering is further enhanced by the creation of strong functions in Risk, Finance and HR and this removes duplication and strengthens control. Also within this workstream we will exploit the rationalisation of our geographic footprint from over 30 countries to less than 15 but will concentrate even further than that the operational support of these business particularly in terms of payments and IT.

Finally, within this workstream we will take the opportunity to greatly reduce the legal entity footprint of the group from more than 1600 entities to less than 1000. That is now well underway, over 100 entities have been eliminated so far this year.

The final workstream is distribution and channels. Here we start from a position of strength. Our Galaxy internet platform is leading edge, as the techies like to say, Internet 2.0, and is already providing market leading services like Money Manager and mobile faster payments. But we believe there is much more to go for. We are already the largest internet bank with 8.5 m users, and we will increase this to at least 13m by end 2014. We believe mobile gives an opportunity to move the game on even further, not just in servicing and costs but in things like near field contactless payments and personalisation.

Within this workstream as well we will improve our telephone Intelligent Voice Response service to a best in class 70% of transactions dealt with one touch where it is currently it is already good performing at 60%.

As I mentioned earlier, we also see great opportunity from simplifying the product set including much more capable parameterised pricing and product functionality on an individual basis.

Clearly the success of Simplification and the Strategic Growth Initiatives depends upon excellent execution. We will utilise the capability we have created for Integration and use the same principles of strong project controls and detailed milestone tracking. Accountable senior executives are already in place for all the workstreams and major initiatives and quick wins are, as you have heard, already in delivery.

The total cash discretionary investment involved. I have mentioned £2.3 billion for Simplification and as Antonio mentioned, a further £2 billion on the Strategic Initiatives. So in total £4.3bn over the period to the end of 2014. That is in addition to the spend on Verde and the normal “run the bank" maintenance projects. This represents a material delivery challenge but to put it in perspective, in total quantum is about the same as that posed by Integration over the last three years. So we are confident that we can leverage our Integration experience to deliver the Best Bank for Customers and the best bank for Shareholders.

Thank You. I would now like to hand over to Tim Tookey

<u>Tim Tookey – Group Finance Director</u>

Thank you very much Mark and good morning everyone.

This morning I will set out <u>how</u> the initiatives that Antonio has taken you through will feed into the performance drivers for our business and as a result, I will update you on the Group’s financial targets.

Let me start by updating on our 2011 guidance, before going into more detail on the medium term.

Our current view on 2011 is broadly unchanged from that which we have set out previously, but I’d like to add some additional comments today. At the time of the Q1 IMS, I outlined various pressures on our net interest margin – since then, markets have become very difficult indeed but despite these effects, we are still targeting a net interest margin of just above 2 per cent for 2011.

We clearly expect core income to be slightly down as a result of increased margin pressures, the lack of liability management gains this year, and the reductions that you have seen in the size of our balance sheet from customer borrowing and repayment trends.

However, I am pleased to say that as a direct result of cost actions taken over the last couple of months, we now expect costs to reduce slightly this year. In addition, we are confirming that we remain on track to deliver our target integration cost synergies of £2 billion by the end of the year.

Our overall impairment guidance, and the division by division comments which I set out earlier this year, remains unchanged. Additionally, I am very pleased with the continued strong improvements in the loan to deposit ratio, which now stands at about 146 per cent.

And lastly, we have achieved total non-core asset reductions in the first half of over £30 billion, which has enabled us to repay £60 billion of government and central bank debt, which is a material amount.

Now let's get into the detail of the future

The board's strategy and action plans presented by Antonio will enable us not only to deliver for our customers, but also to create strong and stable returns for our shareholders. Over the next three years, as we focus on attractive UK customer segments and their product needs, we will target an outcome of sustainable, predictable returns on equity, above our cost of equity earnings that will be more resilient in what is a very uncertain world.

Whilst we remain on track to deliver our target run-rate of synergies from the integration programme, we will go further and deliver additional cost savings of £1.5 billion by 2014 from the Simplification programme as Mark has outlined. And this will be equivalent to a run rate saving into 2015 of £1.7 billion..

Conditional upon the operating environment over time, we intend to make a series of specific new investments. These will be targeted at making us "The Best Bank for Customers", through improving our customer propositions and growing our core business income streams. Building on the good recent progress, we will continue the strengthening of our balance sheet and our liquidity positions.

Before going into the detailed guidance, it is worth putting our plans into the context of our medium term economic outlook and assumptions.

We continue to believe that a slow recovery over the next couple of years remains the most likely outcome for the UK economy. We see GDP growth of some 1.5 per cent or thereabouts in 2011, with a further increase in 2012.

As for base rates, we continue to expect low rates to remain in the short term, with one base rate increase later this year, and further slow but steady increases over the next couple of years, to take the base rate to about 3.5 per cent by the end of 2014. The slow recovery will sadly see unemployment remain high for a little while, whilst house prices (and indeed commercial real estate prices as well) will fall slightly before recovering a little next year.

Within that context, let’s now take a look at the various performance drivers, starting with earnings.

As Antonio illustrated in a number of case studies, and I have shown a few of them here, in addition to our business-as-usual investments, we will invest about £2 billion over the next few years in the core business. The P&L expense of these investments will grow over time to about £0.5 billion per annum by 2014 which is equivalent to about one third of the annual expenses benefits from the simplification programme.

These investments will be strongly focused on improving core banking and SME propositions, developing wholesale and debt capital markets capabilities, and building bancassurance. All of this being in line with our strategy to be “The Best Bank” for all our customers. All investments will be subject to disciplined tests, including the fit with our risk appetite and, importantly, our financial returns.

What will this achieve in terms of income growth and mix?

Well we target growing core income faster than nominal GDP growth over the medium term – and the emphasis of the projects we have just looked at will see the primary growth coming in other operating income.

Whilst this focus will drive OOI, we will continue to move towards a lower risk, less capital intensive balance sheet. This aspect of future income will also reflect

- the higher future costs of liquidity,
- liability margins remaining under pressure for longer, as base rate rises are likely to be slower than previously anticipated,
- and the rising overall costs of wholesale funding.

As a result of the combined effect of these factors, I expect 2014 income will be roughly equally split between NII and OOI, the latter being net of insurance claims.

Turning now to net interest margin itself.

As you know, the factors impacting our net interest margin which are within management's control have been managed very actively. As reported previously, we have made huge progress on asset repricing but there is always more that can be done. We also remain focussed on balancing new business pricing with our strategic aims.

Over time, but probably not initially, we will share in the benefits of base rate rises but, in the meantime, we continue to operate in a competitive deposit environment. We are now able to reduce our wholesale funding requirement, which gives us greater flexibility in the mix of funding types and sources, and as a result, greater control over our funding costs.

