LLOYDS BANKING GROUP PLC – 2018 STRATEGIC UPDATE PRESENTATION

WEDNESDAY 21 FEBRUARY 2018

Lord Blackwell, Chairman

Thank you very much Douglas and welcome therefore to the second part of our Presentation this morning, where Antonio and the team will set out the next chapter of our strategic development. This does mark an important inflexion point for the Group with a significant change in gear in the transformation of our bank. As you know the last two strategic plans have focused on the recovery of the Group's financial strength and on restoring our customer focus. But both António and I have repeatedly said that we could not be complacent. We have recognised that the environment we face in technology and competition is moving at pace. So two years ago the Board and the Executive set out together on a major exercise to create a vision for the Bank of the future. And as that clarified, we have translated that into an ambitious transformation programme to meet that challenge, a transformation programme to which the Board and the Executive team are totally committed. And the whole Board believe this scale of ambition is the right approach to enable us to maintain our core purpose of supporting the UK economy, helping Britain prosper and to sustain our long-term competitiveness as the best bank for customers, colleagues and shareholders.

So with that let me hand over to António to take you through the components of that transformation and how we will deliver it. Thank you. António

António Horta-Osório, Group Chief Executive

Thank you Norman. As you have heard in the results section of the presentation, 2017 closed the successful delivery of our second strategic plan and provides solid foundations for our third strategic plan, GSR3.

We have a number of structural advantages which are difficult to replicate in terms of how we meet customer needs, including our differentiated multi-brand and multi-channel propositions, our customer reach as the largest banking franchise in the UK, and our leading digital capabilities. Together these have seen our customer net promoter scores increase by almost 50 per cent since 2011 to 62.

At the same time, our market-leading efficiency, which is both a strategic and culture driven outcome, fully embedded in the organisation, allows us to significantly increase investment, again, in our next transformation phase.

Our prudent, low risk participation choices and strong capital position have been reflected in the recent improvement in our external credit ratings and cost of funds, and should also decrease our cost of equity going forward.

Finally, our management team discipline and rigorous execution capabilities have enabled us to deliver capital generation and profitability that are markedly stronger than our peers.

Looking ahead, it is these qualities that underpin our confidence and scale of ambition. GSR3 represents an exciting opportunity and the entire management team is energised, committed and determined to deliver the next phase of our transformation.

Our confidence is built on the fact that we are already delivering a market leading digital experience. We are by far the UK's largest digital bank, and are able to meet 68 per cent of our customers' banking needs online – which is at the top end of the targeted range we set out 3 years ago.

This scale has been achieved through the best-in-class experience our customers enjoy, with market-leading functionality resulting in being rated number 1 digital banking app since 2015. And having achieved this scale, it gives us the capacity to continue investing more than our competitors in market leading platforms – an ongoing source of competitive advantage.

While we have delivered best-in-class experience to our customers, we need to constantly evolve to meet their changing behaviours and expectations.

Customers increasingly want greater personalisation, more connected and seamless experience, but with higher security and safety in the online environment. They want simpler products with greater convenience and ease.

The strategic plan we are presenting today aims to provide a proactive response to the opportunities created by these changes.

So, let me briefly outline how our 4 strategic priorities will enhance our existing strengths and transform the Group for success in a digital world.

First, to continue to provide a leading customer experience we will drive stronger customer relationships and experience through data-driven insights and offer more personalised products and services.

Second, in digitising the group we will deploy new technologies, such as cognitive and machine learning, cloud, and API channels, to improve our efficiency and productivity and make banking simpler and easier for customers.

Third, we will maximise our Group capabilities by bringing the best of the Group to all customers and delivering deeper relationships and integrated propositions. An example of this is Financial Planning and Retirement, where we will provide our banking and Insurance customers with a truly holistic proposition to meet their retirement and long term savings needs.

And, fourth, in transforming our ways of working we will enhance our talent pool by focusing on skills of the future, whilst embracing new technologies to drive better outcomes for customers and colleagues.

We are therefore announcing today more than £3bn of strategic investment over the next three years, a 40 per cent increase over the last plan, to deliver the scale of transformation, we believe, will be necessary for us to succeed in a digital world.

As I have mentioned, the scale of investment we are uniquely able to afford in building new platforms and customer propositions is a massive undertaking, and provides the scope to be highly ambitious in delivering both an efficient and market leading business.

So what will these priorities deliver? By enhancing our digital capabilities we want to remain the number 1 digital bank in the UK, with Open Banking functionality. We are proud of being the only large UK bank to have complied with the Open Banking implementation deadline earlier in the year.

And the frequency of customer interactions with their digital bank provides increasing opportunities for offering relevant online information and guidance to help customers identify propositions that can serve additional needs – a very effective and cost efficient way of widening our relationship with them.

We continue to be committed to our multi-channel model and see branches as another customer-driven resource where we want to retain the number 1 branch network in the UK. We will, therefore, refocus our branch network to meet more complex and value added banking needs, such as mortgages to first time buyers, Financial Planning and Retirement, and business banking.

With one of the largest databases in the UK we will invest significantly in our data capabilities to ensure we are able to harness this resource more effectively and provide more personalised propositions to better meet our customers' needs. Vim and Jakob will take you through this later on in one of the breakout sessions.

