LLOYDS BANKING GROUP PLC
2012 HALF-YEAR RESULTS PRESENTATION

The Plaisterers Hall, London – Thursday 26 July 2012

António Horta-Osório, Group Chief Executive

Good morning everyone, and welcome to our first half results presentation.

I am joined here by the full executive team, which is now complete. As you know, George Culmer joined us as Group Finance Director in May, and you will hear from him later; Cathy Turner joined in June as our new Chief Administrative Officer with responsibility for Legal, Audit, HR and Corporate Brand; and Andrew Bester joined as the new CEO of Wholesale in July.

In the first part of my presentation, I will describe our strategic progress in this half year, our continued risk reduction reflected in our ratings update, and the resilient operational performance we have delivered in a challenging environment.

George will then give you more detail on our financial performance for H1 and Mark Fisher, our Group Operations Director, will update you on the progress we are making on the simplification and cost programmes.

Finally, I will summarise our first half, and talk you through our expectations for the remainder of the year and our outlook for the medium term.

So, turning first to the first half highlights.

We made further substantial progress in strengthening our balance sheet and reducing risk.

We have further reduced £23 billion of non-core assets, ahead of expectations.

Our core tier 1 capital ratio has now increased to 11.3 per cent, we have completed our term wholesale funding programme for the year by the end of April, and, as you will hear from George, our liquidity position improved further.

And we have continued to deliver above market customer deposit growth, further reducing our wholesale funding needs by around £40 billion, and allowing us to further improve our Group loan to deposit ratio.

There is no doubt that this is a challenging environment for the banking sector, with subdued loan demand, high funding costs, very low interest rates, and a stringent regulatory environment. Nevertheless, the actions we've taken to reduce balance sheet risks, non-core assets, costs and impairments, when combined with the delivery of improved management profitability at the Group level and stable core returns, should give you a clear idea of the potential of Lloyds' core bank going forward.

I am of course disappointed to report a statutory loss for the period driven entirely by our decision to increase the PPI provision by a further £700 million to address this disappointing legacy issue. More on that later.

We have continued to implement our strategic initiatives, building for the future with an additional £600 million investment behind the growth initiatives in the first twelve months of the programme.

And elsewhere, we've seen encouraging developments.

Last week, we signed high level terms of agreement with the Co-operative Group for the disposal of Verde, and we remain on track to complete this disposal as required by the end of November 2013.

In June the substantial progress we are making in delivering our strategy was also reflected in the outcome of the Moody's rating review, which reaffirmed Lloyds' short-term Prime-1 rating, while the longer-term rating was lowered by only one notch to A2, a good outcome relative to others in the sector, and as good as we had hoped for.

And we have now completed two thirds of our international divestments, having announced the exit of 10 international locations.

Also, the changes we are seeing in the external environment endorse that a strategy focussed on traditional retail and commercial banking in the UK is the right one for Lloyds. Our business model is aligned with the White Paper's proposed banking reforms, and the recent regulatory authority focus on supporting the UK's economic recovery is most welcome.

So it is clear that the strategy we set out a year ago remains entirely appropriate, even more given the deterioration in the external environment, and the progress we have made against it means, in my opinion, that the Group's prospects are getting stronger in spite of this deterioration.

I will now look in more detail at the key achievements in the first half against this strategy.

A cornerstone of this strengthened balance sheet has been the substantial growth in customer deposits we have achieved over the past 18 months. In the first half we delivered a further increase of 3 per cent, and 6 per cent year on year, broadly consistent with the growth rate we achieved in 2011. This solid performance reflected in particular our compelling multi-brand and multi-channel customer proposition.

As a result of this strong deposit growth and the substantial non-core asset reduction, the Group loan to deposit ratio reduced further to 126 per cent, 28 percentage points down from the beginning of last year, with the core LDR down to 103 per cent. As you can see, we are well on track to achieve our target of a long-term loan to deposit ratio of 120 per cent by early 2013, approximately two years ahead of target, which will lead to a 100 per cent LDR in the core book.

We also continued to strengthen our balance sheet by reducing the non-core portfolio, and we made strong progress again in the period, in spite of challenging market conditions.

We achieved a substantial reduction in non-core assets of £23 billion, with £11 billion in Q2, ahead of expectations, and again in a capital accretive way, as we had committed. This included reductions of £11 billion in treasury assets, £3 billion in UK commercial real estate and £5 billion in International assets of which £2 billion was in Ireland. George will give you additional disclosure on our non-core assets.

We remain confident that we will reduce non-core assets by at least £30 billion this year, and to £90 billion by 2013, one year ahead of target. We now expect our non-core assets to reduce further to £70 billion or less by the end of 2014, 50 per cent of which will be retail assets; so non-retail assets being around 5 per cent of total funded assets. As a consequence, from 2015 onward we will cease to report on the non-core business separately.

Moving on to capital.

Our core tier 1 capital ratio increased to 11.3 per cent at the end of June, up from just over 10 per cent a year ago. This was mostly driven by our management profits and a reduction in risk-weighted assets, with one-off legacy items offsetting progress, which would have otherwise been even more significant. Our Basel 3 fully loaded core tier 1 capital ratio stands at 7.7 per cent, up from 7.1 per cent at the year end, and I expect it to continue to trend towards our core tier 1 ratio throughout the transition period, well ahead of regulatory requirements.

The total capital ratio increased to 16.6 per cent, from 15.0 per cent a year ago, positioning us well relative to the ICB's recommendations for loss absorbent capital in excess of 17 per cent.

Now turning to the income statement.

Our income performance continues to be affected by the subdued economic environment, very low interest rates and higher funding costs.

However, the actions we have taken to accelerate our cost management programme and reduce impairments meant that we improved Group profitability and returns, and continued to deliver stable returns above our cost of capital in our core business.

Even though we delivered a resilient underlying performance in this first half, we are disappointed that we had to make further provisions in both the first and second quarter for PPI contact and redress which impacted our statutory results, as a consequence of the current claims experience which did not decline as quickly as anticipated in Q1.

Notwithstanding pressures on the top line, we have continued to invest a proportion of the simplification cost savings, around £600 million so far, to grow our core customer businesses through the launch of new products and services.

We are continuing to do what we said we would do, and a bit more. We have made good progress but it is clear that some of our businesses need some additional attention to operate more effectively in their particular environments.

However it is also clear that our initiatives are delivering the sort of returns we want in the 3 to 5 year restructuring journey we started last year.

Some highlights are:

In Retail, we are investing in new channels for customers, ensuring that our products and services remain convenient and accessible, and thereby increasing usage and engagement. We are pleased with the very strong increase we have seen in our internet banking user base by 650,000, which takes us to over 9 million users. We now have 2.5 million mobile banking users accounting for almost 25 per cent of all customer log-ins onto our banking systems.

In Commercial, we are on track to exceed the SME Charter commitment of £12 billion of gross lending in 2012, while we have now increased our target by a further £1 billion, and we are proud to have supported 64,000 start up businesses so far this year. And net lending to SMEs is also positive and accelerating despite a falling market.

Let me move on now to the performance of each of our divisions.

In Retail, we have delivered further reductions in costs and in impairments, more than offsetting the fall in income. As a consequence underlying profit increased 12 per cent, with return on risk weighted assets improving to over three per cent, well above our cost of capital.

Customer deposits increased by 3 per cent since the year end, significantly above the market as a whole. This successful deposit growth is a result of Retail's ongoing commitment to its multi-brand multi-channel strategy, the investment in our relationship brands Lloyds, Bank of Scotland and Halifax, and a strong focus on holistic and continuous fine tuning in the pricing of both our loans and our deposits.

In Mortgages we have continued to supply one out of four loans to First Time Buyers, having supported 25,000 people in H1 to get their first home; and we have achieved an overall gross lending market share of 18 per cent in the period.