External factors, however, continue to dominate the trends in our net interest margin. With the base rate expected to be lower for longer, and wholesale funding costs remaining higher for longer, the potential for liability margin growth is limited, certainly in the short term. On top of this, the deposit market competition that I just mentioned and the cost of increased regulatory liquidity requirements will unfortunately put additional pressure on further margin growth.

As we have seen over recent weeks, markets are incredibly difficult to forecast which makes margin predictions far from easy. However, based on our assessment of these various internal and external factors, we expect the net interest margin for 2011 to be more than 200 basis points, and the Group NIM to be in the 215 to 230 basis points range by 2014, with the Core business margin higher than the Group margin.

Looking at costs.

As I said in February, we cannot avoid increases in costs from the new Bank Levy, the increased VAT rate and employers national insurance which amount in aggregate to about £400 million per annum. However, with the integration on track to deliver our target savings, we have a further £600 million per annum of cost savings to achieve over the £1.4 billion run rate achieved last year. That is the £2 billion in total.

In addition we are targeting cost benefits from the Simplification programme from which we will absorb the annual expense effect of the strategic growth initiatives that Antonio set out. Furthermore, I currently estimate about £0.5 billion cost reduction from the Verde branch disposal, which is likely to conclude in 2013.

After an estimate for other items, principally inflation, 2014 costs are targeted to be about £10 billion. This cost profile excludes the Simplification programme implementation costs, a proportion of which will be reported below the line over the next few years.

Reflecting lower income projections than before, this tough management of the cost base is likely to result in a cost : income ratio improvement to between 42 and 44 per cent by 2014, equivalent to between 39 to 41 per cent adjusting for operating lease items.

Turning now to impairments.

Over the past 24 months we have seen substantial improvements in the Group’s asset quality ratio and we believe, given our current economic outlook, that the impairment charge will continue to decrease this year, with further reductions next year and beyond. Our risk appetite going forward is very closely aligned to the more conservative heritage Lloyds approach, and is of course now fully embedded groupwide. All existing portfolios have been thoroughly reviewed and re-confirmed as having appropriate provisions booked, whilst the risk profile of all <u>new</u> business is subject to tight and centrally managed, disciplined controls. We expect to bring the Group's overall Asset Quality Ratio down to 50-60 basis points in the medium term, with core business at the lower end of this range.

Of course, the lion's share of past impairments has come from the non core portfolios. So let me talk about those portfolios for a second.

What we regard as non core has been thoroughly re-assessed as part of the strategic review and a number of changes have been made within the wholesale and international portfolios. For example, our Lex Autolease business is now core, as is our social housing portfolio. Going the other way, a select number of our overseas operations move to non core and will be run off or disposed over time as we significantly reduce the number of overseas territories in which we operate.

We maintain a very tight definition of non core which encompasses those assets or businesses which may fit one or more of the following criteria:

- delivering below-hurdle returns,
- being outside of risk appetite
- may be distressed,
- or subscale,
- having an unclear value proposition, or
- simply a poor fit with our customer strategy.

Whilst the data on this chart excludes Verde, the net effect of these switches on the quantum of non core assets is insignificant but non core income and capital reduce slightly from that previously reported. Commencing with this year's interim results we will increase our income statement disclosures on the non-core portfolio.

We expect to more than halve the size of non core assets over the next 4 years to the end of 2014. And we will achieve this by continuing to take a disciplined approach which will balance the imperatives of risk, capital and liquidity management. Our non core Commercial Real Estate and corporate loans will be managed on a day-to-day basis by our dedicated workout unit reporting to our Risk director, while non-strategic activities will be managed by dedicated teams until run-off or sold. All of this under the control of the Group's Asset Review Forum that Antonio referred to.

As we achieve this run down, we believe that the overall non-core reductions will be net capital generative over the period 2012 to 2014.

I said I would comment on the branch divestment required by the EU, known as Project Verde.

We are very pleased with the progress made following the March announcement that we would accelerate the start of Project Verde. The information memorandum was issued a few weeks ago to prospective buyers, with indicative offers expected in July. We expect to identify a purchaser by the end of this year, but do not expect the transaction to complete until 2013, given the separation and business migration issues that will need to be resolved. Actually executing the sale will be a complex process with costs very dependent on the nature of the buyer and their existing capabilities. However, such costs could be as much as £1 billion.

As you know, the EU divestiture agreement includes a mechanism which allows the buyer to dictate that they take a slightly smaller asset base, but an unchanged current account market share, than that put forward by the EU, so being precise about the impact on Lloyds of the sale isn't possible. I have set out here, however, the approximate impacts on us of the sale based on the EU proposal using current financials, although things will naturally move on by the time of expected full legal completion in 2013.

Now let's move to other topics and firstly creating new business flexibility.

Our strategy for being "The Best Bank for Customers", and the consequent focus on customer deposit growth and building our wealth business, will combine with the non-core asset reductions and Verde to give us a lot of funding and capital flexibility going forward. We will use this to continue to reduce our wholesale funding requirements and further improve the loan to deposit ratio which we now target at 130% or lower, and we will also increase our liquid assets over time to help meet the new LCR and NSFR requirements.

But very importantly, this will also provide us with a lot of capacity to grow our core business. The combined result may be a slightly smaller balance sheet, but one which will deliver less capital intensive, but more resilient earnings, supported by a prudent funding profile.

Talking of funding, let's look now at wholesale funding.

We continue to make excellent progress here. The strength of our term issuance coming on top of the non-core reductions, has facilitated further material reductions in government and central bank facilities, down £60 billion to £37 billion, which is an excellent result. I expect remaining facilities will be repaid in line with contractual maturity dates, the last of which is in October 2012 but it is clear that this topic is no longer the major issue that concerned all of us 18 months ago.

Our annual wholesale funding requirement is now clearly lower and we will probably only issue new funding of £5 to 10 billion over the rest of this year across our public and private programmes combined. Beyond that, I expect annual aggregate issuance to be about £25 billion, of which maybe two thirds will come from public programmes.

Looking briefly at the new liquidity ratios that are some years off being in force.

Well, perhaps unsurprisingly, we will more than meet the new requirements for both the new Liquidity Coverage Ratio and the Net Stable Funding Ratio, and we will achieve this by 2014, well in advance of regulatory requirements. This will, however, require us to increase further our holdings of primary liquid assets to a level broadly equivalent to our less than one year wholesale maturity profile, which will itself of course be smaller than it is today as the CGS becomes fully repaid. The cost of holding these incremental liquid assets will impact our Net Interest Margin as I have already said.