Moving on to our second priority of Digitising the Group. We will continue to simplify and modernise our IT architecture, scaling up end to end customer journey transformation to cover more than 70 per cent of our cost base, compared to 12 per cent during GSR2. You will hear more on this from Zak in one of the breakout sessions as well.

Our third strategic priority of Maximising Group Capabilities will deliver targeted growth and we expect to see a £6 billion increase in net lending to start-ups, SMEs and mid-market clients, as you will hear from David in the breakout sessions, and over 1 million additional pension customers and £50 billion of asset growth in our open book financial planning and retirement propositions.

We see a significant opportunity as the UK's only integrated financial services provider to meet our customers' banking and insurance needs holistically, as you will hear in more detail from Antonio Lorenzo in another break-out session.

Last but not least, Transforming Ways of Working will focus on how we will deliver our bold transformation agenda itself. As part of this, we will adopt Agile methodologies for more than half of our change projects, significantly improving productivity and responsiveness. Jen Tippin will take you through this and define Agile characteristics during one of the breakout sessions.

Importantly, the success of our transformation will depend on our people. We will therefore significantly increase our investment in developing in-house capabilities and increase training hours by over 50 per cent compared to the previous plan, focusing on the key skills our workforce will need for the future.

Importantly, our strategic plan will also deliver greater value for our shareholders.

While we are targeting a significant increase of 40 per cent in our strategic investment to over £3 billion over the plan period, we will achieve a net reduction in our cost base to less than £8 billion in 2020. Our continued focus on efficiency has created capacity for increased strategic investment in the business, while achieving superior returns for our shareholders.

We will be able to more than offset inflationary cost pressures being faced by the sector and expect to achieve a low 40s cost:income ratio as we exit 2020, inclusive of any future remediation costs.

In addition, whilst we expect to grow in key targeted areas, we are improving our expected through the cycle AQR guidance from 40 to 35 basis points, with an expectation that this will be less than 30 basis points throughout the plan period.

Whilst investing significantly further in the business, we are committed to generating superior returns for our shareholders and are increasing our RoTE target to a range of 14 to 15 per cent from 2019 onwards, despite this being based on a higher target CET1 ratio of c.13 per cent plus around 1 per cent management buffer.

Finally, we are reconfirming our existing guidance of generating between 170 and 200 basis points of CET1 capital per year. As we discussed in the 2017 results section, we are committed to a progressive and sustainable ordinary dividend, while retaining the flexibility to return surplus capital.

In recent years, we have successfully delivered on the overall targets we set ourselves in early 2014 within our Helping Britain Prosper Plan, providing ongoing support to the people, businesses and communities of the UK.

To highlight just a few. We have provided more than £10 billion of lending per year to first time buyers since we launched the Plan 4 years ago and our target is to provide a further £30 billion over the next 3 years.

In recognition of the evolving skills needs of the UK we have trained over 700 thousand individuals, businesses and charities in digital skills since last year and are looking to increase this to 1.8 million by 2020.

We have increased net lending to SMEs by 15 per cent since 2014, significantly outperforming the 1 per cent growth seen in the market. Recognising the critical importance of start-ups, SMEs and mid-market businesses to employment and exports in the UK economy, we are targeting an additional £6 billion of net lending in this space by 2020.

We also became the largest UK corporate taxpayer in 2015, and will further increase our total taxes paid in the coming years. And we have made great progress in our gender diversity target, up from 29 per cent in 2014 to 34per cent in 2017. These are just a few examples of our commitment to the UK economy; as the largest UK financial services provider, focused, completely focused on helping Britain prosper

The external environment is evolving rapidly and the team and I are confident that this exciting and ambitious plan, with the significant additional investment, will mean we remain at the forefront of UK financial services.

We will continue to be a simple, low risk, customer focused business while transforming the Group into a leading digitised, UK financial services provider.

As Norman and I have said, this is a bold and ambitious programme. But the sound platform we have now established gives us the confidence that we are ready to deliver the pace and scale of the transformation required.

I would now like to hand over to Juan Colombas, our Chief Operating Officer, who will give some more detail on how we are investing to transform the business.

Juan Colombás, Chief Operating Officer

Thank you António. As António has just outlined, GSR3 constitutes an ambitious transformation for our Group. I would like to briefly explain to you how we have prepared to successfully deliver a transformation of this scale.

Let me start by introducing our current model which distinguishes us from our peers. We are focussed on a single geography; we have a simple operating model; and we have a centralised management team, who have a proven track record in managing transformation. In a world where you need to be nimble to respond quickly to external changes, we believe our model gives us considerable structural advantages.

Last July, we announced changes to our organisational design to prepare us for the successful delivery of GSR3. As a result of these changes we have brought together under one umbrella all the critical components needed to implement the transformation. This simplified structure is unique and provides a more consistent approach to the end-to-end transformation of customer journeys, alongside a greater focus on our digital and transformation agenda.

Investment decisions are now organised around customer journeys; this ensures better allocation of resources and greater focus on Group-wide outcomes. We have also moved from the traditional annual investment allocation process, to one where investments are reviewed more frequently. This will allow us to adapt to a changing environment and reprioritise if required, depending on customer behaviour and market dynamics.