In Wholesale, underlying profit before tax in the first half declined modestly year on year; although we delivered a slight increase in returns. While continued customer deleveraging and higher wholesale funding costs drove a decrease in underlying income, the continued improvement in asset quality drove a substantial decrease in impairments.

These returns are still not acceptable, and we have reviewed the strategy and asset allocation to improve these going forward in the context of the ICB recommendations.

Total costs rose modestly, as cost savings and continuing cost management focus were offset by ongoing investment in core customer facing resource and systems; in line with the priorities set out in the Group's Strategic review.

I am looking forward to Andrew Bester leading the next phase of the re-shaping of this business as we also advance in our plans to become a ring-fenced bank, ahead of the regulatory deadline, and we will let you know more on these plans at the Q3 IMS.

Moving on to Commercial.

Commercial delivered a strong result with underlying profit before tax increasing by 24 per cent.

It has continued to focus on strengthening its customer relationships and on supporting SMEs through the difficult trading conditions by further developing its understanding and support of individual business requirements. This is demonstrated by, amongst other things, the growth in our net lending to SMEs, with core loans and advances increasing by 4 per cent against a contracting market, as I mentioned.

Customer deposits grew by 3 per cent, ahead of the market, and reflecting our ongoing success in attracting new SME customers, particularly through current accounts.

In Insurance we continue to generate strong returns with IRRs on new life pensions and investment business of over 16 per cent, and a combined operating ratio on our general insurance business of 80 per cent.

Sales through the bancassurance channel have nevertheless been impacted by subdued demand for investment products and by the preparations for the RDR.

In terms of results, core underlying income is down 19 per cent with the changes to economic assumptions and adverse weather accounting for most of this reduction. The remainder has been partly offset by further action on expenses, which decreased by 8 per cent.

These are decent performances in challenging markets, particularly given the impacts referred to above, although we will have to do better and get it right in the context of RDR. As I said before, RDR will materially change the landscape of bancassurance and Wealth from January 2013 onwards and we will update you at the Q3 IMS on our latest plans.

Wealth, Asset Finance and International profits were stable, with a continued reduction in impairments and expenses, offsetting a decrease in income of 3 per cent.

The focussed deposit gathering strategy delivered 29 per cent growth, primarily due to continued strong inflows in both the wealth and international deposit businesses which have strongly supported our overall deposit growth. Our European online business is expanding quickly, bringing a stable, diversified retail Euro deposit base to the Group, and the international wealth deposits are also progressing strongly following a more targeted approach in the business and the perceived safety of the Lloyds brand in the current European turmoil.

Our Asset Finance unit continued to deliver strong profits and returns and is continuing to gain market share in the segments where we already have significant leadership positions.

As I have said before, only by focusing on customers' needs and addressing those needs in a cost effective way, can we expect to deliver strong and sustainable benefits to our shareholders. Throughout the Group we are focused on implementing a number of service initiatives to drive improved customer experience. These are already showing significant progress, as Mark will detail later on.

Internally we measure customer satisfaction through the Net Promoter Scores, which indicate the likelihood of customers recommending us to others and is based on a comprehensive set of over 45,000 customer interviews every month. On this basis, all of our major brands made significant headway in the first six months of the year. There was good improvement at the Halifax and the Bank of Scotland, reflecting the investment in their relaunch as standalone brands, and also on Lloyds that has the highest scores and ranks highly among high street brands.

At a channel level we also saw improvements across branch, telephony and the internet, and as a result our overall Group wide score has seen significant progress with an 11 per cent increase in the first half. We will continue to build on this strong start to improving our customer advocacy across all brands and all channels.

As part of our 'Best bank for customers' strategy, we have also committed to reducing banking complaints per 1,000 accounts to 1.3 by the end of 2012, a 40 per cent reduction from 2010. We are making good progress towards our target, having already achieved 1.4 at the half year.

This reduction was driven by initiatives to remove the causes of complaints, for example by ensuring that our telephone banking teams now have the ability to see details of earmarked transactions on a customer's account, which enables our customers to get the right outcome faster, as we ensure that complaints are resolved at first touch wherever possible.

These improvements we are making to the customer experience have also been evidenced by the continued significant decline in our FOS overturn rates, where we now have the best outcome of the five major banks. Only one out of four customer complaints going to the ombudsman is decided in the customer's favour, from one out of two 18 months ago; which clearly proves the appropriateness of our customer redress policies.

Retail deposits increased by 3 per cent in H1, and by 5 per cent year on year, once again outperforming market growth.

This solid performance across all our brands reflected the compelling customer proposition Retail has developed, and has again been achieved in a cost effective manner, as you can see from the headline ISA rates in the first half of this year.

This strong evidence of customer preference and trust in Lloyds is a sign of appropriate segmentation and illustrates the value of the core bank we are building to the benefit of our customers and shareholders: a stronger, simpler and more efficient retail and commercial bank which will create strong and sustainable returns over time.

This concludes the first part of my presentation. I would now like to pass over to George for more detail on our financial performance in the half year.

George Culmer, Group Finance Director

Thank you António and good morning everyone. I am delighted to be here to present results for the first time,

This morning I'll update you on our performance in the first half and then cover our balance-sheet, funding, liquidity and capital positions.

As you heard from António, in the first half we delivered a resilient underlying performance with improvements in costs and impairments offsetting the expected decrease in income, with NII impacted by the smaller balance sheet and higher funding costs, and OOI by subdued demand, and adverse economic assumptions and weather in insurance.

Underlying profit for the half year is £1.1 billion for the Group and £3 billion for the core business.

Management profit for the group was £1.2 billion; however this was after a number of offsetting items.

Volatility of our own debt was a charge of £357 million and is the mark to market movement on our EMTNs and ECNs, and reflects the improvement in credit spreads towards the end of the half.

Asset and bond sales of £585 million comprise the loss on asset disposals, associated fair value unwind and gains on bond sales.

'Other volatile items' of a charge of £452 million is mostly timing and accounting and economic mismatches as we hedge out the Group's interest rate and FX exposures.

Liability management of £168 million is the gain on our own debt purchases, while the fair value unwind of £157 million is significantly down on prior year which included a much higher level of impairments.

And that brings us to the management profit of £1.2 billion for the group and £2.7 billion for the core.

Looking now more closely at underlying profit, and starting with income.

Underlying income of £9.2 billion is £1.9 billion down on prior year. £648 million of the movement comes from subdued lending demand and customer deleveraging in the core business and accelerated non core asset reduction.

Increased wholesale funding cost contributes a further £254 million, while Insurance saw an impact of £266 million primarily from changes to economic assumptions and adverse weather. Non-recurring items of £257 million mostly comprise recoveries and write-backs in the prior year.

Looking at the net interest margin.

In the first half of 2012 we delivered a robust margin performance. The core net interest margin was broadly stable at 2.32 per cent with asset repricing offsetting deposit spread pressures.

The non-core margin has fallen 25 basis points since year end, largely due to wholesale funding costs, although the impact on the Group is mitigated by the decreasing proportion of non-core.

And for the total group the margin stands at 1.93 per cent for the year-to-date, and 1.91 per cent in the second quarter. For the full year we expect the net interest margin to be in line with existing guidance at around 1.93 per cent.

Moving on to asset quality.

Our asset quality ratios continue to show favourable trends with the group AQR of 1.1 per cent reflecting the continued improved quality of the core book, an improvement in experience in non-core and again the decreasing size of that book.

And going forward we remain confident that we can achieve the group AQR target of 50 to 60 basis points in 2014.

In terms of impairments, the first half charge of £3.2 billion was 42 per cent lower than the first half of 2011 and continues to benefit from our prudent risk appetite and strong management controls.

While the external benefits of low interest rates and stable UK retail property prices are partly offset by subdued UK growth, rising unemployment and a weak commercial real estate market.