The eventual cost will depend on future funding costs, but this is part of the cost of operating in an increasingly tightly regulated environment, but the result will be a more prudent and more resilient business and that resilience is clearly an important and welcome output.

Let me now turn to our capital position and specifically the impact of future Basel regulations.

I set out in February the high level impacts of Basel 2.5 as we call it and Basel 3 and the offsetting benefit from RWA reductions from non core run down. Let me give some further detail this morning.

When Basel 3 starts in 2013, we expect to have a Core Tier 1 ratio prudently in excess of 10 per cent. The top two bars here show that we expect the implementation of Basel 2.5/Basel 3 to have a combined negative effect of less than 1 per cent on our Core Tier 1 ratio by the end of 2013 and of course, this includes risk weighting associated with the holding in insurance operations that equates to 10 per cent of Core Tier 1.

The transitional rules which phase in the new Core Tier 1 deductions start in January 2014 and will take 5 years to come in. These will further impact our ratios as to holdings in insurance operations, excess expected loss and any residual deferred tax assets relating to trading losses that may still be on our balance sheet at that time.

With regard to the insurance adjustment, in the second half of this year, we will complete further capital restructurings within those businesses which will reduce the total core tier 1 impact of Basel 3 by just over £2 billion. This significant mitigation is worth 50 bps of Core Tier 1 under full Basel 3 and will reduce the transitional rules impact to circa 20 bps per annum. The Basel 3 treatment of excess expected losses is expected to have a similar transitional effect. As before, however, we will see substantial RWA reductions from the non-core asset disposals and, of course, the completion of Project Verde. The overall result is a very manageable transition to the new world – one in which we will always maintain prudent levels of capital in excess of regulatory requirements.

Now let me bring all of this together and remind you of the financial targets for 2014, which Antonio set out earlier.

We are aiming to significantly improve cost efficiency through the Simplification programme, generating sustainable cost savings over and above the integration and this will allow targeted investment in the core business. The investments will help us deliver core income growth, in excess of nominal GDP growth whilst growing our margin to between 2.15 per cent and 2.30bps but, importantly, the margin achieved in our core business will be higher than this.

The continuing non-core run-off and disposals are to be net capital generative over the 2012 to 2014 three year period. This will also help us improve the Group's balance sheet shape thereby reducing the loan-to-deposit ratio, and we will meet the new liquidity ratio requirements ahead of the regulatory implementation dates. Our prudent risk appetite and disciplined risk controls will lead to a reduction in the cost of risk.

The disciplined and high-return investments in the core business will contribute to us delivering a sustainable statutory return on total equity of between 12.5 and 14.5 per cent by 2014, despite the drag at that time from the residual non-core assets and still with positive earnings momentum being carried into 2015. Such returns will be in excess of our cost of capital.

And, so in summary where does this get us to?

The “Best Bank for Customers” strategy will deliver shareholder value through strong, sustainable, low-volatility earnings, achieving an appropriate and increasing return. As part of delivering value to shareholders, it is also our very firm intention to resume dividend payments within a sustainable, progressive dividend policy, but only after regulatory capital requirements are defined and prudently met. It is also a very clear objective of ours to return the Group to being fully privately owned once more.

And with that, I will hand you over to Kate O’Neill, who will co-ordinate our question and answer session.

Question and Answer Session

Question 1: Steve Hayne – Morgan Stanley

Steve Hayne from Morgan Stanley. Two questions please. Number one. Thank you very much for all the additional guidance and you are referring to an intention to move towards a progressive dividend policy in due course. There is a lot of new guidance, but the one thing that is missing is some sort of target payout ratio in 2014. So that would be my first question if you are willing to provide some guidance on that?

My second question relates to Halifax as a challenger brand. If I take all things the same for any retailer, you have a cost of goods sold, you add a margin and that gets you to price. At the moment your cost of goods sold is quite elevated in terms of your wholesale funding cost, your cost base currently exceeds your competitors. So I am wondering how you can get to a price you can be particularly competitive for Halifax. And therefore I am wondering whether I should think about that as somewhat of a loss leader that you might actually be taking losses on that to help other parts of the Group grow their business? They are my two questions, thank you.

Answer: António Horta-Osório

Thank you very much for your questions. Starting with the question on the dividends. As we said, this is going to be a journey. This will take 3-5 years to do and we are providing you guidance and clarity for 2014. As I said we want to increase clarity, we want to provide you with a clear sense of direction. And we want to provide you with the metrics with which you will be able to assess our performance.

In terms of capital requirements, although there is increasing clarity there is still a lot of uncertainty. And although we don't know what exactly this will mean, we know clearly that that direction will be upwards, so will be more capital required. And that is why we said and we know this is a very important decision, we are absolutely committed to start paying dividends when our capital requirements are clearly defined and are prudently met. And this will be a progressive dividend bonus. First point.

On your second question on Halifax. Halifax has an amazing tradition of being as I said a challenger to the market, providing clear, fair, no nonsense offerings. And the cost as you described it is composed of many parts. One of the things we are addressing which is the key block, the first key block of the strategy, is to simplify the bank. The simplification will not only provide a more agile and responsive organisation from the customer point of view, it will provide substantial cost savings. And therefore our cost position in terms of the costs apart from the funding costs you mentioned, will substantially improve. And we will over time, as we showed, be in a competitive position in terms of cost, with a cost to income target ratio of between 42 and 44% which is lower if you include the operating list charges, which we think fully supports the proposals that we want to revive Halifax as a challenger brand.

<u>Question 2: John Kirk – Redburn Partners</u>

Thank you, it's John Kirk at Redburn Partners. Could you give us some guidance on your assumptions behind the non core run-off? Because the pace of run-off looks quite slow compared to the one of your competitors, so I am wondering if you could share some of your analysis behind that pace of run-off?

And then secondly, could you talk a bit more about your ambitions in debt capital markets and those sort of things, because it strikes me that you will have quite a job taking market share off the big players in that market. So if you could give us an idea of how much share you have got now and how much you aspire to? Thank you.

Answer: António Horta-Osório

Relating to the non core, as we said, we are going to more than halve from the end of 2010 to 2014, we are going to more than halve the non core assets, which we think will be a significant achievement and you have to understand that we will be managing this from the value perspective, impact on capital, market situations. So we think this is quite aggressive, quite ambitious and also in terms of risk weighted assets, it will be halving the amounts that presently exist.