On the ground, we are co-locating teams from across the business, bringing together all the capabilities required to deliver the transformation. These teams are adopting an Agile approach and focussing on 'outcomes to be achieved', rather than 'initiatives to be delivered'. This helps to ensure faster and more efficient delivery of change for our customers.

As an Executive Team, we are committed and excited to position our Group as a leader in transformation.

As you have heard from António, over the next 3 years, we will deploy more than £3 billon in strategic investments, representing a 40 per cent increase on GSR2. To get a sense of the scale of the transformation, on an annual basis, this is roughly the same as the £1.3 billon invested in FinTech companies in the UK in 2017.

Importantly, as we increase our strategic investments, we are not giving up on our ambition to deliver market leading efficiency. Over the GSR3 period, we will bring down our operating cost base to less than £8bn in 2020. We will do so by maintaining our cost discipline, and by redeploying the efficiency gains we will generate from technology-enabled productivity improvements,

Our largest ever strategic investment will focus on three main areas, all of which will support our GSR3 strategic priorities; Technology, People and Data.

In GSR2 we built the UK's largest digital bank; in GSR3 we will go beyond this to create a leading digitised, simple, low risk, customer focused, UK financial services provider.

We would like to invite you to 3 break-out sessions, hosted by the Business and Transformation leads. These will take place in smaller groups and you will have the opportunity to hear more about each of our strategic priorities and ask questions to the team that will deliver the transformation.

After a short lunch break, George will then present our financial projections and targets, before António provides some closing thoughts on our strategic plan. You will then have the opportunity to ask questions.

BREAKOUT SESSIONS – NO TRANSCRIPT AVAILABLE YET

George Culmer, Chief Financial Officer

Good afternoon everybody. I hope you found lunch plentiful and the breakout sessions useful. You will be pleased to hear that the end is now in sight. What I am going to do now is very briefly summarise the financial and business performance that we will be delivering over the next phase of our strategy.

The first thing is, António mentioned today earlier on, the UK economy is resilient and going forward while we are prepared for contingencies, our base plan and projections assume this performance continues with a steady increase in base rates to 1.25 per cent by the end of 2020 as I think I said earlier. Now against this backdrop, as you have heard, we have a clear strategy that will deliver superior returns and create greater value for our shareholders. Over the next three years as you have heard we will be investing over £3 billion of strategic investment to support our priorities of delivering a leading customer experience, further digitising the Group, maximising capabilities and transforming the way we work.

These priorities will in turn drive sustainable and low risk growth, further improve our market leading efficiencies, deliver superior returns and a lower cost of equity and enable strong capital generation and an attractive capital return policy.

In terms of sustainable growth, going forward we have clear targets to remain the number one digital bank and the number one branch network. And across the Group we will maintain our strategy of targeted growth in both channels and products where we are below our natural market share and which are attractive to us.

As you heard in the breakouts this morning, these areas include in insurance, financial planning and retirement and the target of a £50 billion of open book asset growth, home insurance and protection, and individual annuities. In Commercial we are targeting £6 billion net lending growth to start up, SME and Mid-market businesses and improving our product ranges across trade, working capital, payments and cash management.

In Retail we will deliver targeted growth in motor finance, continue to deliver on the integration of MBNA, and use enhanced capabilities and personalised propositions to grow in attractive under represented market segments.

And in mortgages, while we expect the market to remain competitive, and we will continue to balance volume and margin considerations, we still expect to grow the open book over the plan period.

Finally, we will also retain the flexibility to consider inorganic growth opportunities that enhance our product or capability offering, and where our financial strength, low cost operating model and proven integration skills give us clear competitive advantage.

In terms of risk profile, this targeted growth will be in line with our low risk business model. This model is underpinned by our prudent participation choices and the portfolio de-risking that we have undertaken over the last few years. As a business over 95 per cent of our assets are in the UK. Over two-thirds of our portfolio is in secured assets with an average LTV of 44 per cent across our mortgage portfolio. Our high quality unsecured portfolio represents just 6 per cent of total loans. And our run off assets are down by over 95 per cent since 2010 and comprise just 2 per cent of loans and advances.

And finally, we have very limited exposure to high volatility business lines. At our last strategy update we talked about a through the cycle AQR of around 40 basis points. Going forward IFRS 9 will obviously introduce greater short-term volatility, and the acquisition of MBNA will also add around 4 basis points to our annual charge. However we believe that with our low risk model, our active de-risking, the benefits of enhanced data and analytics capabilities, that through the cycle AQR has fallen to around 35 basis points and as mentioned this morning, we currently expect an AQR of less than 30 over the plan period.

On costs, as you know, we have a strong record for reducing costs. And this will continue in the next phase of our strategy. Our strategic investments and management actions in changing the way we work, transforming more than 70 per cent of the cost base and driving a 30 per cent improvement in change efficiency and reduction in external contractors will deliver operating costs of less than £8 billion by 2020 compared with more than £10 billion in 2011.

This action on costs and our target top line growth will drive further improvements on our cost:income ratio and going forward the cost:income ratio will include both operating and remediation costs, as well as of course the costs of strategic investments that we have announced today.