Within the divisions, Retail's total impairment charge decreased by 35 per cent to £0.8 billion with continued reductions in both secured and unsecured portfolios.

In Wholesale, the 31 per cent reduction to £1 billion largely reflects a £0.3 billion improvement in the core book where we have seen reduced levels of large defaults.

In Wealth, International and Asset Finance, the impairment charge fell by 51 per cent to £1.3 billion, with lower charges in the wholesale Irish and Australasian businesses. In Ireland we are seeing a significant reduction in the rate of increase in newly impaired loans. While in Australia the net wholesale book now stands at just £6.8 billion following the recent successful disposals.

This improvement in portfolio quality is consistent with what we are seeing in 'new to arrears' and newly impaired data.

In Retail, 'new to arrears' in secured is down 14 per cent on last year, and in unsecured by 31 per cent, and in Wholesale and Commercial, we are also seeing a reduction in newly impaired assets.

These trends support our confidence in the sustainability of the improvement in impairments, and for the full year we now expect to come inside our previous guidance of an impairment charge of £7.2 billion.

Moving now on to the statutory result.

Here we show the movement from the management profit to the statutory loss after tax of £641 million.

Simplification and Verde costs totalled £513 million. Simplification comprised £274 million of this, while Verde costs were £239 million.

On PPI as you have heard from António, claims continue to run ahead of previous estimates. The additional £700 million we have provided in Q2 reflects our assessment of the expected total, based on current complaint levels, projected future trends and separate analysis. The provision however does remain sensitive to future claim levels.

As described at Q1 the past service pension credit of £250 million relates to the move to CPI for discretionary pension increases within the Group's main defined benefit schemes.

And finally the tax charge for the half of £202 million includes £120 million from the lower carrying value of future losses following the reduction in the UK corporation tax rate, and a further £258 million of insurance policyholder tax that has no net impact on the P&L.

Turning now to the balance sheet.

As you already know, we continue to take action to strengthen the balance sheet and have made significant progress over the last 18 months.

In the first half of 2012 we have kept up the pace.

In the last 6 months we have grown deposits by £13 billion and reduced non-core assets by £23 billion. We have also seen a reduction in core lending of £8 billion, although it was pleasing to see this stabilise in the second quarter.

These movements have helped us drive a £37 billion reduction in wholesale funding and build our liquidity buffer by £10 billion, mainly in the first quarter. These actions have improved the Group's loan to deposit ratio from 135 per cent to 126 per cent, while our primary liquidity portfolio now stands at £105 billion, providing a substantial buffer and giving us optionality.

Looking in more detail at non-core

The non-core portfolio now stands at £118 billion with the decrease in the first half including £11 billion of treasury assets, £2 billion in UK commercial real estate and £5 billion in international assets.

Non-core RWAs stand at £93 billion, and are down 14 per cent since year end, and broadly in line with the reduction in non-core assets.

As António has said, we now expect the non-core portfolio to be below £70 billion in 2014, and with more than 50 per cent of that being retail assets, we will cease separate reporting of non-core after 2014.

On wholesale funding, we continue to reduce our requirements and improve the profile. At the half-year only £73 billion or 34 per cent of wholesale funding had a maturity of less than one year compared with 45 per cent at December 2011, and 50 per cent a year before that.

And less than one year money market funding now accounts for only 21 per cent of total wholesale funding again down from 27 per cent at the end of 2011, and 34 per cent in 2010.

On liquidity, the group has built up a strong position and considerably in excess of our ILG requirement.

As mentioned, our primary liquidity at the half-year was £105 billion and this represents approximately 240 per cent of our money market funding, and around 140 per cent of all wholesale funding with maturity of less than one year.

We also have significant secondary liquidity holdings of £110 billion, which provide access to the open market operations at a number of central banks.

Liquidity requirements is an area of evolving regulatory guidance, however this level of liquidity gives the group significant flexibility, one of the first examples of which was the successful recent tender for £4.6 billion of senior unsecured funding.

Coming finally to capital.

In the first half our core tier 1 capital ratio increased by 50 basis points to 11.3 per cent, while our fully loaded Basel 3 ratio increased from 7.1 per cent to 7.7 per cent. Both measures benefited from management profits and RWA reductions, offset by statutory profit items and other adjustments, including of course PPI.

Going forward we will continue with our strategy to maximize capital generation, while the successful resolution of open items such as the treatment of insurance, recognition of defaults, CVAs and SMEs could represent significant upside potential to our pro forma numbers.

I am comfortable with our current capital position and outlook, and confident of meeting our guidance to be both prudently in excess of transitional requirements, and of course to comply fully with Basel 3.

That completes my review of the financials and I would now like to hand over to Mark.

Mark Fisher – Group Operations Director

Thank you George, and good morning everybody. I'd like to spend a few minutes updating you on our progress on costs and the Simplification Programme that I talked about when we were here last February.

Starting with total costs, we have seen a reduction of 6 per cent compared to the first half of 2011.

The key driver of the lower costs has been the Simplification Programme where run rate savings have now reached £512 million, up from £242 million at the end of 2011. Simplification investment costs were £274 million in the first half.

The savings from the programme we are reporting today are ahead of our original plan and completely consistent with achieving the target of £1.7 billion saving in 2014 with an exit run rate of £1.9 billion.

To put some context to these results, it's worth looking at the longer term trend.

Costs have reduced significantly since the acquisition of HBOS but the key point is that for the last five half years costs have progressively reduced half year on half year; first, through the Integration Programme and now through Simplification. This is after re-investment in our strategic programmes and is a pattern we very much like and one we are working hard to continue.

I am sure you will note that typically second half year reductions are not as strong as the first. This is largely due to the UK Bank Levy which accrues in the second half. For example, the levy costs last year were £189 million.

Moving to the half on half comparison here is some more detail on how the 6 per cent cost reduction breaks down.

There were final synergies of £168 million from the Integration Programme but a very material benefit from Simplification amounting to £298 million in the first six months.

These savings are partly offset by the £135 million investment we have made in our Strategic Initiatives, such as the ongoing development of our digital channels.

Then there is an inflationary increase in wage costs of £46 million representing a 2.5 per cent increase for the majority of our staff.

The range of other cost movements unusually sums to a net positive variance of £22 million. Within this are a number of increases – such as inflation on non-labour costs, energy prices and higher regulatory costs – but these are more than offset by the impact of one-off items.

Now for a closer look at how Simplification is going.

I am very pleased that within a year of announcing the programme we have already achieved more than half a billion of sustainable run rate savings.

In fact we are ahead of where we expected to be at this stage. We have seen a strong flow of early deliverables whilst the more 'heavy lifting' projects have mobilised and moved into build.

In 2012 to date, we have announced over 4,000 job reductions bringing the total since the start of the programme to over 6,000. I am pleased that we continue to achieve over half of our job reductions through natural attrition, management of existing vacancies and redeployment.

We remain focussed on reducing our supplier base. Over the past 12 months we have moved from just over 18,000 suppliers to less than 14,000. You may remember I said a year ago that our target was to reduce the supplier base to less than 10,000 which I thought was still a high number. With the progress we are making I am confident we are going to achieve the target earlier than expected, and beat it by the end of 2014.

We continue to make very good progress in flattening the organisation, reducing management layers and increasing spans of control.

Crucially we have also started to simplify the organisation in other ways. We are consolidating our back office operations into 15 scale efficient centres from our existing 27. Having worked through the detail of our property plans we now forecast reducing our non branch office buildings by nearly half from 112 to 68.

We are also making a difference for our customers.

Our Account Transfer, or Switchers, process is the first significant re-engineering of a core process and is going extremely well, averaging around 2,000 transfers each day since we launched the new process in April. We are seeing errors reduce, and colleagues are spending 75 per cent less time on the process as a result of automation and the removal of 23 manual process steps. Customer feedback has been extremely positive. They like the fact that they typically receive a text message confirming the process is underway before they leave the branch.

