LLOYDS BANKING GROUP PLC – 2014 HALF-YEAR RESULTS PRESENTATION

THURSDAY 31 JULY 2014

António Horta-Osório, Group Chief Executive

Good morning everyone, it is good to see so many here so close to August. Welcome, and thank you for joining us for our 2014 half year results. George will shortly present the financial results in detail, and we've then set aside some time for Q and A as well.

I will start with the key strategic and financial highlights in 2014 so far, describing the progress we've made on our strategy to be the best bank for customers.

We continue to successfully execute our strategy to deliver a low risk, highly efficient UK retail and commercial bank, focused on our customers' needs, and on supporting the UK economic recovery, which continues to accelerate.

Our strategy of putting our customers at the heart of our business has resulted in lending growth in all of our key customer segments, and ahead of the markets in SMEs, mid-market Corporates and Consumer Finance.

Similarly, deposits have grown 3 per cent over the last 12 months, where we have focused on growing our relationship brands at least in line with the market. I will come back to lending and deposit growth shortly.

Our UK focused, low risk approach is embodied in our Helping Britain Prosper plan which we launched in the first quarter. We are the first UK bank to launch a plan like this and it directly supports our business strategy. This simple, but ambitious plan, sets out our seven long term commitments and aspirations to help our customers and their communities to prosper.

We are also continuing to deliver benefits for our customers through our Simplification programme, and at the same time, further improving our efficiency. Our cost to income ratio, already the lowest in the sector, reduced further to 50.5 per cent in the first half, and we remain firmly on target to meet our full year guidance.

Achieving consistently low costs is one of the key elements of our competitive positioning. It ensures that we can offer better value for our customers and at the same time better returns for our shareholders.

Moreover, it is, in my opinion, the only consistent approach to the recent regulatory trends and a low interest rate environment.

In the first half, we have also continued to make progress in the reshaping of the Group, and on improving the strength of the balance sheet. We now have more than 95 per cent of our assets in the UK, have reduced our run-off portfolio by a further £8 billion, in a capital accretive way, and have further increased the coverage of our NPLs.

We also executed the TSB IPO in June which was very well received as you know, meeting another milestone in our strategic plan. We were able to increase the size of the offering to 38.5 per cent of TSB shares, from the originally expected 25 per cent, as a result of strong demand from both retail and institutional investors. We were also very pleased with the quality of the investor base and that the price went up by around 10 per cent in the after-market and has kept to those levels.

In terms of the strength of the balance sheet, our Common Equity Tier One Capital Ratio increased to 11.1 per cent at the first half. This is up by 40 basis points since the end of quarter 1 and by 80 basis points since the end of 2013. This increase has been driven mainly by improved underlying profitability and a reduction in the Group's risk weighted assets, in spite of charges for remaining legacy issues and for our AT1 exchange offer. This exchange offer, however, contributed to the improvement on our leverage ratio, which now stands at a strong 4.5 per cent.

Underlying profit in the first half was £3.8 billion, an increase of 32 per cent compared to the first half of 2013, and up 58 per cent excluding the effects of St James's Place which we had last year, driven by progress on all the lines of the profit and loss account: revenue, costs and impairments.

We have delivered a statutory profit of £863 million, after making provisions for further legacy charges of £1.1 billion, mainly for PPI, which George will cover shortly, and the LIBOR and repo rate issues we announced earlier this week. These issues were extremely disappointing and I re-iterate that the management team and the Board are absolutely determined to make Lloyds an organisation of the highest integrity and standards.

In summary, the Group has had a strong first half at the same time as continuing to resolve the remaining legacy issues. We are supporting, and benefiting from the acceleration of the UK economic recovery, and are well placed to continue to make further progress in the remainder of 2014 and beyond.

Turning now to an overview of our financial performance:

The increase in underlying profit to £3.8 billion was supported by loan growth in our key customer segments, and by an expansion in net interest margin, which increased by 39 basis points to 2.40 per cent. As a result, net interest income grew by 12 per cent, driving income growth, excluding St James Place, of 4 per cent.

At the same time, costs reduced by a further 6 per cent year on year, excluding charges for FSCS, as we further simplified the business. Impairments also fell sharply, by 58 per cent, as we continued to de-risk the balance sheet and economic conditions continued to strengthen.

The improved profitability, together with a reduction in run-off assets, drove an increase in the Group's return on Risk Weighted Assets to 2.90 per cent, an improvement of 95 basis points on H1 2013.

George will take you through the details of the balance sheet shortly. Our underlying profitability was the primary driver behind the improvement in our fully loaded capital ratio to 11.1 per cent. We also saw an increase in the Basel III leverage ratio by 70 basis points to 4.5 per cent in the half year, driven again by underlying profitability, as well as the issuance of new AT1 securities we undertook in April as I mentioned at the beginning.