And on this basis we are targeting a cost:income ratio in the low 40s as we exit 2020 compared with the 51.8 in 2017 and we will continue to target cost:income reductions each year.

In terms of profits, over the last few years we have delivered consistent and strong underlying profits and increasing statutory returns as we have resolved legacy items and dealt with remediation.

Looking forward, our targeted growth, resilient net interest margin, low risk business model and lower operating and remediation costs will drive strong statutory profit growth. And after tax profits will further benefit from an effective tax rate of around 25 per cent compared with more than 30 in 2017 and our previous guidance of around 27.

Looking at return on capital, again as you have heard, we are firstly increasing our targeted capital requirements to circa 13 per cent plus a management buffer of around 1. We are a prudent bank, this increase will make us even stronger and more resilient. And this capital increase should theoretically reduce our statutory returns by around 90 basis points.

We are however today announcing that with the actions we are taking and our confidence in the delivery, that we are increasing our RoTE guidance to 14 to 15 per cent from 2019 onwards.

And these market leading returns, will be generated by a bank with a clear low cost of equity. Our simple differentiated business model with its UK focused, reshaped and de-risked business, market leading efficiency, strengthened capital base and ambitious transformation plan will drive both higher returns and a lower cost of equity and therefore superior returns for our shareholders.

Finally on capital, as you know, we will continue to target annual capital generation of 170 to 200 basis points with our strong profit growth, giving us headroom to fund business and RWA growth and absorb any capital headwinds. We have a clear framework and track record for capital returns to shareholders. Our dividend will provide a progressive and sustainable earning stream, reflective of the consistent strength of our underlying earnings, while we continue to return our capital surplus by an appropriate means which we currently see as share buy-backs.

With that I will hand over to António for the close.

António Horta-Osório, Group Chief Executive

As George said, we hope the sessions with our management team today have helped you gain a better understanding of our capabilities and priorities for our next strategic plan. We are confident the four strategic priorities we set out will deliver a further fundamental transformation of the Group. GSR3 is a bold and ambitious plan, and represents a very significant step-up in our strategic investment over the next three years.

We have all the critical components required for successful delivery of this transformation. We have solid foundations on which we can build. Our strong track record and expertise of delivering large and complex change programmes, our experience of building the largest digital bank in the UK and delivering customer journey transformation, and the experience and dedication of our management team which will allow us to seize the opportunities that lie ahead.

GSR3 represents an exciting opportunity for us and our entire management team and the senior leadership team across the Group are energised, committed and determined to delivering across the four priorities of this strategic plan. And we are confident that delivery of this ambition will translate into greater value for our shareholders, as outlined in our revised financial targets.

That concludes the presentation. Many thanks for joining us here today and we will now take your additional questions.

Question and Answer Session

Question 1: Jonathan Pierce, Exane BNP

Thank you very much. Good afternoon it is Jonathan Pierce from Exane BNP Paribas. I have got three questions. I am sorry to focus on numbers as opposed to the qualitative aspects of the strategy. Just thinking about your numerical targets, firstly I wonder George if you could set out for us, for the spreadsheets, the sort of size of the amortisation of purchased intangibles, fair value unwind and any additional restructuring that might come below-the-line over the course of the next year or two? And I guess, related to that, can I just check the investment spend of £3 billion, is that all going to be expensed or will a portion of that be capitalised and will it be above-the-line and so on and so forth? That is the first. Do you want me to give you the other two?

Answer: George Culmer

It sounded like two questions

Answer: António Horta-Osório

So you have one more!

Further question

Okay I guess if I have got one more, I will ask quite a crude question and it simply relates to where your targets appear to be pointing 2–3 years out relative to consensus. Because if I simply take the 2020 exit numbers, I am getting to a revenue that is a billion and a half pounds or so above where the consensus is, impairment probably a little bit lower and you are ending up with an EPS number that is substantially above consensus at the statutory level at the moment. We can all take a view on impairment, but maybe you could give us a bit more confidence as to why you think revenue is going to be that much better than what the market has in?

Answer: George Culmer

Okay we will deal with those in order. In terms of the sort of below the line, you will have seen this year, I think we had about £0.6 billion, which I think was about 0.3 of ring-fencing, about 0.1 of property and about 0.1 of MBNA amortisation. For 2018, dealing with the short-term, I would expect there to be about another 0.2–0.3 on ring-fencing, probably about another 0.1 in terms of property and probably about 0.1 in terms of the MBNA integration spend. Fair value unwind, without having precise sums in my head, 0.2 or 0.3 of that type of order below-the-line, those are the sorts of numbers we were talking about below-the- line. The more than £3 billion, yeah we are going to take that above the line, yes an element of that we are going to capitalise, of course we will, that relates to revenue generation, relates to cost take-out etc. But all of that will go in and all of that

is in the number. When we talk about our operating costs of below £8 billion, that was below that £3 billion or the more than £3 billion element that I am expensing, the element that I am capitalising, depreciating, that is all in that number. The only numbers I would take below the line would be were there any redundancy or anything like that. As I said we don't know what is happening on headcount, so haven't put any predictions in for that, but the more than £3 billion will be dealt with above the line and is in the number.