In February I mentioned improvements we were making to the Cash ISA process for this year. Through the tax year end we successfully managed significantly increased volumes following a range of changes, including auto-validation of data entry and enabling customers to re-invest their funds online. By the next tax year end, I expect the ISA process to be fully automated.

In Commercial, we are rolling out a more effective loans process with greater automation and a reduced number of handoffs. Across the regions where this has gone live we are already seeing a 45 per cent reduction in the time it takes for customers to draw their loans. Our relationship managers now have more time to spend with their customers. In fact, in Birmingham and South London regions, where this was initially rolled out, they are now ranked 2nd and 3rd in new term lending, up from 13th and 14th last year.

In General Insurance, we have completely redesigned the process for handling home insurance claims, and customers have a dedicated advisor through the process. We have rolled this out for dealing with the largest type of claim – ‘escape of water’ – and are already seeing up to a 40 per cent reduction in follow up calls between us and the customer with settlement times reduced by 30 per cent. We are now rolling this out across other claim types.

We continue to see a rapid increase in customer usage of the internet channel as we improve our digital service, including strong growth in the use of mobile banking. Our latest peak of customer log-ons was 4.2 million on the 30 April, and we are well on the way to seeing more than 1 billion internet banking log-ons overall in 2012.

And as Antonio has mentioned our improved service is reflected in lower levels of complaints across the board with a strong improving trend in all measures.

Finally, this slide shows the trajectory to our cost savings target. The savings are split by the four core workstreams that I have described in previous presentations.

By using a balance of initiatives we aim to deliver a reasonably linear increase towards our target. So far we are one year into a three and a half year programme – approximately 28 per cent of the way through and we have delivered 27 per cent of our benefits run rate target.

Overall, we are strongly on track with a good line of sight to benefit delivery in 2013 and 2014, and the programme is now well into its stride.

Thank you, I’d now like to hand back to Antonio.

António Horta-Osório, Group Chief Executive

Thank you Mark.

I would now like to sum up the highlights of the first half, our expectations for the rest of the year, and our outlook for the medium term.

We have a clear strategy which is being consistently implemented. Overall, the first six months represent further good progress on implementing our strategy to strengthen the Group's balance sheet and liquidity position, to reshape the business portfolio to fit our capabilities and risk appetite, focussing on UK retail and commercial banking, to simplify the group, improving agility and efficiency and simultaneously to invest for the future.

We are, as you have seen, on track to meet our 2012 financial guidance despite the subdued economy and the adverse external environment:

Simplification is already bringing annual run rate cost savings of over £500 million.

We confirm our loan to deposit ratio target of 120 per cent should be reached in the first quarter of 2013.

We now expect the 2012 impairment charge to be less than previous guidance.

And non-core assets are now targeted to be below £70 billion by the end of 2014, when we will cease separate reporting.

We also remain confident that our other medium-term financial targets are achievable over time.

Looking ahead, the operating environment will remain challenging, as the outlook for the UK economy remains uncertain and exposed to continued vulnerability in the Euro zone.

It is clear that corporate and consumer deleveraging will continue to impact demand, and interest rates will remain lower for longer.

As I have said many times now, this will be a long and difficult recovery.

Also, the sector as a whole continues to face a number of challenges and uncertainties, some of them arising from past industry behaviours, which have attracted much comment in recent weeks. This will make rebuilding trust even harder for the industry and addressing these issues 'head-on' a top priority for management. This is what we intend to do at Lloyds.

As far as the Banking Reform White Paper is concerned, we are already close to loss absorbency requirements, and given that our business model is aligned with the ring fencing goal, we plan to discuss with our regulators the advantages of becoming a ring-fenced bank ahead of regulatory requirements.

And turning to recent policy and regulatory changes aimed at encouraging UK growth, again this supports our chosen operating model and we will therefore play our part in making it happen.

In concluding, I believe we are building a very powerful yet simple core bank, totally aligned with our customers' interests and the external environment. We have, unfortunately, to do this at the same time as we deal with legacy issues, accelerate the shrinking of non-core assets that 15 months ago still represented one third of our funded assets, and execute the EU mandated sales of Verde and other assets.

In this 3 to 5 year journey, now 2 to 4, we are doing what we said and a bit more. We are delivering on our operating guidance for 2012 while delivering the balance sheet guidance faster than planned, in spite of the deterioration of the external environment, given what we perceive to be an increase in the external risks.

Simultaneously, we are relentlessly pursuing the creation of a leading cost efficiency competitive advantage and a portfolio characterised by a lower risk premium through the cycle which will differentiate Lloyds from its competitors.

These measures will, I believe, create a sustainable return on equity above our cost of equity and therefore deliver strong and sustainable returns to you, our shareholders.

Thank you – we would now be happy to take your questions.

Question 1: Chris Manners – Morgan Stanley

Good morning everyone, it's Chris Manners from Morgan Stanley here. Just two questions if I may. The first one was you have had six plus quarters of sequential falling net interest margin on a group basis, and you are guiding that the second half is going to be 193 basis points and so the margin should actually start to tick up from here. Would it be possible to run us through what the biggest moving parts are? You know is it repricing, funding mix, the Funding for Lending scheme etc?

And the second one was just on the core loan book. Obviously it shrank by £8 billion in the first half, stabilising in the second quarter. How do you see the outlook here? I mean the way that I look at it is that if you have got 7.7 per cent Basel 3 core tier 1 ratio, the Financial Policy Committee is indicating that UK Banks need to raise capital levels, that capital will still be a constraint on your thinking about growing that core loan book. Thanks.

Answer: António Horta-Osório

Okay Chris, good morning. Look by starting by the NIM, as I said at year end results, we expected NIM to go down this year by the same amount as last year and I said it should be concentrated on the first half and then flattening out. So we have exactly the same guidance both in terms of intensity and shape as we have and as you are seeing.

How do I see things going further? Well as I have said then, as our core loan to deposit ratio reaches 100 per cent, our wholesale funding costs will progressively decrease and given that we are offsetting the repricing of liabilities with the repricing of the loans, I believe we will see the NIM progressively ticking up. And in my expectation this should happen by the end of Q1, so around March. So you will see a flat NIM approximately through H2 as we have said at the beginning of the year. And given that we are now with the ratings outcome of Moody's and also with different schemes to support growth, and we now have excess liquidity, that as we told you we were hoarding because of the Moody's review as an insurance, that was costing us money, that we were expecting not to use, like an insurance. We will now deploy that excess liquidity, the first of which deployment was as George told you the buyback of senior and secured bonds by £4.6 billion and therefore all these factors together leave me to expect that our NIM will tick up by around March next year, and given that I am not an economist, maybe I'll get it right!

On our current loan book and following what I just told you, first I expect the UK economy as I have told you many times to continue deleveraging because we have as a country more credit versus GDP than we should, but while I expect our mortgage book to continue ticking down a bit because we want, as I told you before, to rebalance our market share from 26.5 per cent in mortgages and 23.5 per cent in savings to 25 per cent, which is our natural market share post Verde and which will bring us, as I told you, the core loan to deposit ratio to 100 per cent. So I don't expect a significant difference in behaviour in the mortgage book over the second half, although I think we will reach what we want by H1 next year. I do expect SME growth net lending to continue to increase. We are now at 4 per cent up from 3 per cent last year. And given the Funding for Lending scheme and good dynamics that we have inside the bank, I think we will continue increasing net lending positively in spite of a falling market of 4 per cent. And by the way we have 20 per cent of that market so it means the market is falling 6 per cent, while we are increasing 4 per cent, so it is a 10 percentage points difference which is very significant.