Our total capital ratio is now circa 20 per cent, in line with what we expect will be the total capital requirements set by the regulators.

Turning now to look at the UK economy.

I have said many times that a strong economy requires a strong banking sector, in the same way as a strong banking sector requires a healthy economy. We are the largest retail and commercial bank in the country, and therefore our future and the prosperity of the UK economy are inextricably linked. Therefore, we have a special responsibility to help Britain and its communities to prosper.

In terms of the UK's economic performance, GDP is now growing robustly and unemployment is falling, and as a result there has been an increase in both consumer and business confidence.

The UK housing market has improved across the UK, with year on year price increases of nearly 9 per cent in the last 12 months, indicating increasing confidence in the housing market.

While we are still in the early days of the Mortgage Market Review, we can see that both regulators and lenders are taking steps to ensure that the current affordability levels do not become stressed when base rates rise in the future.

The growth in the economy and the increase in employment, together with an increase in disposable incomes, are having a positive effect on our key markets. We are starting to see an increase in volumes, a greater demand for credit and also increased confidence and business investments.

I will now look at this in greater depth.

In the first half of 2014, we grew our net lending in mortgages by 2 per cent year on year, in line with the market. Our gross new mortgage lending was £20 billion, an increase of 40 per cent versus the first half of 2013 and we continued to support first time buyers, lending around one third of this amount to these customers.

For SMEs, which are a key driver of employment and economic growth, we have grown net lending 5 per cent in the last twelve months, compared to a market that has contracted by 3 per cent, while in Mid-Markets, we have continued to gain share in a market that has contracted, by around 3 per cent as well.

Regarding SMEs, we have now grown for more than three consecutive years, increasing our net lending by over 15 per cent in the period, when the markets in the same period has contracted by more than 10 per cent.

In Global Corporates, lending was up 3 per cent year on year, although it fell in the first half, mainly as a result of a small number of large repayments in the first quarter and our selective participation strategy, given a decrease in margins in this segment.

I was pleased to see that growth in our newly formed Consumer Finance business accelerated strongly, as we targeted, with UK assets increasing by 11 per cent year on year, and an annualised 16 per cent increase over the last six months, driven by strong growth in Motor Finance.

In summary, on lending, at the Group level, if you exclude run-off and Global Corporates, which we don't target in terms of net lending, we grew our net lending by 1 per cent in the first half so a 2 per cent annualised growth rate. In the context of a recovering economy where the demand for credit lags GDP growth, this is above the market and is confirmation of our determination to support our customers and the UK economy. I see this growth accelerating in the future; as the economy continues to strengthen.

On the liability side, in Retail, our multi brand approach has continued to deliver, with deposits increasing in all of our relationship brands, notably in Lloyds Bank and in Halifax.

We also saw strong growth in the deposits we gather through our Transaction Banking platform in the Commercial division, which we have increased 11 per cent thanks to the technology investment we have made in this area.

As we have substantially completed the reshaping of the balance sheet, we are increasingly de-emphasising the use of some of our tactical brands and our international on-line deposit business, while keeping our loans and deposits growing in a synchronised way. This in turn supports stronger returns given the corresponding additional reduction in our cost of funds through mix, on top of the on-going reduction given our ratings upgrade and lower Credit Default Swaps level in the market place.

Let me now make some comments on performance at the Divisional level.

In Retail, underlying profits increased by 32 per cent, mainly driven by impairments reductions. Supporting first time buyers with appropriate mortgages, and providing banking services to start up small businesses are key commitments of our Helping Britain Prosper plan. In the first half of 2014, we delivered on these commitments, supporting over 40,000 first time buyers and 52,000 business start ups, as well as launching innovative new products such as our Club Lloyds current account.

We also undertook a significant re-segmentation that involved moving our small business customers (with sales up to £1 million) into the retail network. This will enable those customers to receive greater focus from the bank, and a corresponding better service and products that better meet their needs. This should see Lloyds gaining market share in the segment going forward.

Commercial Banking profitability and returns have improved significantly driven by a very strong impairment performance. This shows the underlying strength of the Commercial division's income generation in the face of quite adverse market conditions, which shows the adequacy of our customer focused strategy. Profits grew by 35 per cent and the return on risk weighted assets increased to 1.96 per cent, getting close to our 2015 target of returns of over 2 per cent.

There was a resilient performance in the Insurance business which has been affected by significant legislative and regulatory change and also by higher than expected weather related claims in the first quarter.