In terms of, I haven't looked at what the consensus is for 2020 so I can't sort of comment on what that does for implied revenue type of numbers, but I think we have been quite clear in terms of our low 40s. I think we have been quite clear that that is a change of definition which we haven't majored on, but that it will include remediation, but the reason we have given such a hard target as well, which I think is helpful for people, and we are saying below £8 billion for those operating costs. And that's operating costs including all the consequences of that investment spend, but excluding the remediation, but my low 40s is both those elements: Operating costs, investments, plus remediation will be in the low 40s. That is our expectation.

Look, in terms of how that pans out and back solving into income numbers, as I say, I don't know what the consensus is for 2020 so I can't comment on, but that is right for our business.

Answer: António Horta-Osório
I think the only thing I would add to what George said, that obviously cost:income is a ratio of two numbers and the guidance we gave was below £8 billion and that is what I would add. Any more questions?

Question 2: Alvaro Serrano, Morgan Stanley
Hi, Alvaro Serrano from Morgan Stanley. Just on costs, the below, as you say, below £8 billion leaves a certain leeway, you are making £3 billion investment which is a very large number, can you give us a sense of how the cost base in terms of staff costs, maybe depreciation and amortisation and how the different lines might change the shape of the usual traditional banking versus what you see going forward? And also given it seems like the 40 per cent target is the key target, where do you see more flexibility of revenues to disappoint or do better? What would you flex in that £8 billion?

And the second, just for clarification, the below £8 billion, does that include remediation costs?

Further answer: George Culmer
No that is operating costs, so that excludes remediation. The low 40s cost:income includes remediation, but that below £8 billion excludes remediation.

To your first bit, it is a sort of yes and no. I mean thematically what you might expect to see, and we have done this for the last few years and we talked about it in the presentation, but to create the capacity to make this level of investment we have driven down BAU costs and we will continue to do that as we drive efficiencies through the business. And that will replace, to a certain extent, as I go to the previous question, as I capitalise and amortise and all that type of stuff, that you will continue to see a drive down in what we would call those business as usual expense and you will continue to see an increase in things like depreciation come through because that is the nature of the cost base in terms of the increased automation and that is the nature of our spend. So I am not going to give you the precise breakdown of the number, but that is something we have seen over the last few years and you will see that continue. Drive down BAU, create the capacity to invest and you will see a pick-up in things like depreciation charges coming through.

In terms of how we flex, we will deal with it if and when we get there. I think again we have shown over the last few years and I know it is hard to perceive this from the outside looking in, but the real advantage that Lloyds has as it operates as a single entity, the stuff that Juan talked about, and being able to respond. I have worked in multi-national businesses and it takes you a quarter to work out what is going on, a quarter to work out what to do with it and by then the year has nearly gone. So being able to actually meet weekly, have the business in front of you, see the results and as a management team, determine action and take that early enough in the year to have 11 months impact or 10 months impact on stuff makes a massive difference in terms of how you run the business. I know we talk a lot about how we utilise that for managing the sort of spread, but how you utilise that for managing the day to day operations of the business as well, it is a big structural advantage. I know it is easy for me to say and hard for you to realise, but that is how it works.

Answer: António Horta-Osório
And I would like to add a point to what George just said which is, as I said in my introductory remarks, this is a critical strategic advantage which is both strategical and cultural. To have a culture of austerity in the sense that you don't spend more than what you should, is what enables us to release money to have higher and higher levels of investment over each of the last 3 plans we did and it becomes a virtual circle because the more we invest, the better we have products for customers, the higher the NPS.

Also the investments which are driven at productivity, they lower the costs. The more we release to further invest and you are on a virtuous circle where our cost:income allows us to both invest greater amounts of money to the benefits of our customers and deliver superior returns for our shareholders. We have been repeating this for six years and it is now a reality, we have 46 per cent cost:income and the average of the sector is 60. Of course you can adapt for different business mixes. You can adapt for costs in the centre. You will not get a very different picture. And this is a critical strategic advantage and even more critical in a digital world.

Question 3: David Lock, Deutsche

Hi, it's David Lock from Deutsche. I have got two please. The first one is on the capital generation target you have given, 170–200 bps. I note that obviously you have raised the RoTE target and the capital generation is pretty similar to where we are today. You have talked about pensions being a drag on that, you have talked about IFRS 9, I just wondered if you have baked in any risk weighted assets inflation in there?

Answer: George Culmer

A bit yes and you are right, I mean we talk about statutory profits doing that and my capital guidance says that. And that is because of that, as we move forward over the last few years rather, markets go away, markets will do what they will do as we move forward. But in terms of reducing my balance sheet as you have seen in the reconciliation earlier today, we have had a fundamental benefit from RWA. As I go forward, I sort of both will be growing my book, RWA growth. I think RWA intensity will increase as well, a bit of mix, bit of as we deal with regulation. On top of that there are things like pensions that we have talked about as well. So it also gives me a bit of flexibility to deal with capital headwinds, but that is why one goes up and one is relatively stable.

Further question

And just separately on operating lease depreciation. I appreciate it is not in the cost:income ratio target, it wasn't I don't think in your previous strategy targets as well. How should we expect that to evolve over the coming 3-4 years?