We now want to do two things. First we want to increase our mid corps net lending, building on the best practices we have got in SMEs, and I think we will achieve that through the second half of the year. So by year end you should see our mid corp segment to also turn net positive in terms of lending. And given the Funding for Lending scheme which we welcomed immediately as it came out and we thought was the proper thing to do, when I told you about the holistic solution of financial stability, where we were better in capital supervision and ring-fencing, increasing the credibility of recovery and resolution. And therefore liquidity should not in my opinion be super equivalent as well. We are going to use the Funding for Lending scheme specially to offset the disadvantage that we have in larger corporations where our funding costs as I have told you many times, did not allow us to be competitive, not for credit standards but because of funding costs. And therefore we expect those efforts to reverse quickly because you know in larger corporations these things are quicker and therefore I think that all these impacts combined, so continued positive SME lending, mid corps turning positive by December, larger corporations stopping shrinking given the elimination of the cost disadvantage, and mortgages still decreasing until H1 next year, I think again (with the risk of not being an economist), I think our core book will start increasing by June next year.

Question 2: Chintan Joshi – Nomura

If I can follow up on your comments on the Funding for Lending scheme from the previous question. The Bank of England clearly expects that UK banks will grow lending to the economy. From what I am hearing from you that is probably not going to happen at least until June next year. What kind of pressures would you expect from the regulator if being a large participant you are not able to deliver some stability in your UK lending as an aggregate number? And whether you would need to react based on what regulatory pressures you may get on the back of that?

And my second question would be on asset quality. You have stated that you expect lower impairments than before. Given the macro-political outlook I would think that would be quite brave guidance. You must be seeing something in your operations that gives you that confidence. If you could just elaborate on where some of the quarter-on-quarter / half-on-half strengths are coming from? Thank you.

Answer: António Horta-Osório

Well on your first question, I strongly disagree with what you said. Because the purpose of the Bank of England scheme and the objectives overall of the regulators in this shift towards growth is exactly to support two segments. First, small businesses which do not have access to other funding sources. And second, first time buyers in the mortgage market. We are keeping a very strong focus on first time buyers and although our market share in gross lending in mortgages is 18 per cent, we kept a 25 per cent market share in first time buyers where as I said, we are giving one out of four new mortgage loans in the half. So we will continue the first time buyer effort. And the reason why our mortgage book is decreasing is because people are repaying their loans which is up to the customers to decide.

On the small businesses, we are probably the only large bank that is increasing SME on a net basis and as I just answered to Chris, we are 10 per cent above the market, so that is absolutely in line with what the economy needs. We are the largest bank in this country and therefore as I said many times, our future and of the UK economy are inextricably linked.

On mid-corps, irrespective of the Funding for Lending scheme, we are going as I said to replicate the best practices of SMEs and make it grow on net terms by December. So in terms of pre-scheme and after-scheme, we will continue to contribute to SME net growth. We will turn positive in mid-corps and the only reason why our core book as a whole will not increase is because customers are repaying their mortgages which is their wishes. And large corporations is less relevant to the economy because as you know they have multiple funding sources. So I think we are absolutely in line with the authority's objectives. We do not do it because of regulatory pressure, but we do it because we think, number one, it is the right thing for our shareholders. And secondly, it is the right thing for the economy and again being the largest bank in this country, what is right for the economy is right for Lloyds.

In terms of the asset quality question which you are absolutely right in asking, I strongly believe with the caveats I said before about economists, that the number is incorrect. And the reason is because everything we see in the bank, all trends in NPLs, in all segments, continue to trend better than we expected and falling, as you saw in George's presentation and I will ask Juan to comment and give you more colour in a moment. And therefore I am very confident that the economy will be around flat this year as I said many times, and will start to recover next year as CPI comes down, given energy prices and some appreciation of the pound, which will increase peoples disposable income and will allow them to spend a bit more. Nevertheless I think as I always thought, this is going to be a long and difficult recovery as all debt recessions are, recovery from debt recessions are always long. And when I was probably being accused of being too cautious twelve months ago, you are accusing me of being too optimistic and I am basically saying the same thing. And I think the facts absolutely substantiate what I am telling you, also unemployment is lower than people would have thought and is not compatible to yesterday's numbers. So I think we can be a bit more optimistic than the mood of yesterday's number. Juan can you give some more colour on these numbers?

Further Answer:Juan Colombás

Yes to comment on Antonio's point. To give you some more colour, I think if you look at the different portfolios, all of them are performing much better. The second thing I would say, I think it is very important in our Bank to separate the core from non-core. I would recommend you to look at the numbers separately in both portfolios and you will see that our position has always been that our core book is a good book and our non-core book is well provisioned. This is how we see the picture in Lloyds in terms of provisioning. The encouraging thing is that the core book. I mean you have seen the new to impaired trends across the whole bank and all of them are improving as well which is a very good leading indicator of what impairments could be in the coming months. And the good thing is that in the core book, the level of impairments that we are having in the different portfolios are really good. Look at the quality of these books and we are very confident that the core book that we are building for Lloyds in the future is a very good one.

Question 3: Ian Gordon - Investec

Good morning, it's Ian Gordon from Investec, just one question please. George you referenced in your remarks the evolving regulatory guidance as the Bank of England and FSA seek to reverse some of their policy mistakes of the last five years. Specifically in relation to emerging FSA guidance in relation to liquidity buffers, can you help us with some quantification of the latitude this may give you? Obviously the tender offer which you referenced earlier gives us an indication of the direction of travel. I am assuming that is some of the benefit is wrapped into your margin guidance, but what we can't yet see from the outside is what level of dispensation the FSA may be giving you?

Answer: George Culmer

And I am sorry, I am going to frustrate you today by not giving you a precise number. Part of that is because precisely as you say, this is actually evolving regulation so there was a meeting this week which didn't shed too much light on what precisely that meant. So I can't give you that precise number. Obviously we do have flexibility in terms of the balance sheet structure in terms of how we might deploy it to support some of our core lending activities. So I won't be precise, but the big message is that that optionality is there through all the hard work and endeavour of the last 18 months and puts us in a very good position, but sorry I will not and cannot give you what precise pound, shilling and pence number that equates to.

Question 4: Sandy Chen - Cenkos Securities

I just have one question, it is going back to impairments. And related to the mortgage book. Looking at the UK mortgage book, 40 per cent on a loan to value basis is still 80 per cent LTV or above, 23 per cent is still 90 per cent LTV or above. Are your improved impairment assumptions based on a relatively flat set of house prices over the next twelve months or are you factoring in say the 5-10, 15 per cent house price declines that some economists as you said are looking for? And if that is, what is going on in terms of that underlying dynamic in impairment assumptions?

Answer: António Horta-Osório
I have my Chief Economist on the first row so I cannot comment anything else about economists! But our forecast in the Group is for reasonably flat house prices which we had. Last year we had forecast minus 2 per cent which actually happened. This year we forecast reasonably flat house prices which are happening and therefore we forecast accordingly. So you saw as Juan mentioned, the non performing loans are trending downwards. We thought in the beginning of the year they would trend slightly upwards as I think I said at the time. So they are trending better than we thought. And the house prices are behaving according to flat house prices in spite of some predictions they might fall. I really don't share that view because I think that in the UK as long as interest rates are very low, as you know, there is no over supply because of housing permits. And therefore it is reasonable to consider reasonably flat prices and that is what we consider. We have to provision according to an expected view and not according to an extreme scenario. Of course we know what would happen in extreme scenarios and we do not think that will be, as we said sometimes in previous questions, in other presentations, very, very significant. And in fact what we think is that house prices are going to be flat this year, should continue to be flat for the next foreseeable future. We have been reasonably good in terms of our Chief Economist's predictions in predicting house prices, so I am quite confident about that. You want to add something?

Further answer: Juan Colombás
On the mortgage book, in the mortgage book I think you have to analyse it by vintages, so it is a combination of a couple of years, or three years of bad vintages. So the important thing of the book is that these bad vintages ended in the middle of 2008 so they have been on our books for years now and our expectation is that they are seasoning. So at some point the rest of the vintages are a very good quality and you know that the average life of a mortgage is 4-5 years. So we should expect that if the rest of the conditions remain stable, that we shall see an improvement in performance.