Relating to wholesale, as I also said, our strategy is not at all to fight with the investment banks in terms of full fledged investment bankers. I made very clear. The Group has a very strong position in medium sized corporates and large corporates, very strong position with long-standing relationships. But this relationship in the past has been based on credit related transactions and therefore it is intensive in terms of credit. We had a much lower share of wallet in non credit intense activities such as debt capital markets, foreign exchange or rates to give you examples. And we intend to leverage our position with customers by increasing our share of wallet of our existing customer base. And we are not going to develop at all equity activities. On the contrary we closed down a small equities activities we have. We are not going to chase business from global or multi-national corporations or push it through any high risk businesses.

Question 3: Michael Helsby – Bank of America, Merrill Lynch

Thank you, it's Michael Helsby from Bank of America, Merrill Lynch. I have got a couple of questions on non core and core and then just one on assets. Firstly on your non core. I know you have given us the revenues in non core, but I was wondering if you could give us any colour on what costs are embedded within the non core assets for businesses and therefore are part of the £1.5 billion cost savings that you have announced?

And also when the assets are going to be falling off, what revenue you have, when you have modelled, you think you are going to be losing as part of that?

Just on the core business, I appreciate today a lot of the income growth is coming from other income and clearly that is very clear. If you could just give us a sense for what type of core balance sheet growth you think is achievable over your planning period that would be very useful?

And then just to wrap up, thanks very much for the clarity that you have given on your provisioning. I think that has been a wide source of debate in the market, certainly in the last three months, I was wondering if you could extend the comment that you have made on the fact that you are comfortable with your provisions, to say that you are comfortable with your risk weightings as well? Thanks.

Answer: Tim Tookey

Thanks for the question Mike. I said form the podium that with our half year results we will give more granularity on non core. So in August you will see the break out of expenses estimated between core and non core. Importantly we are going to be pretty tough on how we allocate the expenses there because I only want to go out and show something where I have got a very high level of confidence that we can manage the expenses down as the assets go down, not necessarily totally in sync, but you wouldn't thank me if I ended up with a lump that I then had to tell you we were going to flip back into core in a couple of years time. So that will be there with our half year disclosures which I think you will find helpful.

You also asked about the run down profile of revenue over time. Well we talk about wanting to more than halve the non core assets over the four year period. And you know we didn't offer in response to John's question, a profile of it. It is very hard to predict. And I am absolutely with Antonio that where we will balance the metrics of risk, capital and liquidity, to get the right kind of run off profile. But I think when you look at the kind of assets that we have in some of those areas, then you have got some pretty poor performing assets in there, I referred to it when I was talking about the drag on returns that we are still going to be having in 2014. So if I halve the assets over that time frame, I may well be losing more than half the income because I am going to be left with some more awkward territories. I am not going to be able to halve Ireland for example in four years and that is a pretty poor portfolio as you know. So whatever profile you are going to model, you probably want to think about the income coming off faster. But only when we can get it disciplined by being net capital generative over that three year period in aggregate. That is going to be something we are going to manage to.

You also asked about core balance sheet growth. We haven't gone specifically on that today because it is a very uncertain world that we operate in. When we were talking at Q1 we spoke about having perhaps more capacity for core growth than we were actually able to achieve. And perhaps a degree of disappointment that we weren't seeing more core growth. You know, I mentioned this morning, we are still seeing these customers deleveraging and payment trends. So we have got a lot of capacity to grow the core business over the next few years. But we will only do it prudently and we will do it within a very disciplined risk appetite. And I really look forward to being able to sit here in a few, on many occasions and be talking about growth in core, but I am not going to give you a target or percentage in there.

I think your last point was on RWA's. Yes we are very comfortable with our risk weightings across all our portfolios. Remember these models get deeply reviewed and challenged internally by a central team and also nothing change in them unless the FSA bless. So yeah very comfortable with my risk weightings.

Michael Helsby
Thanks very much.

<u>Question 4: Cormac Leech – Canaccord</u>
Hi, it's Cormac Leech from Canaccord. Three short questions please. Just on the net interest margin. I think you guided at it going from about 2% in 2011 to about 2.2% or so in 2014. Could you unpack a little bit for us like you did at the full year results, kind of what the swings and roundabouts are on that?

Secondly, just on capital and then just a brief one on Ireland. Let me give all the questions to you. But go ahead with the margin question.

Answer: Tim Tookey
On the swings and roundabouts, I was clear in February and I we are still in the same situation today, that the trends in margin going forward are probably going to be more dominated by external factors than the ones that are within our control. We have made great progress in delivering on the actions that the Management Team can do and as I have said in the prepared words, there is always more that can be done, but the markets out there are difficult to predict. And I fully appreciate that makes putting shape on it quite difficult. But if you sort of peel back a couple of layers of the onion, and I am talking about wholesale funding being higher for longer, base rates lower for longer, I make comments about probably not initially in terms of sharing the benefit of base rate rises with shareholders perhaps mainly customer favoured, given that the pressures in the level of competition in the markets. So that probably gives you a shape that would not be a straight line progression in your margin.

Further Q
To put that slightly differently, if we were to assume there were no base rate rises whatsoever over the next 3-3 ½ years, what kind of group margin should we be thinking about?

Answer: Tim Tookey

Well thankfully I hope we are talking about a hypothetical situation. The level I have given people as a rough steer previously is to think about 25 bps for a full year being roughly £100 million of income on average. If we decide to share or give all the benefit to customers, won't be £100 million. If we decide to keep all the benefit it will be more than that. Therefore that is a blended average across different sharing profiles. And as I say, today there will be less of a sharing with the initial rises and more towards the end.

Further Q

Then just on the capital. Your guidance, I think you talked about being prudently above 10% in January 2013 going into the Basel III, is that after the 0.6% reduction related to CVA or just before it actually? So should we be thinking about 10% including the 0.6% hit from CVA or before it?

Answer: Tim Tookey

Definitely included.

Further Q

Okay. So the fully loaded Basel III January 2013 would be about 8%?

Answer: Tim Tookey

Fully loaded, do you mean by ignoring the benefits of the transition?

Further Q

Putting five years of deductions straight through at that point?

Answer: Tim Tookey

Well hopefully in my slide I have given you the impacts of insurance and excess expected loss, so you can multiply them up and do from that.

Further Q

So two questions really to that. Is there further scope to gear up Scottish Widows by the £2 billion? And then also how much capital are you kind of thinking you need to run the Group going forward? Should we be thinking about 10% or 9.5%?

Answer:

I think in terms of the Widows situation, where we are expecting to complete further capital restructuring in the second half, I think that will probably be it in terms of capital restructurings. And that is on top of about £2.5 billion of Basel III mitigation that we did last year. We will continue to look for areas where we can further mitigate, but quite frankly we have got the transitional impact now down to something that I feel is very manageable indeed.

Further Q

And should we be thinking about 9.5% or 10% to run the Group do you think?