Answer: George Culmer

I mean it is in the cost:income target. What we do is deduct it from income. So in terms of coming to our cost:income ratios, you take that net income line and you take our costs and so you know it is a deduction, so it is not excluded, so that is quite important. And it has been growing, two reasons for that, one predominantly in Commercial Banking where we have had some write-offs from some legacy assets. We had some Aero Engines where we took some write-offs in 2016 and the residual about £30 million I think in 2017. It is also reflective of the growth in Lex Autolease as well, so it is volume generated. So in terms of the OOI growing then that is the cost of sale for that particular part of the business. But it has certainly been slightly higher in the last couple of years, we have had some write-offs in CB. Those assets are gone.

Further question

So those write-offs are complete?

Answer: George Culmer

Yes that is correct.

Question 4: Fahed Kunwar, Redburn

Hi it's Fahed Kunwar from Redburn. I just had a question about other operating income. One of the things that was quite striking on your market share chart was a lot of the stuff where you are below your natural market share seems to be Insurance – obviously you had a little bit of a difficult year this year. Should we think about the insurance revenues as a growth revenue line now, as in the back book drag is going to be offset by the front book, so we are going to start to see growth there? And thinking about the other operating income line in general, you are running at about £6 billion ex-Treasury gains and Vocalink. It has been a difficult line again for the last few years. Should we think about that growing as well or do we see that as remaining flat and difficult going forward?

And the second question was on the return on investments. £3 billion is a big number. Obviously the cost reduction over investment isn't an easy thing to do, but how do you think about the revenue growth and how much do you attribute the investment versus loan growth and rate rises? How should we think about your ROI or how do you think about the ROI? Thanks

Answer: George Culmer

So OOI first, it is going to stay quite tough I think in the OOI line in terms of the income business. For 2017 I think as I said I think we had a target at the start of the year. I said if you strip out Vocalink, I think we would like to be ahead of the prior year. I think we actually came up about £6 million short so we were slightly undercooked. As I look out for 2018, if I strip out Vocalink

as it stands today I think we will be there or thereabouts, 2018 versus 2017, in terms of OOI. As I said I think it will stay a relatively tough business. Within that, insurance is a growth business and as you heard from Antonio in terms of the strategy and go forward as I build assets as I build those revenue streams, not just the FP&R but in terms of the Protection and so forth, they will build and that new business stream will build. The reality will be though, in insurance in simple speak, you have got a back book that is kind of running off and I am running to replace that with a front book. I think for 2018, the back book run-off may exceed the front book increments. So I think you will see insurance profits pause if not decline a bit in terms of OOI in 2018 but thereafter that new book builds and takes you away. And the insurance build, which I hope you got from Antonio, this isn't about actually next year or the next three years. In terms of what we are doing here, in terms of building that capability, in terms of we are building that asset base and accumulating those assets this takes us beyond 2020. And I think Antonio has a slide for 2025. This is about building out for the long-term. But I think you won't see much of that in 2018 where I think the back book run-off will exceed the front book. But thereafter you will build and it will continue to build, that is the beauty of it.

On the return on investments, again going back to Juan's presentation and again going back to the structural advantages. We manage this centrally. And when we look at our investment spend, we actually apply three crude lenses. One, it may not surprise you, is financials. One, we look at strategic, you know how close to the heart and how important this is. And the other lens we look at is in terms of our capability. So that £3 billion spend we kind of strip down, certainly the first year spend, at a very granular level in terms of how we prioritise it and how we code it, what makes the cut and obviously stuff which doesn't make the cut. And within that, to your question, within the financial bit, I will look at those that drive cost take out and those that generate income. And when we try to get clever about it, we will say it is easier to put income. So if I pay a healthy discount to the income stuff can I get some form of comparable weighting. But we apply that centrally and then as a team, we the GEC will come and decide where we spend the money, looking at those three lenses. So you have a very controlled, very centralised, very deliberate process that determines where we spend our money, where we think it is to the best endeavours, the best benefit of the Group. And again in a compare and contrast, this isn't decisions being taken in faraway places where you are not sure what the motive is and what the decision making has been, you elevate this all up to the centre. I see that list, we decide as a team what is on the list and what is not on the list. And what we will do as we go through the year is decide how that list might change because that was moment in time view before we do this. Now 80 per cent may stay the same, but other things will come on, things will change. But it is done centrally which again is sort of perhaps difficult to convey to people, but it is a massive advantage as you set out on a project like this in having that control over and that decision making residing at the centre.

Answer: António Horta-Osório
Which means the dynamic throughout the year, some investments may crowd out other investments and that is the right way to allocate investments in a transparent and inline with the centres you were trying to say. So that the best investments dynamically get the most of the resources.

Question 5: Chris Cant, Autonomous
Thanks, it's Chris Cant from Autonomous. If I could just ask one please. You have given two pieces of cost guidance. You have given your cost:income target which I think is an exit run rate for 2020 and you have given your sub £8 billion figure which I think is for the full year 2020. So I am just trying to square the two because a lot of people will be trying to look at the implied revenue number. Within that £8 billion for 2020, how much is elevated investment spend going through the P&L which will drop away when I am thinking about your run rate into 2021? Because obviously some of that £8 billion is part of your £3 billion. People are doing this maths so we are all going to come up with different revenue numbers. So it would be really helpful if you could give us the right answer?