<u>Question 5: Cormac Leech – Liberum Capital</u>
This is Cormac Leech here from Liberum Capital. I just have two questions, one on the NIM, I think that you guided that from first quarter of next year maybe we will see the NIM for the Group start to tick up slightly. Are you making any assumptions about Bank of England base rate changes in that forecast? In other words if we for example saw a 25 basis point cut in the Bank of England base rate, would that change the guidance for the Group? And I just had a question on other operating income.

Answer: António Horta-Osório
I am assuming flat interest rates for the rest of our three year plan which is the reason why we said in November last year that our guidance in terms of income orientated targets would be delayed beyond '14, but achievable over time. Because twelve months ago the structure of the yield curve was positive as you know. The market was expecting interest rates to start increasing six months ago. Now we are assuming interest rates gets half a percent throughout '14. And it is on that basis that I gave you my assumption. So of course if there was a cut in interest rates, there would be an impact on NIM.

Further question
Okay. And sorry could I just ask one following, just to invite you to possibly provide a little bit more transparency on how much of your mortgage book is available to reprice over the next couple of years because I am conscious of the old legacy Lloyds TSB book. I am not sure if you are willing to comment on that or not?

Answer: António Horta-Osório
We have never commented on that to be honest and I don't know those numbers by heart. There is a proportion of the book that we can't reprice on an individual basis as you know. And another one that we can, like we did in the Halifax book in May. And we can do that in that part of the book if we want going forward. But what I just told you does not take into consideration any unilateral repricing in the same way that when I say that NIM guidance for this year was in line with previous years, we have as I said at the time, incorporated the repricing of May in the estimate. So this new estimate has interest rates flat throughout '14 number one, number two, no unilateral increase in mortgage prices included.

Further question

And just briefly, on other operating income, if I am modelling that forward, is it fair to assume that it should track average interest earning assets or would you expect the growth in other operating income to be higher or lower than average interest earning assets going forward?

Answer: António Horta-Osório

That is a good question as well. As we said in the strategy review, we expect OOI to trend towards 50 per cent of total income, so it should grow over time as it is slightly growing. This quarter, second quarter was not good because the markets were very, very bad and although we have very little exposure to markets obviously, our corporate clients were more standing still as you know given what happened. And on the other hand, also given the markets and lower investment products through the insurance business and into affluent and private customers were not sold, given they preferred deposits where we are performing above expectations and go through NII instead of investment products. I expect this percentage to increase over time as I said at the strategy review and all the investments we are doing on the growth initiatives are mainly orientated exactly at OOI initiatives because we have substantial segments and products in the market which are OOI driven where we have subscale market shares, for example in FX products to our medium size corporations or SMEs. As I said last year, interest rates, money markets in terms of retail, we are subscale in terms of asset management in the affluent and private space. So most of the 20 growth initiatives where we have already invested as I said £600 million are mostly orientated at generated OOI and therefore the percentage should increase towards 50 per cent over time.

Mike please. Can we give the microphone here to Michael Helsby.

<u>Question 6: Tom Rayner - Exane</u>

It's Tom Rayner at Exane. You don't want Mr Helsby asking you questions! Sorry Mike. Just a couple of follow-ups on what you have just said actually. I mean the insurance revenue did look at little bit weak in the first half, sales margins and returns on policy holder funds all seemed to contribute. I was just wondering if the retail distribution review would make a big enough difference to offset this fairly difficult environment? And I have a second follow-up question on the margin if that is okay.

António Horta-Osório

On the first question, George is going to give you more colour on it.

Answer: George Culmer

Well on the insurance as I think we said in the presentations, there are a number of factors that impacted the results. First, it was obviously just the economic assumptions. So the lowering of the assumptions at the start of the year basically means that the value in force is going to unwind at a lower rate. And that accounted for about £100 million of the movement in insurance result from first half last year to first half this year. And obviously we had the awful weather over the summer which again I think was a £50-60 million swing factor in terms of half year on half year. Then in sales of products, going back to part of the earlier comment, it has been a difficult quarter for sales of particular products, also as things like the retail branch prepares for RDR, what we have seen compensating that though again as I think we said in the presentation, we have seen very strong sales through the IFA market of corporate pensions where we very much lead the market. Corporate pensions hit our required returns, they make our required returns. But they are at the lower end and when you see that slight drop in EEV from new business it is just the increasing proportion of corporate pensions that pulls that slightly back from the equivalent number last year.

Further question

Could you comment, on everything you have said about the margin, how material the issue of structural product hedging is to the current margin and the sort of guidance you are offering us?

Answer: António Horta-Osório

Well we don't comment on our hedging in detail. But as we said before, we have some hedges. What we are doing, and I will tell you about our actions so you understand our reasoning. As a bank we are basically a hedged bank. We are retail commercial bank, we have a basic outlook position which basically hedged. And we may open small positions according to what is happening in the market. So relating to your question, what we are seeing is that given the very low interest rate levels in the long ends on gilts, we have growingly thought and decided among ourselves that it makes less and less sense to have hedges connected to the gilts portfolio, given that it doesn't make a lot of sense to put our capital into sub-CPI gilts for ten years. And so we have progressively stopped additional hedging and we have sold some of the gilts on those hedges as you saw or when George explained the volatile items, because we think that as interest rates trend lower and lower, it makes sense for us at minimal accrual costs to increase the duration of our liabilities. That is as far as I am going to go on this one. Michael.

<u>Question 7: Michael Helsby – Bank of America, Merrill Lynch</u>

Michael Helsby from Merrill Lynch. Just two questions. Firstly at the Strategy Day you talked about Verde having a £500 million PBT contribution. Clearly it didn't turn out that way. So I was wondering if you could give us a best guess on what the PBT will be transferring over? Because I think most of us have got £500-600 million still in the models?

Answer: António Horta-Osório

That is a very good point. Well what can I say, I will ask George then to add some colour. It is true that we have absolutely forecast that, but that was in line with the big balance sheet. And there was the option at the request of the buyer, we discussed many times, to go to a lower balance sheet. And the final outcome we reached with the Co-op at their request was for an even lower balance sheet. And therefore the impact on results of the sale is much lower in terms of the net income we forego than already generally forecast.

Further answer: George Culmer

Yes just to endorse what Antonio said, we have looked at this in a variety of ways and it is a bit like, which assumptions you plug in and the timing. But to endorse what you said, we certainly don't expect the disposal to have a material impact on the sort of BAU trends, the PBT level within our business.

Answer: António Horta-Osório

And I mean as you can expect, it is not a good moment to sell assets, as we said all along, and we had to do this. We would like these assets as we said, but this was a mandated EU sale given the rescue of HBOS, this was clearly the best proposal the Lloyds Board was faced with, and given it was a sale below book value our strategy was as we just said, to minimise what we were selling and therefore to have as least capital as possible and results included under sale, which is what we basically did. And I think that apart from being the best offer Lloyds Board was faced with, it is clearly the best offer for our customers and our employees.

Further question

And just separately, your funding position is beginning to evolve now quite rapidly, clearly to your benefit. But it does mean that the mix between short term and long-term is now starting to change quite rapidly as well. You have always talked in the past about 50-50, it doesn't feel like that.

António Horta-Osório

I never talked about 50-50

Michael Helsby

Okay maybe George's predecessor talked about 50-50.

António Horta-Osório

Like I never talked about big NIMs

Michael Helsby
Okay. My NIM is bigger than yours! Sorry couldn't help that! So I just wondered if you could give an update on how you see George, the funding position evolving now you are in charge of the ship?