We continue to focus on leveraging the benefits of Insurance as part of the wider group. We are seeing growing operational benefits, which resulted in a further 2 per cent reduction in costs, and also in terms of capital and balance sheet efficiency, which has enabled Insurance to pay dividends to the Group of £0.7 billion in the first half.

Our newly formed Consumer Finance Division made an excellent start in the first half. We increased UK loans by 11 per cent and underlying profit increased by 5 per cent. In credit cards, where we are investing heavily, we saw a 5 per cent increase in new accounts and an 11 per cent increase in balance transfers.

In Asset Finance, where we are reaping the rewards of the restructuring we have done since 2011, there has been very strong growth, with Lex Autolease seeing a 17 per cent growth in fleet deliveries, while Black Horse increased new business by 70 per cent, both areas increasing their market shares in growing markets.

And with that, let me now hand over to George for a more detailed look at our financial performance.

George Culmer, Chief Financial Officer

Thank you António and good morning everyone. I will give my usual overview of the financial performance and position of the business.

Beginning with the P&L.

As you've just heard, we've made further significant progress on our strategy in the first six months and this is reflected in the Group's financial performance.

Underlying profit increased 32 per cent to £3.8 billion, with the movement in total income more than offset by a 6 per cent reduction in underlying costs, excluding FSCS timing effects, and a 58 per cent improvement in impairments.

Excluding SJP from last year's numbers, income was up 4 per cent while underlying profit was up 58 per cent, with underlying jaws a positive 8 per cent.

Statutory profit before tax for the Group was £863 million and includes simplification costs, TSB build and dual-running costs, as well as legacy and other items such as the ECN exchange that were flagged at Q1.

Statutory profit after tax was £699 million, with the effective tax rate of 19 per cent largely reflecting the impact of tax exempt disposals, predominantly SWIP, in the first quarter.

Looking at the P&L in more detail and starting with net interest income, NII was up 12 per cent on prior year at £5.8 billion. As in the first quarter, this was driven by better deposit pricing, lower wholesale funding costs, and loan growth in key segments, partly offset by expected asset pricing headwinds and run off reductions. In Q2, we also had the accounting benefit of the ECN exchange, which boosted income by around £100 million in the quarter.

The net interest margin for the first half of 2.40 per cent is 39 basis points higher than the first half of 2013 and 17 basis points higher than the second six months. In the second quarter the margin strengthened to 2.48 per cent, mainly due to a 10 basis point benefit from the ECN exchanges.

Looking forward, we would expect the margin to stabilise at around the second quarter level for the remaining 6 months of the year, giving us an expected full year net interest margin of around 2.45 per cent. This is obviously a further improvement from the revised guidance of 2.40 per cent that we gave at Q1.

Turning to other income.

The operating environment for other income remains challenging, but in the second quarter we've seen a stabilisation, with Q2 marginally ahead of Q1 at £1.7 billion, bringing the six month total for other income to £3.4 billion.

As we set out at Q1, other income has been affected by disposals, the challenging Financial and Capital Markets operating environments in Commercial Banking, and the impact of regulatory changes in our key businesses, particularly in Insurance, where we have also seen higher weather claims.

Looking forward, disposals will have less of an impact, and with our underlying businesses continuing to perform resiliently, we would expect the quarterly total for other income to be close to the Q2 level.

Turning to costs.

Costs totalled £4.7 billion in the first half. This is 2 per cent lower than last year and 6 per cent lower excluding FSCS costs, which were recognised in the first half of this year, as opposed to the second half in previous years.

Our market-leading cost:income ratio now stands at 50.5 per cent: 2.2 percentage points better than a year ago after adjusting for SJP.

Disposals and run-off accounted for £254 million of the year on year cost reduction, while Simplification delivered further incremental savings of £235 million.

Simplification has now achieved annual run-rate savings of £1.8 billion and we remain on track to achieve our target of £2 billion of run-rate cost savings by the end of the year.

Included within the £4.7 billion of costs is £0.2 billion of TSB's cost base, giving us Group costs of £4.5 billion for the first six months. And we therefore remain on target to deliver a full year 2014 cost base excluding TSB of around £9 billion.

On impairments, we've seen a further 58 per cent reduction in the impairment charge in the first half to £758 million, with the AQR improving significantly to 30 basis points compared to 69 and 45 basis points in the first and second half of 2013 respectively.

Impairments reduced in every division, and continued to benefit from better credit quality, improving economic conditions, provision releases and the reductions in the run-off portfolio.

As a result of the better than expected trends across our portfolios, we are revising our full year guidance. We now expect the AQR for full year to be around 35 basis points: Again a further improvement from the revised guidance of around 45 that we gave at Q1.