Answer: George Culmer
You are over thinking it! You are right, I mean we have said low 40s as we exit the year including remediation. But then we are very clear that in 2020 operating costs will be below that £8 billion. Within that, going back to one of the earlier questions, as I spend the £3 billion I am going to be expensing a fair slug of that as I move through that. Yes there will be an amortised bit which is still rolling through. I don't see that the calculations takes you to any particular place. There will always be a level of investment. I am not going to sit here trying to pretend what I think that is in 2021. So I am not going to answer your question because I am not sure it takes you anywhere. The key point to me is and we thought about this, that I could have sat here and said, as we have done previously and people have asked the questions. I am going to deliver this much savings. Then you say, well okay I don't know where you are landing. Tell me how much of that reinvesting. We have tried to be more helpful here and say actually this is what we are shooting for in terms of a run rate expense base. To your point there will be some of that £3 billion that is still on the balance sheet rolling off etc, but we try to keep just more helpful, but below the £8 billion gives people a better line of sight and going to Chris' target, these are quite punchy targets in terms of where we are aiming.

Answer : António Horta-Osório
And of course as you also say Chris, some of that will not be repeated to the point that you are making. But in crude terms, in the same way that we are committed to improving the cost:income every year, you should assume that if you wanted to reconcile the two, you should assume that the exit rate of the operating costs will be lower than the average of the year.

Question 6: Martin Leitgeb, Goldman Sachs
Good afternoon, Martin Leitgeb from Goldman Sachs. I was wondering if you could shed a bit of light in terms of what you have assumed in terms of property prices in the UK throughout your planning horizon going forward. What I was trying to understand is that if there were a scenario where property prices, say in London or in the wider South-East, were to come under some pressure, would you expect Lloyds to perform still comparatively well on that basis?

António Horta-Osório
Do you have the estimates?

Answer: George Culmer
No. We do but not here, I can't remember what we've assumed.

Answer: António Horta-Osório
I think our estimates directionally driven are a continuation of house price increases outside London and the South-East and some decline in London. If you remember already four years ago we were the first bank, even before the FPC, to lower the loan to income ratio from 5 to 4 because that was the only way available to us to of de-emphasising market share in London. And the fact is now, 4 years later we have more than 90 per cent of our book in London, with an LTV of lower or equal to 80 per cent. So our book is incredibly resilient to house prices in London going down. 4 years ago we had £36 billion of mortgage loans in the book above 100 per cent LTV in the whole of the country. Now we have one point something billion. 90 per cent of our total book, just to give the final one, is below or equal to 80 per cent LTV. So we have followed the strategy where given what I explained to you in terms of the strategy in terms of mortgages, volumes, prices, risk, capital, we think all points to being prudent, privileging capital. And within that overall strategy we have re-emphasised London already from 4 years ago that has reflect in ourselves having lower new business at high house prices. The increase in house prices throughout this period has lowered the back book prices and our LTV had a massive transformation where we have, as I said, above 90 per cent of the book equal or below an 80 per cent LTV.

Answer: George Culmer
HPI I think we have assumed for this year about 3 per cent or something like that. And we have also, that resilience to Antonio's point, from memory, well obviously you know you stress test the hell out of the thing. But I seem to remember the first 10 per cent fall in HPI has about a billion of RWA pick-up. That is a good indication of that resilience in the book.

Question 7: Michael Helsby, BAML
Thank you, it is Michael Helsby from Bank of America Merrill Lynch. I was wondering if you could give us a comment on margins. Clearly I think in your comments you said you think margins will stay resilient so I was wondering if you could quantify what you think resilient actually means?

António Horta-Osório
It's more than you think!

Michael Helsby
Clearly! It is a request for an average balance sheet please in your disclosure that ties into your banking NIM so we can have better line of sight into what is going on. But more specifically, if you could tell us what the mortgage yield is on your back book, what you are currently originating on mortgage prices? What is the yield is on your deposit book as it looks to me like you are pretty much done from a deposit repricing perspective? That would be really kind. Thank you.

António Horta-Osório
Would you like to know anything else?

Answer: George Culmer
Resilient means resilient. I am not being a smart-arse about it. We don't normally give guidance beyond the 12 months. So this year we have gone beyond that and that was to demonstrate our confidence in our ability to manage this business, a reflection in terms of what you have heard from Antonio about where we see the UK economy going. And I don't have the specifics around the mortgage front and back book to hand and things like that. There is still room to go with things like the deposit rates

and how we actively manage that margin. So obviously when you look at the normal rates that we give you and in terms of savings rates. I think at Q3 they were 47. At Q4 I think they are just over 50. So that is how we absorbed the rate increase and the extent to which things do or don't get passed on and how we actually manage that. So we think in a gently rising environment, there will continue to be opportunities for us that we will be able to play into in terms of how we manage the book.