Answer: George Culmer
Well I am not going to give you any categoric percentages. One of the discussions we have had internally a lot is in terms of things like the short term wholesale, what is the right number? How low can you go in terms of keeping access to markets open, thinking of the world ahead where you are going to have entities that in the years to come are going to sit outside of the things like a ring-fenced bank and need to have their own access to markets. So I won't be precise, it will depend upon the prices at the time. But as the FD, I sure as hell like the percentage of the more than one year going up in my book.

António Horta-Osório
I think it is very important we listen to your question to really understand and now I can speak about it because we have had a very favourable ratings outcome and the progress is done as you have said. So this is the type of things you can only speak when you have solved the problem, not before you solve the problem. When you have 18 month ago £300 billion of wholesale funding out of which £150 billion short term, I really think as I said at the time, that was not the proper balance. And imagine what would have happened should the ratings review have been done. Now we have £73 billion of short term funding, so less than half than a year and a half ago, and less than half means more than £75 billion. Those cost us at least 200 basis points. So it means one and a half billion pounds less in NII, but that was not a free lunch, that was something in my opinion that should have never been there in the first place because we were basically funding a mortgage portfolio with a five year duration with short term wholesale funding.

Question 8: Rohith Chandra-Rajan – Barclays Capital
One on the Wholesale Bank. On your numbers pre-tax return on risk weighted [assets] is about half at Wholesale as it is Retail. And if we look I guess at the pre-provision level it is more like a third and it consumes more capital and all of those metrics I guess get worse under Basel 3. I appreciate you are going to give us more detail at Q3, but I was just wondering if you could give us some early hints towards your thinking in terms of the scale and focus of that business going forward? And then I have a second one on non-core.

Answer: António Horta-Osório
It is very easy, as I said in my speech, either the income will go up or the capital will go down in the division. And I think it will be a combination of the two. So we have to absolutely increase the returns, the strategy last year was absolutely correct in the sense, let's maximise the share of customer wallet instead of being a Wholesale bank just focused on lending. We have been doing good progress on those items as you can see from the market shares in Sterling capital markets issues, in terms of the Arena platform, number of customers, money market transactions. But still the environment worsened a lot, number one. Secondly, the ICB is very clear and therefore the returns as you say are not acceptable as I said and they will have to increase either through increasing income or decreasing capital allocated to the division and I think it will be a combination of the two and we will give you more detail at Q3 IMS.

Further question
Any indication in terms of the scale of the capital reduction?

Answer: António Horta-Osório
We will give you more detail at Q3 IMS

Further question
Very briefly, non-core, so less than £70 billion by the end of 2014 at which you will drop reporting, I was just wondering or to clarify whether that is a very straightforwardly reporting and you will continue to look to reduce those assets? Or whether what is left, you will consider core or take just a longer time to work them out?

Answer: António Horta-Osório

No I think that is a very fair point. Basically what we think is the following. So in '14 instead of 90 we will get to 70. And I know there is I hope an decreasing concern that we have time bombs left in what we won't sell, because we continue to sell ahead of target in a capital accretive way and across the board. But the only thing we can do to increase your degree of confidence is continue to sell which we will continue to do, so it is a matter of time.

But relating to the centre of your question, when we reach 70 in '14, half will be the retail assets like the self certified mortgages in the UK and the retail mortgages in Ireland, which as you know we cannot sell in terms of they are in SVR, it is the option of the client. They are quite sticky, and the UK ones perform well. It is just a closed book because we don't do self certified anymore and the Irish ones do not perform well and therefore we are provisioning them much quicker than others where we have already as you know declared impaired assets above the 90 days over. We have 22 per cent impaired ratio which is more than the 90 days over and we have covered those at the 72 per cent coverage level. So the ones that are not good we are covering provisioning as much as possible as quickly as possible. The self certified book which is most of it, it is £29 billion as you know, it is a good book, but it is not core, so by '14 those £35 billion of assets will come into the core book and we will run them off and you can very well extrapolate the behaviour because they are known, they are retail, they are sticky and they are predictable. The other 35 or less, non retail, non core assets we will cease reporting because given there will be less than 5 per cent of our funded assets, they will become in our view non material and therefore we will bring them back and report as a single bank. But as you correctly ask, we will continue to run them down to zero.

Question 9: Raul Sinha - JP Morgan

If I can just ask about PPI. Would you be able to clarify some of your assumptions behind the £700 million provisioning? And the reason I ask is from the outside it appears that if you take the FSA data for example which was about £730 million for the industry in May, if you annualise that, if you take that for a quarter even that means £2 billion plus for the industry and with 50 per cent market share for maybe Lloyds and HBOS that means a billion a quarter for the Group as an ongoing run rate. And then when I look at the remaining charge on your balance sheet it looks like you have probably got £1.3 billion left. So would you quantify what assumptions you have put behind the provisioning? Do you expect claim rates to tick down from here or have you assumed it to stay at the same levels?

Answer: George Culmer

I think the company's approach to PPI provision has been entirely the right one going back to the early mover and the original £3.2 billion and then at Q1 going for the £375 million which basically costed what we had seen as a spike in PPI claims at that particular time and that was costed based on the assumption it would revert back to previous assessments in terms of claims levels. As you know what has actually happened since is that claims have stayed at a higher level. We have in the last few weeks seen a slight decline in those claims numbers coming through which is cause for encouragement without getting carried away with it. The £700 million we have provided this time has been based upon both an assessment obviously of the claims that we are receiving, but studies into populations in terms of the ones we have received from, expectations for future mailings etc and propensity of those peoples to complain. So we have applied as much high science as one can to this particular number. Yes the run rate remains significant, I think we saw £4.3 billion as you say is the aggregate provision I think we talked about, £2.9 billion in terms of spent to date within the RNS. So you can work out run rates etc. I am not going to give you the precise components of how it is built up as it doesn't mean anything. We have based our assessment on what we think the cost will be and we have done it in the most appropriate way that we can. That all said, future claims levels are uncertain and much as I would love to tell you that is it and there is a line under that, there is still uncertainty.

Further question

Thanks very much and just a quick follow-up on the capital treatment of the sub-debt you will be underwriting for the Co-op Group, whenever that comes in, we obviously don't know the amount, should we assume that will be a reduction against capital?

Answer: George Culmer

We will have to get back to you on that, it won't be a material amount but I will get back to you on the treatment of that.

Question 10: Manus Costello - Autonomous

Thank you, it's Manus Costello from Autonomous. You talked a lot about the improvements in impairment trends. If I look in core Q2 versus Q1 there was quite a big step up in fact in impairment in Q2, I wonder if you could give us an indication of which divisions drove that step up quarter on quarter? And then I have a follow-on that that please.

António Horta-Osório

Juan can give you colour on that, but just to introduce the point, we have said specifically in Q1 that the dip in the AQR of the core book to 35 or 36 was too small and abnormal, so basically we are recovering the trend, but the overall number is very positive, it is below our guidance for the future of 50-60 basis points, but Juan will tell you exactly what happened and why.

Answer : Juan Colombás

There is some seasonality in some of the portfolios so the Q1 is normally the strange quarter so you close the accounts on the previous quarter and there is normally, it can touch on anything and so some of the variances between the Q1 and Q2 are due to these different treatments between quarters. It is not a change in trend. You can see from the different quarters' information we have provided.

Further question

Indeed, so just to follow on from that. On the basis therefore that Q2 is normalised in terms of your pre-tax return on risk weighted assets, that means we see a continual decline in the return on risk weighted assets in the core bank and I wondered, it looks like it is the lowest return for the last seven quarters at least, I wondered if you could give an indication of when you would improve core return on risk weighted assets if 1Q was just an aberration?

Answer: António Horta-Osório

Well I thought I had already answered that question, but I will tell you again. So if costs are going to continue to go down, impairments or trends are in the direction of going down and our NIM is going to improve by March, the volumes by June, so I think you have all the ingredients you need, right.