Answer:

Well I think you have heard us talk today about wanting to maintain levels of capital prudently in excess of 10% as we go through the Basel transition period.

Question 5: Manus Costello – Autonomous

Okay, so I have a couple of questions please. Firstly for Antonio. I just wanted to follow up on the question about dividend payout ratio please. It is difficult to know what your target capital ratio is at this point, but assuming in a hypothetical world you got there, if I take your RoE guidance and I take the fact that you are aiming for revenue growth in excess of nominal GDP growth but in a capital light way, putting those things together would imply that you should be targeting a 50% plus payout ratio. Is that fair once we have reached steady state?

And secondly, Tim, I just wondered if I could get some clarity on the Basel III deductions you are talking about. Did I understand correctly that you are implying that by 2014 you think there will be 100 basis points of excess expected loss deduction that will need to apply? Because it seems quite high.

Answer: António Horta-Osório

Okay, thank you very much. Look as I said on my previous question, we are giving guidance for 2014 because we think this is what we should do in terms of clarity, direction and in terms of you having the metrics but this is a journey and you should see it as you just said as well, as a progression as we will create a high performance organisation over time and there will be positive momentum in 2014 for the future as you saw in several of these presentations. Non core still exists at the end of 2014, we still have the growth initiatives which will be then through the period, and therefore we expect depending on how the economic environment will be, with positive momentum in 2014 and therefore we think that capital will be higher. We are not going to provide a dividend payout or any or any guidance beyond 2013 because there is too much uncertainty. Until we have progressive dividend policy that is absolutely committed to staff dividend payments as soon as there is more clarity on our capital requirements and at this time these will be prudently met and it will be progressive policy.

Further Answer: Tim Tookey

Manus on the second part of your question, what I am doing there is showing you the impact using today's currency because that is the best and the most transparent way to do it. We will of course over time be looking to reduce the level of capital intensity reducing the risk in the balance sheet. So I would hope that we would end up with a lower impact in the future. You have seen in the last 12 months we worked wonders at mitigating the potential impact of Basel III as an example on the insurance businesses that we hold. We will be looking to see how the risk reductions that we are getting in our lending mix could help us mitigate some of that excess expected loss reduction

Question 6: Alastair Ryan - UBS

Thanks, Alastair Ryan from UBS. I know you can't talk about the SLS, so if I could ask a question in a particular way. Of the £37 billion of central bank funding and Government official funding, what would the CGS be of that figure please? [Laughter]

Answer: Tim Tookey

Mr Ryan! I can't comment on the individual programmes as you know, but I do expect that all of our residual funding will be satisfied in line with its contractual maturity profiles. We are subject to confidentiality restrictions on what we can say from there. I think the most important thing for me is when you look at the levels we were talking about twelve months ago, and the £60 billion that we paid off in the first six months, you know, if I can't put a tick in that box yet we are blooming close.

Question 7: Mike Trippett - Oriel

Thanks, Mike Trippett at Oriel. Two questions. I just want to follow up on Mike Helsby's question again on the risk weight, particularly on the mortgage book which drops from sort of 20% to about 16% last year. And given your comments about house price inflation, I just wonder if you could give us a bit more comfort on the direction of the risk weight?

And secondly, should we assume now that Scottish Widows and St James' Place are core going forward? Thanks.

Answer: António Horta-Osório

On the first part of your question, we have through the strategic review absolutely reviewed all the risk weighted assets in the different categories of the portfolios and we are very comfortable as Tim says, that the risk models are okay. We have reviewed them, we don't expect changes going forward.

Relating to HPI, our expectation is that house prices should decrease around 2% this year and the latest information available is much in line with that. Because expectation that we had was a 1% decrease in each of the first three quarters with a 1% increase on the fourth quarter. And the latest data available is in line with that or slightly better. So that is our expectation.

And relation to your question on Scottish Widows, I think I was very clear about that. Scottish Widows and our Bancassurance is critical as the core part of our strategy. And Scottish Widows within it is a low cost provider that provides liquidity for the earnings with a very efficient cost capacity and we believe in the context of the retail distribution review that there are substantial benefits that we can take from it in terms of providing an integrated approach from distributor and manufacturer to our clients between this new organisational structure, whereby we will have our retail teams, our marketing and products teams and our insurance teams working together. So it is an absolute core part of our strategy and we will take advantage of that in several of the ways that I showed you.

And relating to St James' place, we are very happy about the way St James' Place is going, with profitability, good management team and is providing an appropriate position for us.

Question 8: Asheefa Surangi – RBS

Thanks Kate, it's Asheefa Surangi from RBS. Just two quick questions. Firstly on the £25 billion of funding that you expect to issue per annum, 75% of it is coming from the public issuance side of the equation, how much of that is secured versus unsecured?

And also, secondly, the deposit competition you are building into your liability margin and the share between shareholders and depositors, does that mean you expect the competition to bleed from term deposits into current accounts and that is where most of the hit will be coming or is it that you are just mainly expecting there to be pressure on the term side?

Answer: Tim Tookey

Let me take the funding question. You are bang on the money. Yes we did say future issuance about £25 billion per annum for future years, although I think I expect about two thirds of it to come from public programmes. But that is a very flexible two thirds and it will be dependent on appetite and pricing. What we will want to do is maintain our programmes of different structures, different tenures, different geographies, and different currencies. In terms of the secured, unsecured split, I would probably hope to have slightly more than half of it in the secured space. But it would depend upon appetite and pricing. Because for me it is almost more important to maintain a diverse range of funding sources, tenures and structures, geographies, currencies so that we maintain the breadth of the funding base. That gives us the flexibility. It also means that we never over tap any particular market. This should give us more control over our funding costs going forward. And of course that is an important part of delivering on our return targets.

Further Answer: António Horta-Osório

On your second question, we are very conscious of our position in this market. We are the largest retail and commercial bank and we are a multi brand Group. And we are keeping a multi-brand strategy because we think it is the best way, given our assets, given our brands, given our position, to tap the markets in its different segment means. And relating to deposits, we believe that the market is growing around 4% a year. The Halifax brand which already started being revitalised as I told you, had a fantastic product on the ISA campaign, at the tax year end campaign, which did not have the best price and nevertheless had the largest market share of all ISAs in transfers. And this is a clear example to give to you on how we think that in a segmented approach, with a multi-brand approach to the customers, we can have growth in deposits beyond the market growth and we don't have necessarily the best price. And we are growing deposits as we promised in Q1 above the markets, based on offerings and propositions such as the one I told you about, Halifax and as I also told you in my speech, we will have a new savings offering from the Halifax as we relaunch the brand with a campaign in September.