In terms of impaired loans and coverage, the quality of the Group's loan portfolio continues to improve. Impaired loans now stand at 5.0 per cent of total advances. This compares to 6.3 per cent in December and 8.6 per cent at the end of 2012, with the reduction reflecting disposals and reductions from the core business and run-off portfolio.

At the same time, we have also seen an improvement in coverage, with the coverage ratio increasing to 54 per cent from 50 per cent at the 2013 year end and from 48 per cent at the end of 2012.

Looking at underlying profitability at a divisional level: we've driven strong increases in Retail, Commercial and Consumer Finance, as well as improvements in Run-off, due to lower impairments, and other items.

In Retail, we continue to deliver strong profits and returns, with the 32 per cent increase in underlying profit reflecting net interest income, which was up 15 per cent, as well as a 40 per cent reduction in impairments. Reported costs were 10 per cent higher than last year but this is largely due to the accelerated timing of FSCS costs and the reallocation of the support costs previously charged to TSB.

In Commercial, the 35 per cent improvement in underlying profit is a very strong performance in tough market conditions. Underlying profit benefitted from a very significant reduction in impairments, while income was 3 per cent higher, with other income more than offset by an increase in net interest income.

Consumer Finance also benefited from reduced impairment charges, as well as higher income from Asset Finance, and these more than offset the increased investment in the business and were the key drivers of the 5 per cent increase in underlying profit.

Insurance, as you know, was impacted by one-off charges and adverse weather, with underlying profit down by 18 per cent. Most of these one-offs were, however, Q1 items, and the Q2 result of £323 million is more than double the profits delivered in the first three months.

Finally, TSB saw a significant improvement in reported performance, this is largely due to the reallocation of the support costs I just mentioned. TSB is reported within our results on a standalone basis with its ongoing direct costs included in underlying profits and dual-running costs shown below the line.

Set out here is the usual reconciliation from underlying to statutory profit.

The £857 million charge in asset sales and volatile items mostly comprises the £1.1 billion relating to the ECN exchange, as well as the fair value unwind charge. These are partly offset by a credit from the changes to our defined benefit pension scheme and gains on disposals.

As you will recall, the gain in 2013 of £793 million was dominated by gains on sales of government bonds. There have been no such sales in 2014.

On Simplification, we expensed £519 million in the first half. This brings total programme costs to date to £2.2 billion, out of an estimated total cost of around £2.4 billion that will be expensed by the time the programme concludes at end of this year.

TSB costs in the half amounted to £309 million and comprised build costs of £171 million and dual-running costs of £138 million, again bringing the total incurred to date to £1.8 billion. These dual-running costs will continue to be shown outside of underlying profit until we deconsolidate TSB.

Legacy charges totalled £1.1 billion and included a further £600 million for PPI, £226 million for the LIBOR and BBA Repo settlements announced earlier this week, just over £200 million for retail conduct provisions, and £50 million for interest rate hedging product sales.

Finally, the tax charge in the half was £164 million, with, as previously mentioned, the 19 per cent effective rate mostly reflecting tax-exempt gains on disposals.

For the full year, I expect a number of those items which impacted statutory profit in the first six months to either not be repeated or to reduce in the second half. Given our continued strong underlying profitability, and in contrast to the last couple of years, I therefore expect full year statutory profit before tax to be significantly ahead of the first half's total.

On PPI, as just mentioned, we have increased our provision by £600 million to reflect an upward revision in expected claims volumes as well as additional PBR and related costs.

Customer-initiated claims volumes were down in the second quarter, with the average of 39,000 per month in Q2, 7 per cent lower than Q1 and 27 per cent lower than the second quarter of 2013. Claims volumes are, however, still slightly higher than previously forecast and around two thirds of the increase in the provision relates to higher expected future volumes and associated expenses.

On the PBR, we have now substantially completed the proactive mailings relating to 2.8 million PPI policies where we have identified a potential risk of mis-sale, with over 95 per cent of all PBR customers mailed. While response rates from most cohorts are in line with expectations, certain asset finance rates are running ahead and we are also seeing a higher number of policies per customer than expected.

In terms of overall cash spend, this continues to run at about £200 million per month. Of the three key elements of spend, I'd expect PBR costs to be substantially complete in the first quarter of next year and remediation in the first half. Ongoing costs at that point will overwhelmingly relate to reactive complaints and I would therefore expect the cash outflow to be significantly less than the current level.

Turning to the balance sheet.

Our strong balance sheet position and key ratios continue to improve. Over the first half, we generated some £19 billion of funds, led by an £8 billion reduction in the run-off portfolio and deposit growth of £7 billion, which have driven a further reduction in the Group's loan to deposit ratio to 109 per cent.