Question 11: Robert Law - Nomura

Robert Law of Nomura, I have got two questions please. Firstly, on the ICB issue, I am interested that you are looking at accelerating creating a ring-fenced bank. Could you give us some idea of what you think the result of this, the cost to the organisation will be, of the ring-fencing?

Answer: António Horta-Osório

Well what I said exactly, and I think that is a very fair point by the way. What I said exactly is the following. We do not have a strategic question to answer like most of our peers. We said last year we are going to be a UK centred retail and commercial bank with our wholesale bank focused on creating value around the retail and commercial bank. So we do not have a strategic existential question. And therefore we are able as we have already 90 per cent of our assets inside the ring-fence, we are able to move very quickly into being a ring-fenced bank. As I said in my speech, therefore we think the uncertainty for investors and for customers may be advantageous for us in going to ring-fenced bank sooner, but if it is advantageous for us because as you say correctly, there are costs in terms of setting up the ring-fenced bank, those costs for us are not very high. If in the discussions with the Regulators we see it is favourable for our shareholders and customers to move ahead we will. And we think it will be and therefore it is likely that we will be a ring-fenced bank well ahead of regulatory requirements. As we evolve in our discussions with the Regulator that we are now going to start, we will report to you more on that trade-off, but I think strategically it is very clear where we are going and I think that should take away a lot of uncertainty in terms of direction of this bank for the future which I think we are the only one that can really do that.

Further question

And if I paraphrase that, does that imply you think the bulk of your costs would be one-off in nature and any ongoing costs thereafter would be pretty immaterial to the Group? Is that a fair statement? The bulk of your costs would be one off in nature and ongoing would be immaterial?

Answer: António Horta-Osório
That is absolutely correct, that is exactly what is behind this thinking.

Further question
The second area is in terms of the non core business. Now that you are planning to discontinue reporting it for 2015, could you give us some idea of what financial performance is at the moment of the assets you will be retaining so we can get some idea of where you think your underlying sustainable?

Answer: António Horta-Osório
That is a very fair point as well Robert, but we are not seeing it that way, i.e. we will retain the £35 billion of retail assets which you can, the disclosure we are now giving is much bigger than before, so you can assess the behaviour of the UK self certified book and of the Irish retail mortgage as you have this information. The other, at most, £35 billion which will then bring back into the core book, we are going to do that because it becomes immaterial. But it is not because it will be full of problems. As I said many times, we are selling the non core assets across the board based on risk concerns and we will continue to do so and in a capital accretive way. We have on the table every 15 days, at maximum level in the bank, all the non core assets, all in process of being sold and as markets evolve, as buyers come up, as prices change, we are going to sell them all. So our estimate at the moment is that instead of £90 billion by '14, we will have only £70 billion. Given that the retail ones are stable and sticky, we will bring them in the bank and you can model them. And the other £35 billion at most we will bring in the core bank, but will continue to exit. They will not be there forever and I cannot tell you at this moment because I don't know exactly which ones they will be because we have everything on the table that we can sell. It may happen that we get to '14 and instead of £70 billion we have less because we sell £70 billion or less. So let's discuss that as we go. I think the main take here is instead of £90 billion we are going to go to £70 billion. Second it will become immaterial because it is 5 per cent of non return non core so we don't think it is worth reporting separately. And third, we are doing this in a capital accretive way and by the way, in a very different, difficult quarter because quarter 2 was very difficult, and we sold for example our remaining exposure in Australia, which was terrible and it was sold, and everything together was again sold in a capital accretive way. Difficult to have sold such bad portfolio in Australia, that is why you are laughing I guess. Such a good country, such a bad portfolio. Things happen.

<u>Question 12: Claire Kane - RBC</u>
Hi, it's Claire Kane from RBC. Can I have a follow-up on your other operating income trends please. In the core business I believe in Q2 it is down 4 per cent quarter on quarter, 15 per cent year on year and you did mention that there is more of a push towards deposits rather than savings products.

António Horta-Osório
Not a push, a client preference. We do not push things.

Clare Cain
Okay, can you then maybe give us an indication of the marginal cost of these deposits if you are seeing these come down? And also how that ties up with your aim to get the 25 per cent market share?

Answer: António Horta-Osório

Yes that marginal cost of deposits has been around for us, 200 basis points. We measure as I told you many times, sorry not to you but in these presentations, we absolutely measure the cost of deposits versus Wholesale funding. And the reason why we have been growing deposits at twice the market rate is twofold. First because the customers have been having a natural preference for the products we have given to them for example in ISA season with the same value date that is a request of the customer which was very important given the queues that happened last year for example or in October last year when we set out for the first time a drawing lottery process in Halifax which we now have close to a million customers enrolled. So first is the customers' preference, but second, we are only doing the deposits as I said many times, as long as the marginal cost of deposits as you ask was lower than our marginal wholesale funding cost. And given that the wholesale funding cost was much more expensive, we have continued to increase deposits and those marginal deposits were probably about 200-200 and something basis points. Given that now our rating has relatively improved, and that we have additional schemes as we have discussed previously, it is likely that on the margin we skew our portfolio a little bit less towards deposits and a bit more towards lending given the Funding for Lending scheme. But overall this is a marginal thing and the main take you can I think, you should, take is customers', given the financial markets conditions in the first half, have preferred deposits to investment products and that has an impact in OOI and benefits NII, because our wholesale funding costs were higher. So we just accepted what the clients want and as times move depending on customers preference probably they will go back to OOI, which will also I think will be enhanced by the fact that the Retail Distribution Review is putting the market a bit on hold because there is uncertainty and therefore when it is implemented in January 2013, you should see a more natural behaviour depending on the clients' response to the Distribution Review.

Question 13: Peter Toeman - HSBC

Peter Toeman from HSBC. I wanted to come onto your statement about dividend. Are you sort of signalling here that FSA or other regulators might preclude you from making a dividend payment until your Basel 3 fully loaded number gets to say 10 per cent or is there some other thinking here?

Answer: António Horta-Osório

No and I haven't yet commented on dividends, so it was difficult to have hinted anything. What I said in Q1 was, I told you in Q1 that when we knew the White Paper contents in terms of the ICB and the draft Basel 3 paper on CRD4 rules, we would give you what we thought was likely path to dividends. We now have the White Paper of the ICB which does not present any significant differences to what we thought but unfortunately as you know the CRD consultation paper was delayed to September so we think we will only be able to give you that path in Quarter 3, that is the Q3 IMS. In any case as I said in Q1 IMS, we are following a capital maximisation strategy which is based on lower non core in a capital accretive way and lower costs and lower impairments on the core book. So whatever will be the content of the CRD4 paper, we would not change our strategic direction because we are maximising capital as much as we can and in spite of the one off hits that we have, we have been generating between 20-30 basis points of core tier 1 capital per quarter. In January 2011, this bank was 10.2 per cent and now it is 11.3 per cent so we are 110 basis points higher with a PPI hit of £4.3 billion. So we are maximising capital generation, we think the core book is very powerful as we told you. Key leading retail brands, leaders in their markets, totally segmented. We are achieving a leading position in costs where we will achieve the key competitive advantage which as I said now for many years is what retail in the UK should do. UK retail banks have never been very focused on costs. Especially now in a low interest rate environment, in a high regulatory cost environment, and difficult economic circumstances I think costs are even more key. As we get to a cost leadership position we will grow in offering our customers more value for money and as we offer them more value for money, those segments as I mentioned before, where we are subscale, will increase as they bank more with us especially in OOI, and this will become a virtuous circle whereby we will then in the future have flat costs and start to increase it. And so I think we are absolutely in the right strategy and the only reason why I don't tell you more about the path is because we do not know the content of the CRD4 paper, but the capital maximisation part of the strategy is absolutely clear.

More questions? No. Well if we don't have more questions, thanks for a very lively debate. Thank you very much for coming in spite of the torch relay and speak to you soon. Thank you.

End of Q&A