Question 9: Peter Toeman – HSBC

Peter Toeman from HSBC. Two questions. Number one, you are thinking on the increased cost of wholesale funding. Does that include anything that you may have to pay under ring-fence arrangements for unring-fenced businesses who are presumably wholesale depositors who are going to be more reluctant to leave money with you?

And second question is on liquidity. If I have understood you, I think you are saying you have to hold primary liquidity against short term wholesale funding under new arrangements. And I think that might cause you to hold about £50 billion more of liquidity. And I wonder, does that mean the earning assets of the Group are going to be higher than they would have been, than you would have foreseen a few months ago? And does that go some way towards compensating for the margin reduction from 250 basis points to maybe 215 basis points?

Answer: Tim Tookey
Thanks for the questions Peter. On the ring-fencing point, we don't yet know what kind of ring-fencing structure will be put in place or indeed where the boundary if there is one will be drawn. And it is quite possible, given that we are a retail and commercial bank that actually all or virtually all of our activities will be in the ring-fence. So until we have greater clarity on that, it is a bit like trying to do a rubik cube blind folded, I wouldn't quite know where to start and draw the line. So we at the moment are looking at how we fund the business and how we fund the bank. And it is quite possible that we end up with virtually all of it in the ring-fence. In which case it would be sort of not applicable. So have I specifically allowed for something? No, because I don't know what to allow for or what kind of structure.

On your point on liquidity, we will have a chat afterwards, because using my words, you shouldn't have got to £50 billion of additional liquid assets. So come and have a chat later on and I will sort you out! [laughter] But I will help clarify your model for you. But of course there is a margin impact as I set out from this. But of course there is also further asset repricing work that we can be doing as well as pricing of new business. So yes there is an offset and yes it is incorporated within the margin guidance I have given.

<u>Question 10: Chris Manners – Morgan Stanley</u>
Thanks. It's Chris Manners from Morgan Stanley, just two questions for you. The first one was on forbearance and your £340 billion odd of mortgages, how many have been modified and how much have they been switched to interest only or otherwise forborne on?

And the second one was just about the ECNs, looks like they are really very, very unlikely to be triggered given the capital targets you are setting now. Presumably, is it worth buying them back? The yield is pretty high on them and it doesn't look like they will count towards regulatory capital going forward? Cheers.

Answer: António Horta-Osório
I will take the first one and maybe Tim can answer on the second one. Look relating to forbearance. We have analysed all portfolios in detail with the special emphasis as you can imagine on forbearance. I would like to start by saying to you that forbearance is a good thing for customers as long as we do it appropriately and prudently, and it meets customer needs. Our portfolio on forbearance and we are not going to say exactly how much it is, is much lower than in the papers, much lower. What is important is, it is appropriately provisioned. We have very appropriate policies for putting customers into forbearance and stress tests in terms of how they can withstand changes in the markets in base rates for example. The portfolio is provisioned, the policies are appropriate. And I can also tell you that from the start of the year until now, customers are demanding less of this than in the past year. So we are very comfortable at this point.

Further Answer : Tim Tookey

I will comment on the ECNs. I mean it is an interesting question, but let's just remember one thing. I mean we would not be permitted to do anything with the ECNs now anyway because any kind of a trade in any part of the capital structure is forbidden until the end of January unless it is either into equity or into some kind of a CoCo. So whatever is going on in the future, there is nothing I could consider at the moment. And of course we don't have clarity yet from regulators on where CoCo's or different types of CoCo's are going to fit in either capital structures or stressed capital structures or how they may contribute to buffers. You know we saw news last week on where they might fit or not fit into the G-SIFI or G-SIB as they are now known buffers. Haven't got any clarity yet from the FSA on where they might fit. So it will be something we will keep an eye on Chris, but it is not something for today.

<u>Question 11: Joe Dickerson – Espirito Santo</u>

It's Joe Dickerson from Espirito Santo. I just had two quick questions. The first is, of the 15,000 employees that are part of the cost reduction programme, how many of those if any are related to Project Verde?

The second question is I am just trying to square the increase that you anticipate in wholesale funding with your reduction in the expectation of issuance of wholesale funding down to the £15-20bn and also against the fact you dropped your base rate expectation down. So was the prior expectation too aggressively low or what gives there? Particularly in the context of where you fund say covered funds rolled into Barclays at a material gap to Barclays? There could be some substantial opportunity there. Thanks.

Answer : António Horta-Osório

Thank you for your questions. Look the first thing I would like to emphasise on the 15,000 that we mentioned. These are jobs, these are not people. And we think like the Bank leading the path through integration, that we will be able to manage in the most sensitive way through natural attrition and through internal re-deployment these numbers to affect a much less number of people. Okay this is the first important point.

We hire more than 10,000 people every year in the normal course of attrition, people that leave the bank, retire etc. But relating to your specific question, the number of people which will go with Verde are not included in this number.

Relating to the wholesale spreads and maybe Tim can comment in more detail, what we expect is that as we have lower loan to deposit ratio, and this is done through an increase in commercial deposits and retail deposits, so more sticky deposits and we run down our non core assets, we will be issuing less and therefore it is logical everything else being constant, that our spreads may reduce over time.

<u>Question 12: Rohith Chandra-Rajan – Barclays Capital</u>

Thanks, morning. Rohith Chandra-Rajan from Barclays Capital. A couple if I could please. One just to clarify the RoE guidance and then I will talk about divestitures. The 2014 numbers you have given for RoE presumably are post the EC required divestments. I note also your comments about creating Halifax as a challenger bank and switching etc. But wondered if you had any update on comments on discussions with the ICB regarding their requirement for enhanced divestitures?

And then secondly just on dividend, just wondering if there are clauses in some of your capital instruments that defer resumption of dividend payments for at least 12 months after the EC dividend stopper is off? Thank you.

Answer: António Horta-Osório

Okay, relating to the first question exactly as you said. Our guidance for 2014 relating to Verde will be divested by 2013 so the calendar we have which is in my opinion a tight timetable and that is why we accelerated the process in March. We have to complete the sale of Verde by November 13 and that given my previous experience in other acquisitions, I think that is a tight timetable and that is why we accelerated it on top of having all of our integration finishing in the third quarter and therefore having highly experienced people available to work with the potential buyer to doing the completion of the deal. So Verde will have to be sold by 2013 and therefore as you asked, in 2014 the target guidance given is with Verde excluded because it will no longer be there.