The £8 billion reduction in the Run-off portfolio is well-ahead of the run-rate to hit our original full-year guidance of £23 billion, and we now expect the portfolio to be below £20 billion at the end of the year.

Elsewhere on the balance sheet, equity increased by 17 per cent, driven by underlying profits and the issue of over £5 billion of AT1 securities as part of the ECN exchange.

Underlying profits also contributed to the 2 per cent increase in TNAV to 49.4 pence, while the reduction in TNAV during the second quarter primarily reflected legacy items and the charges relating to the ECNs.

And finally, RWAs on a fully-loaded basis reduced by 6 per cent to £257 billion as we continue to implement our low risk strategy and de-risk the balance sheet.

This 6 per cent reduction takes the total decrease in RWAs over the last three years to 33 per cent, reflecting the progress we have made in de-risking the balance sheet and in particular the reduction in non-core and run off assets.

Finally, looking at capital and leverage.

As you heard, our fully-loaded common equity tier 1 position increased to 11.1 per cent from 10.7 per cent at Q1 and 10.3 per cent at the year end. This increase is obviously after the £1.1 billion of net charges relating to the ECN exchange as well as PPI and other legacy charges, and has again been driven by underlying profits, the dividends received from Insurance, and the reduction in risk-weighted assets.

On leverage, we remain in a strong position and have increased our ratio on a Basel III basis to 4.5 percent from 3.8 per cent at the start of the year, including a 50 basis point benefit from our AT1 issuance adding to the positive effect of strong underlying profitability. The continued strengthening of our key capital and leverage ratios are clear evidence of the successful execution of our low-risk strategy and the capital generative nature of our business.

That concludes my review and I would now like to hand back over to António.

António Horta-Osório, Group Chief Executive

Thank you George. In summary, our three year strategic plan as set out in June 2011, has now been substantially delivered. We have strengthened the balance sheet, re-shaped and simplified the organisation, and stepped up the investment in new and improved products and services for customers by re-investing more than one third of our Simplification Programme's cost savings.

At the same time we have addressed head-on and sought to resolve our legacy issues. This week's extremely disappointing announcement on past behaviour demonstrates that we absolutely took the right decision to re-focus the Group on becoming a low risk UK Retail and Commercial Bank, focused on the customer and ensuring we operate to the highest standards. It is that strategy which will ensure that we don't have issues in the future like the past cases we are dealing with.

By seeking to place customers at the heart of everything we do, having a low risk culture and prudent risk appetite and by achieving a leading cost position, we have been able to grow income, restore profitability and improve returns. We have continued to grow lending in each of our key customer segments and further strengthened our capital position. I believe the increase in underlying profit and returns in the first half of 2014 clearly demonstrates the strength of our chosen business model.

Before I finish, I think it is worth touching upon the regulatory environment in which the Group operates. As well as the PRA stress tests announced in April, the Bank of England has recently issued a consultation paper, focused on bank leverage. Lloyds is very well placed regarding this indicator, with a leverage ratio of 4.5 per cent versus a current minimum of 3 per cent.

We also continue to work with the relevant authorities on the evolution of regulation in relation to ring-fencing. Given that we are now predominately a UK focused, retail and commercial bank, we anticipate that the vast majority of our business will be within the ring-fence, therefore not anticipating any shift or uncertainties in relation to our strategic direction.

It is clear to me that the regulatory environment in which banks exist has changed I would say 'forever'. I strongly believe that our strategy and business model ensure that we are very well positioned to respond to this new regulatory environment.

As a result of the progress we have made on our strategy and the consequent improvement in our performance, the UK government, in March of this year, was able to continue the process of returning Lloyds to full private ownership at a price of 75.5 pence, with its shareholding now reduced to 24.9 per cent.

And, we are increasingly well positioned to continue to support and benefit from the accelerating UK economic recovery and I am confident in the delivery of strong and stable returns to shareholders as a consequence of the strategic decisions we took in 2011, and of their successful and timely implementation.

Consequently, I can confirm, as previously stated, that we will be applying to the PRA in the second half of the year, seeking approval to resume dividend payments, starting at a modest level.

Also looking forward, with many of the targets we set for our organisation in 2011 already achieved, we have been looking at how we will take the Group into 2015 and beyond. These plans are well developed and we intend to share them with you in the autumn.

Thank you, this concludes our presentation. We would now like to take any questions you may have.

End of Presentation

Question and Answer Session

Question 1: Raul Sinha, JP Morgan Cazenove

Morning gentleman, it's Raul Sinha from JP Morgan Cazenove. I got the mic first, so I will go first. Can I have two please. Firstly on capital. You are now at 11.1 per cent on Basel 3 core tier one and clearly based on what you are flagging for the second half of the year, this is going to continue to build pretty strongly. In the past you have talked about 11 per cent being sort of broadly the right level for you. So I was just wondering if you can talk about what you plan to do with the bucket loads of excess capital that you will have? That would be helpful.