So I will take your comment on average balance sheet. I think the first one of these I ever did you asked for an average balance sheet so I will get back to you. So you know we remain confident you know in how we are managing the business, in terms of how the look forward appears to us in terms of plan, in terms of benefits of MBNA coming through. In terms of utilising market efficiencies in terms of wholesale funding, even as the TFS rolls off, given the rating upgrade. In terms of being able to access new funds. So we still see there is more mileage in basic spread management between the assets and liabilities of the business.

Answer : António Horta-Osório
And we have told you that in Quarter 4 that the margin, in the results in Quarter 3, that the margin would be around the same as Quarter 3. We told you the margin would be around 285, it was 286. We are now telling you in 2018 it will be around 290. So Michael you will believe it or not at your own peril.

Further question
Thank you. Sorry, one more. Just clearly a lot today has been about Open Banking and the opportunities that you think that brings to the Group. Clearly if Open Banking works and it is going to break down inertia and as a bank that is the biggest in the UK, has the biggest back books with some of the richest pricing, someone might think that actually that is a big threat to you. So I was just wondering clearly what your perspective is? We have heard from the guys, but what does that do to transparent pricing as things start to accelerate in the turnaround?

Answer : António Horta-Osório
Well as I think you heard from Vim, in his session, we see Open Banking as a significant opportunity and we have already implemented as I said, the first of the big banks to implement it. We think we have a fantastic customer franchise, they interact with us at a growing pace through a multi-channel, multi-brand approach. The more they interact with us the more insight we have on what they want. And they are changing quickly what they want and we are very well positioned to provide them with that. Open Banking is another opportunity for us to provide aggregation.

Our customers tell us that they like aggregation, but they would prefer their main bank to do it. Well we are the main bank to one out of four clients in the UK. As you heard in Vim's session, we have very interesting plans for that which we will be panning out as we install each of the innovations that we have in our plans. More questions please?

Question 8: Ed Firth, KBW
Thanks very much, it is Ed Firth again from KBW. I was interested in your comments on RWA intensity. And I guess particularly around the mortgage risk weightings. I know the PRA have been looking at that, I don't know if you have got an update. But I noticed in the stress test your mortgage book performed somewhat worse than peers. And yet your risk weighting seems somewhat better than most peoples and I wonder should we expect some sort of uptick in that as we go forward over the next few years?

Answer: George Culmer
There is a marginal update as the PRAs proposals kick in. It is not a material amount as we currently already do things like through the cycle RWAs as opposed to point in time. My comment also around intensity was when you look at the different mix in terms of where we expect the business to grow and when I look at the composition of the overall book as well. So those are the sort of main things that I was referring to when I talk about the RWA growth. So there will be a bit of mix and a bit of factoring in of things like the PRA proposals as well.

Further question:
So maybe I could ask the question in another way then. When I hear your LTVs etc, it looks like your mortgage book is very well placed to protect in any downturn etc. and if I look at the provisioning that came out of the stress test it was higher than everybody else's. So what is the source of that? Is it the old Birmingham Midshires book or have you got some sort of little pockets of a problem or something more structural?

Answer: George Culmer
If you look in the appendices, I am hoping we have still got the slide in. We do an analysis, there are things like the specialist book which is a legacy book which is rolling off and I forget the percentage of pain that causes in the stress, but an awful lot comes from that book which is a legacy book. It is seasoned, it is rolling off, it is going to diminish as we move through time. But if you look at the size of that, that specialist book, that is one of those areas that causes us significant amount of our delta in the stress.

Ed Firth
Thanks very much.

António Horta-Osório
Any final questions as we approach the end?

Question 9: James Invine, SocGen
Good morning its James Invine here from SocGen. Can you talk to us about the status of your deal with JLR? I think if memory serves me correctly you are now in the fifth year of your 5 year deal. Is that right? Is that going to be renegotiated this year?

António Horta-Osório
Vim would you like to take that question? Vim will answer you.

Answer: Vim Maru
We started to write new business on JLR in 2014. So you see some of the growth that you have seen on the JLR book and the motor finance book has been a function of the fact that that book is still seasoning. So we saw growth of I think 19 per cent last year. That will start to mature as we start to see repayments on the business that we wrote in 2014/15. That was a deal that runs to 2019 and obviously we will be looking at continuing that relationship with JLR.

António Horta-Osório
Okay so it finishes next year, not this year.

Question 10: Ian Gordon, INVESTEC
Hi, it's Ian Gordon. Just one question please. It is a point of clarification for George. I think when you were talking earlier about below the line items, you said you didn't know what the redundancy costs might be and that can't be true because you know everything. So I guess more seriously my question is, are we talking about redundancy costs contained within the £3 billion investment or are we talking about redundancy costs which might flow from the efficiency gains?

Answer: George Culmer
It's the latter and I really don't know because, as we explained in the first of these this morning when we talked to the media, it depends upon what our customers do. So as you will have heard today from Vim and from Jakob etc. The service proposition is driven by the customer demand and we will respond to that in terms of FTE, in terms of branch footprint etc. and I will deal with that when it comes. But the more than £3 billion does not include any redundancy.

Answer: António Horta-Osório
We would not call that strategic investments and that strategic investment is all above the line.

Okay so I think we come to an end. Thank you very much for bearing with us all this time, but we thought this moment required more time together and I hope this was useful. Thank you very much for coming.

End of Strategic Update Q&A