Relating to your second point, and as I said in my script, we think that one of the trends of the market is being greater switching between customers. We welcome competition, we think it is very important that customers can compare prices. And if they are not happy with their current provider, they should be able to switch and they are growingly switching. Nevertheless you can always improve switching propositions and we have proposed, which is one of the recommendations the ICB specifically mentions, a new system for switching customers whereby we redirect the direct payments on the customers accounts and therefore customers may have all their direct debits redirected in a maximum of seven days. This solution will take less than two years to implement. It has been endorsed by all other major banks and by the Payments Council. Therefore we anticipate that in the future there will be easier switching and less riskier switching. And therefore if clients are not happy they will be able to switch and we have incorporated those trends in our strategic plan.

Relating to your question about discussions with the ICB, our Board position is very clear to the Preliminary Report as we have made public. We are engaging with the ICB. We will continue to engage over the next few months in order to submit our final proposal and see the outcome of the final report.

Further Answer: Tim Tookey

Shall I take the final point on the dividend clauses. There are certainly some instruments that require within their own terms and conditions to be brought up to date before an ordinary dividend could commence. So I think technically therefore it is quite difficult to pay something let's say 1 February next year to pick a completely hypothetical date, because you would have some instruments that weren't up to date. I think also that if you think back, we have had several questions on dividends. We are talking about an absolute recognition of the importance of dividends, absolutely. But a firm commitment to make sure that we maintain prudent levels of capital and we need to have our regulatory requirements defined and prudently met. So just be a little bit cautious in how you are looking at this and some of the timing aspects on the dividend.

On the return on capital point, absolutely agree with Antonio. Of course it excludes the EU divestment because that will have gone. I think there are also a couple of other things that are relevant to how I look at the return and the absolute level of it. It is of course a return for 2014 and as Antonio set out, this is a 3-5 year plan. So not only have we not got the full benefit of the initiatives in 2014, but we will also have, because it is a statutory return if you like, I am giving on total equity, there will still be an element of drag in it from some of the last restructuring costs that will still be there in 2014 which clearly will be nil and gone by 2015. So there is a number of things giving a lot of momentum actually on the return factor. And on the equity side of course, a lot of the equity is tied up in non core and therefore delivering much less than an acceptable return. So there is a good momentum story on the return into 2015.

Question 13: Simon Samuels – Barclays Capital

Thanks. Morning, it's Simon Samuels from Barclays Capital as well. Two questions actually. First of all I just wanted to go back to the earlier questions on risk weighted assets. I just wanted to confirm at the time of the Q1 results you said you didn't expect any further reductions in risk weighted assets for the remainder of this year given anticipated model changes. And I just wanted to confirm whether that was still indeed the case?

Answer: Tim Tookey

Simon, fair question. What I was referring to there was to make sure that people factored in the Basel 2.5 numbers in their thinking. And I have given you an estimate in the slides today, the same as I gave back in February of what that is likely to be. So if we can improve on the RWA's from there, terrific. What I was trying to do was get people to remember there is Basel 2.5 coming at the end of the year and perhaps to be a little bit cautious in taking the reduction we have achieved in the first quarter and multiplying it by four.

Further Q

So is that a yes or a no?

Answer : Tim Tookey

It means if we can have a more efficient, less capital intensive balance sheet, I will be delighted.

Further Q

The second question is actually to do with your overall capital ratio. So you have got a fully loaded Basel III core tier 1 in 2014 of 8%. Including all the regulatory reductions that will be phased in. And on that same basis, every other major UK bank is in double digits. And you are clearly the most systemically important bank in the UK as you said yourself. You are the largest bank, you have got a third of the market etc. So could you just talk us through your thinking as to why you seem very comfortable running with a capital ratio that is a couple of hundred basis points or more below your competitors on that like-for-like comparison?

Answer : António Horta-Osório

It is very interesting to hear your calculation but we probably have a different calculation.

Further Q

Sorry to interrupt you but it is very simply the 10% minus 5 years of 40 basis points deductions per Tim's slide.

António Horta-Osório

No what I am saying, your calculation versus peers I mean. We have as I said, there is substantial uncertainty in relation to what the capital requirements will be, although we are having growing clarity. But it is clear that the capital requirements will be higher. And we are working on a prudent basis on our strategic plan assuming those higher capital requirements. And it is in that context that we feel very comfortable about the progression of our capital base going forward.

Further answer : Tim Tookey

Simon, I agree with your maths in the sense that if you want to look through the transitional piece you will take off 2%. However I think I would like to just remind you what the start number is, because the start number you should be thinking about from the words that Antonio and I both used today, about having a capital ratio prudently in excess of 10% as we go into Basel transition. So you will get to 8% if you think prudently in excess means nothing. So I think actually you should be thinking about what we mean prudently in excess of. And I am happy to have a chat with you afterwards if that would help. We could explore it more.

Question 14: Claire Caine – Royal Bank of Canada

Hi, Claire Caine at Royal Bank of Canada. I just want to follow up. I believe Antonio in reference to the RoE targets, you said it was on a higher equity base in 2014 rather today and I wonder if you could confirm if that is in absolute terms?

And then going on from that, in terms of the non core reduction, can we then expect strong growth in the core RWA and how much of that can we expect to come from the DCM build out and in particular market risk weighting ?

And then finally, where do you see the retail versus wholesale business in 2014 rather than say would that possibly not be 100% in the retail ring-fence?

Answer : António Horta-Osório

Okay, relating to the retail non equity. As we said, we just answered the previous question. We are assuming capital requirements will be higher in the future. There is uncertainty in relation to the precise numbers, but it is clear the direction. Anything you hear from Basel, anything you hear at international and local level, points to higher absolute levels of capital. And that is why we are committed to address our capital position in a prudent way so that we address that scenario. So our return on equity for 2014 in the guidance provided assumes those higher levels of capital.

In relation to core and non core. Our core will grow, given the growth initiatives that we have. We are investing in our core business with customers. And our non core will more than halve in the four years from '10 to '14. So progressing we will have a growing core and a smaller non core. But by 2014 we will still have around £65 billion of risk weighted assets in non core. And as you saw, that will be a drag on profitability because they are non core and they don't meet our criteria. But the core will be growing mostly in terms of the growth initiatives because we are foreseeing an economic environment with a relatively stable economy as we told you and we are not assuming a very high growth economy. We are assuming a stable economy with a long and slow economic recovery.

And relating to the ring-fence, and Retail & Wholesale. We are mostly a retail and commercial bank. So most of our activities by 2014 will be in these areas. And we believe that the ring-fence should include the protection of the key economic functions in an economy and therefore it should include payment systems. It should include deposits, especially deposits relating to retail and small companies and medium size companies. And it should include the flow of credits and the provision of credit to the economy. And therefore most of our assets and most of our core businesses would be included in that definition and therefore within this criteria we would expect most of our business to be inside the ring-fencing if those are the definitions that are going to be used.