And then secondly, Antonio if I could just clarify, does the dividend payment, is the dividend payment subject to the stress test or is that a conversation that is separate with the PRA? Thanks.

Answer: George Culmer

Shall I go first I may touch on some of that second question as well. Yes we did, we said that based on our own bottom up analysis that we think a requirement of around 11 per cent on the steady state basis was the number we should be shooting for and that remains the position. You know around there are still some uncertainties out there. Steady state, I think as I said before, if you struck the number today you would have a slightly higher number because there is some de-risking and things like the pension scheme that we were well under way. We just want to complete that and get credit for that and similarly it won't surprise you to know that when I look under stress conditions for PPI, I have to hold some capital for that. But I will journey through that, I will get through that and we think around 11 is still about the right number to talk about.

In terms of where we go and in terms of discussions to come, obviously the discussion with PRA when we talk about dividend, they will look at a number of things. They will look at statutory profit, they will look at capital position and capital generation. And I think they will also look, well they will also look at your second point about stress tests in terms of our resilience. What I think these first half numbers demonstrate is that we go into those discussions in a good position. You know we have generated a statutory profit as I said in the presentation, and as you picked up on, I expect statutory profits for the full year to be significantly in excess of the half year position and I would accordingly expect the capital position to continue to improve. And on the stress test I suppose, we submitted our numbers on 15 July and we feel in a good position in terms of the data that we submitted.

So I go into those discussions with confidence, I think they reflect the Bank in a good position and good capital generative. You know we await the outcome and we will see how those conversations develop, but we go in, in a good position.

Question 2: Tom Rayner, Exane BNP Paribas

Good morning, it's Tom Rayner from Exane BNP Paribas. Could I have a couple of questions on your guidance please, just on the AQR of 35 basis points obviously implies a pick up in the second half so just to get a feel for whether the second half is the sort of base to move forward from?

And on the stable margin in the second half, really why do you think it is going to be stable and on slide 9 if you focus on that sort of left hand chart maybe you could explain in line with the different drivers because it certainly looks as if a further margin improvement would flow through naturally into the second half, but I wonder if you could comment on both of those please?

Answer: George Culmer

You are right, when you look at the margin evolution Tom over the last few quarters, we came in what it was, Q4 to 228, 229, 232 in Q1, 248 in Q2. Within that 248 there is about 10 basis points of ECN pickups. So if I strip that out, 5 or 6 basis points which we have seen in the last couple of quarters. It is a similar thing Q2 to Q1 as we saw Q1 to sort of Q4 on the savings side I have got about 4 or 5 basis points of benefits coming through. And that is just shaving a few basis points here, whether it is on the fixed or whether it is on the instant access that we are benefitting from and that drives about 4 or 5 basis points. There is a bit of benefit from wholesale funding, but I am down in the 1 or 2 basis points and going against that I have got some asset pricing headwinds of one or two basis points. I think the guidance that we have given is appropriate. There may be some limited more upside in terms of liabilities. There is also in terms of where that asset pricing moves to there is the potential for that to pick up. The bank will naturally benefit as we continue to cleanse and run-off the things like the run-off book in terms of the overall margin. But we think the guidance accurately reflects what we are seeing on an underlying basis and some of the headwinds that might be out there.

Answer: Juan Colombás

Yes on the AQR, the trend is very positive compared with the previous year. Quarter one was 35, Quarter two is 26. So average over the year is in the first half is 30. And we are guiding for 35 for the year so it's 40 in the second half. The reason for that is that even though we are seeing very improving trends in all the portfolios in mortgages, in Commercial and the run-off is

decreasing the weight of it and also the impairment charge is lowering. So what we are, I mean, we prefer to be a bit cautious because some of the improvement is due to the write-backs and releases that we are seeing so the write-back in the first half has been £500 million which is a bit lower than in the second half of last year, kind of £700 million. And it is mainly because of the run-off contribution to the write-backs is lower because the portfolio is lower and the reaction is lower. So this combination of improving trends with the lower write-backs, we would prefer to be cautious to see what is the final number in write-backs in the second half. The portfolios in itself are performing very well. You see the impaired loan ratio continue to improve and it has been from 6.3 as George has said from 6.3 to 5, which is a very good indication that all the things are going in the right direction and we are not seeing anything to change the trend, just a cautious view.

Further question

The coverage ratio, the increase we have seen is that mechanical, just driven by mix or is there any sort of decision there to increase the coverage?

Answer: Juan Colombás

It is a combination of things, so it is partly because we are decreasing the impaired loans and therefore some of the provisions we have in IBNR the weight of IBNR in impaired loan increases. And some of the things are of course mix as well. But I think it is a good reflection that the improvements in the AQR is not a consequence of releases and de-releases of provisions in the balance sheet.

Further answer: António Horta-Osório

And just one point Tom, which I think is quite important within this competitive advantage that we are trying to build both in terms of a low risk strategy, low cost of equity and a superior cost to income position. On your question about margin, and I have said this in several times in different occasions we have been here together, I think it is important to mention that this is part of a deliberate build-up over time of what I think is a competitive advantage in the way we manage our multi-brands, multi-channel approach in terms of pricing. Because as I have said to many of you individually, we do this on a weekly basis, we manage not each of them separately assets and liabilities, but we manage them together and what we really focus on is having a core loan to deposit ratio of 100 per cent, what we really focus on is on the difference of the two. We manage them on a weekly basis at the highest level of the organisation. And the fact that we have multi-brands and multi-channel simultaneous approach enables us to serve customers better according to their differentiated needs and this is especially relevant as I have said many times in a low interest rate environment. Manus please, I see that you are eager to jump in.

Question 3: Manus Costello, Autonomous

Thank you very much. It is Manus Costello from Autonomous. I had a couple of questions please. Antonio you mentioned the growth of your international online deposit base, I wondered if you could update us on what size the German deposit base is at the moment and whether you have any indications of what you might do with that, would you think about growing international assets particularly in Consumer Finance, might be an interesting growth area internationally I wondered?

And secondly, I think for George, a question not so much on NIM as on the interest earning assets. I get very confused exactly how you calculate your interest earning assets. Because if I look at your gross loan balance in the first half, it averaged £508 billion but your interest earning assets were only £489 billion and I would have imagined they would have been higher especially given that you have got £50 billion of liquid assets which should come into there? And the reason I ask is just for us from a forecasting perspective, we are trying to work out when interest earning assets are going to go up. And it is very difficult to do that if we don't know how they are calculated.

Answer: António Horta-Osório

That is a fair question. I think I will give some time for George to think about that while I answer your first question. And look, on the first question maybe you did not get exactly what I said on the presentation. We are not increasing the online deposit business, we are shrinking it. What I tried to mention in my speech was, given that we have as you know, for some time 100 per cent old core loan to deposit ratio, as the non-core decreases eventually to zero, the Group loan to deposit ratio which is now 109 will turn to 100 per cent. In that context we have clear objectives because we take a customer approach on market share of deposits on our franchise brands. So Lloyds, Bank of Scotland and Halifax and these have been growing and again in the first half above the market. And we manage all of our tactical brands and non franchise deposits for value. In that context we have decreased the value of our online deposit in Germany, which are now around £17.5 billion. They have decreased slightly in the first half by about 10 per cent more or less. And that enables us given that internet deposits are you know are absolutely much more price sensitive from a customer perspective that enables us as I said on my speech to have two effects in terms of lowering our funding costs. We have effects through mix, like on online deposits or on non franchise brands like Birmingham Midshires or Scottish Widows Bank to give you an example. On top of the normal funding cost reduction that we are experiencing from the fact that we have been upgraded in terms of ratings, we have a much better credit default swap level and

overall funding costs in the market are going down. So we are decreasing online deposits in Germany and we don't have any intention of increasing international assets on the other side so to leave that clear. And now I think George will be able to tell you on the second part.

Answer: George Culmer
Thanks for the long answer. It didn't help! Let's see if we can be more helpful after this in terms of the calculation, the different trends and will try and come back and be more helpful.

Further question
More generally then, when are interest earning assets going to start going up?

Answer: António Horta-Osório
Manus I think apart from the technical point, strategically I think you should think about the following. We have as I said on Q1 results, to clarify that out, we have a closed book of mortgages which is now part of our normal bank because they are our customers. They have our current accounts, and they have our credit cards, we see this on a customer approach. So we moved as you know our old self certified book into the normal bank, it is seasoning very well, it is performing well, there are no issues with the book. But that book is a closed book in the sense that we don't do it for several years now, self certified mortgages. So you have to consider in terms of your calculation that that closed book is shrinking as it matures over time. The rest of our mortgages will grow in net terms as I have said many times, and since September 2013 now with the market so we grew them by 2 per cent in the first half and you should expect our mortgages in net terms to continue to grow with the market.