Tim Tookey

Did you have a market risk question there?

Further Q

Yes, it was in relation to, if the increase in core RWA how much of that would be coming from increase in market risk weighted assets due to the DCM build out?

Answer : Tim Tookey

Thank you for clarifying. The market risk element that were likely to be in there by the end of this year is just under £10 billion of RWA's. The reason I know that number is that is the lion share of the Basel 2.5 impact that is shown on my earlier slide. In terms of it going forward, it will be relatively modest. But we would expect it to be a low capital intensity business. So it won't be a significant part of RWA's going forward.

Question 15: Gary Greenwood – Shore Capital

Gary Greenwood from Shore Capital. Two questions. The first one just on the targets. I admire your courage in setting targets for 2014 which is certainly in a very uncertain economic environment as you have mentioned. I just wondered if you could talk about the tolerance of those targets to the change in economic scenario .

And then the second question just relates to your international operations in terms of the consolidation of those businesses and in particular what your plans are for Australia? Thank you.

Answer: António Horta-Osório

Okay, thank you very much for your questions as well. Look as you said, there is very significant uncertainty going forward, but our central scenario is a scenario of a slow and long economic recovery. So with continuing economic uncertainty. As I said as well, you have a significant probability of downward scenarios, either from a double dip or from sovereign debt contagion as we saw recently. But we are assuming a slow and continuing recovery. So our base scenario. Within that scenario we think the targets that we have provided in terms of range, they are quite robust. And we have provided them for 2014 because we think we should provide you with clarity, a clear sense of direction and a metrics which you will be able to evaluate our performance every quarter. Of course as we also said before, there is going to be positive momentum in 2014.

First because the non core will see a running down, as you saw from the numbers. We will still have £65 billion of non core assets by then. Second, because we will still have some restructuring costs in 2014. And third, because the growth initiatives which we will be implementing as we drive simplification. So as we make the bank more agile, more simple, we will get cost savings. And as we see we are realising those cost savings, we are reinvesting a third of those in the growth initiatives which means relating to your question, that we will be controlling to the extent possible, our own destiny. i.e. costs are totally within our control. We control costs first and then we allocate part of the capital liberated to growth initiatives which have been contrary to the past, they have been assigned and allocated on a centralised way with all teams in a single manner, competing for the scarce capital. And we chose the best growth initiatives out of a much wider set of initiatives and they are quite robust. In the same way that Mark told you, that in simplification where you saw on the slide, there are four major groups. But you have more than 30 initiatives in terms of simplification, also in terms of growth initiatives we had more than 30 initiatives that have a lot of merits so the pre-screening originated 30 initiatives and then given the uncertainty in terms of the future, the higher capital requirements and the scarcity of capital, we have chosen 20 initiatives. And these 20 initiatives which are quite robust in itself and as a group, are going to be continuously reassessed every year against their benchmark, against the market evolution and against new initiatives that the team will be bringing so that there will be constant competition internally for capital allocation. And we therefore believe this is a very, very deep process which will drive a high performance organisation and will continue to provide momentum to this bank beyond 2014.

Further Q

And the international operations?

Answer : António Horta-Osório

Relating to international operations, we strongly believe also in the context of what we just told you that we should concentrate further in the United Kingdom. And why should we concentrate further in the United Kingdom? If you believe like we believe that a strong banking sector is key to fostering economic growth, and that a strong economy originates health and robust banks, we being the largest retail and commercial bank in the United Kingdom, we have all the interests for the benefit of our shareholders are concentrated in the United Kingdom and doing even better what we already do well. And therefore also in terms of international context, where we had subscale positions, or we don't have competitive advantage, we are going to streamlining, reducing the number of countries from 30 to less than 15. And we are going to use as well those resources as well in the context of the simplification and of the growth initiatives concentrating in the United Kingdom. And we are not going to commit on specific countries because we have regulatory requirements. We will have to speak to regulators first who will have to speak with our teams and we will have to manage this process over a three year period.

Question 16: Jason Napier - Deutsche Bank

I was going to ask three, I will concede and perhaps ask two. The first of these is that I just wanted semantic clarification on what capital generative means in relation to non core? About a third of Group RWA's are currently in non core. Are you saying you can retain the capital that is in those businesses or are you saying the release of RWA's can be used to absorb losses there?

And then secondly in relation to Verde, the numbers published today it is the same PBT as was indicated was made in '08 and the balance sheet looks quite similar. It is the first time I have heard anyone say that the EU document allows a slight reduction in asset size. Could you comment on how slight that might be? And broadly how you think a buyer might bridge that funding gap in the hypothetical?

Answer : Tim Tookey

Capital generative Jason, what I am referring to there is if we think about the capital that is tied up in non core, then over the three year period '12.'13.'14, in aggregate, not promised in each quarter. In aggregate over three years we would want to be a net generator of capital from that run down. In other words, we would destroy less capital through losses than we would release through RWA reduction. Or I will make some profits maybe or operate a break even and I can release risk weighted assets to do it. Combination, don't know. Take a view at the time. This is why we have the asset review forum every week. Meeting and reviewing, looking at proposals for individual assets, groups of assets, books of assets, businesses, thinking about the best way to balance the risk with the capital and the funding. And sometimes you say yourself, actually I have got a very risky asset, I am prepared to take a loss because of what it will do to improve the overall risk profile on what I have got left. On other ones we will take a different view. So that if you like is the framework by which we want to manage it. And the benefit of having that session every week is that we can keep our finger absolutely on the pulse of what the options are by asset and by book.

Further Answer : António Horta-Osório

And relating to your Verde question. What happens in the Verde side is at the wish of the buyer, so the buyer has a possibility, it is not The Group's option, it is the option of the buyer, that in case the buyer wants a slightly different mix of assets in the asset sales, the buyer can ask us to do that until a loan to deposit ratio equivalent to The Group's loan to deposit ratio. It basically relates to the retail bank and it basically relates to IFA originated mortgages so basically C&G which are not customer driven business as you know, it is intermediary driven business. And if the buyer wants, the buyer has the option to ask us to withdraw some of those mortgage originated by IFA's from the portfolio in order to have a loan to deposit ratio that may replicate in terms, the lower parts of the loan to deposit ratio of the Group's Retail Business.

Further Q

So just to clarify, the loan to deposit ratio in question is that a like-for-like with yours or is that for example the forward 130% that you are targeting for the Group? Is it a Group number or a like-for-like?

Answer:

It will be the retail loan to deposit ratio of LloydsTSB at the time.

Kate

Okay everyone, thank you for your questions that were valuable and we will thank the speakers for the Presentation today. Thank you.