The second point is as I also mentioned in my speech, the large corporates. We never targeted large corporate growth because that is not in our point a strategic key success factor. What we target in large corporate in the Commercial division is the client's share of wallet which may be a loan or it may be a debt capital markets issue. And in this quarter both through much better conditions in that capital markets with lower interest rates as you know, and also because we had some large repayments in quarter one, large corporates went down. I cannot tell you how large corporates will evolve in the future because as I tell you, we don't target it but I would assume that with more erratic behaviour they will have a normal evolution of return. The remaining of the segment, so SMEs will continue to grow at 5 per cent. Mid Markets should increase its growth rate to around 3 per cent in H2 as I said at Q1 as well. And our Consumer Finance division building on the extraordinary year that the UK economy is having on car sales was at 9 per cent overall in quarter one, is now at 11 per cent. The six month annualised rate is 16 per cent. So you should expect to see this accelerating.

The final point and I am sorry about the long answer, but the final point is the remaining non-core assets which we said would be around £23 billion at year end and given the excellent performance in H1, will now be lower than £20 billion in H2 and you can model whatever you think is that consequence. So I would expect as I said in my speech, that our key customer segments, so SMEs, Mid Markets, mortgages and Consumer Finance which are growing at an annualised rate of 2 per cent, to increase this growth rate and to ultimately be the growth rate of the bank in the future, as large corporates it is probably even over time and the non-core book disappears.

<u>Question 4: Andrew Coombs, Citi</u>
Good morning, it's Andrew Coombs from Citi. Three questions from me please. Just firstly, you mentioned that you were happy with your total capital ratio. You said you thought the Regulator would end up around 20 per cent. So implies you are happy with your levels of AT1 and Tier 2 outstanding. Perhaps you could comment on the GLAC proposals and what that means for your senior debt that you need to hold on top of the AT1 and Tier 2?

Second question would then be on the Club Lloyds PCA. Clearly it is quite an attractive headline level 4 per cent on up to a £5,000 balance, but perhaps you could give us an idea of how the average cost of that product compares to your existing deposit balance?

And then the final question would just be on the Consumer Finance division. Thank you for breaking that out and as you referred to very strong growth there in the loan balance, but it does seem to have come at a bit of a cost. The NIM is down 15 basis points in that division half on half. So just interested to know what you are seeing there in terms of pricing and also if it is a volume led strategy over margin strategy there at the moment? Thank you.

Answer: António Horta-Osório
OK, thanks a lot for your three questions. I think George will take the first one and I will take the second and third.

Answer: George Culmer

Yes on the total capital, yeah we do think first to start off with that we are in a good position and have a total capital ratio of around about the 20 per cent as Antonio mentioned. In terms of where that finally ends up in terms of what is decided in Australia etc later on this year we watch with interest. But we do start from a good place. In terms of composition, yeah we have a number of options from that and whether we end up having to hold senior with the ability to bail in or whether we just stick with sub, those are all questions for the future. What also something you will look at, obviously is the point of entry into the bank and again what time period one has got to actually be able to move that debt to the PRAs preferred entry point which is likely to be a single entry for us. So I am not going to give you anything particular about what I expect to see in terms of senior or sub composition of that tower. We are in a good space in terms of total. From an optimum perspective we will to have to do some reorientating of that debt as we move to the to the PRA's preferred source of issuance, but I see that all as perfectly reasonable within BAU over the next couple of years.

Answer: António Horta-Osório

Okay on questions two and three, relating to Club Lloyds which we are really very excited about because it is going very well both for new and for existing customers. I think you should see Club Lloyds in the context of a segmentation strategy so throughout the Lloyds brand we are now segmenting and Club Lloyds is a loyalty product driven at our top customers both in terms of mass affluent and wealth and we launched it around two or three months ago so it is very early days for me to tell you about the costs and the implications which we can discuss at later updates. But as you know and I have mentioned that to Tom, we are very, very careful and I really think it is competitive advantage of us on the way we manage pricing in this overall multi brand and multi channel strategy. So I think this product is being very well received in terms of loyalty from our existing top customers. You should see it on a segmentation context. It is going very well, it is early days.

On the Consumer Finance division question, we are not following at all a volume led strategy. We always have into consideration as in any other division, ultimately return on equity. And what is happening in this division to give you a bit more colour are several different trends. We are increasing volumes very significantly in a growing market as I mentioned, but underlying you have two gains. You have the gain of dealerships and activity with if you want on a like for like, like you mentioned in retail organisations, in a like for like for food, like basis. But you also have a very important gain in the beginning of this year which will continue which was driven by the fact that we won an important dealership which was Jaguar Landrover. So you have both perimeter change if you want in that context. We won a very important brand and you have gains on the current dealerships. Point one.

Second point, you are correct as we showed on the numbers. That the margin is trending downwards which I think is a function of the overall market's attitude in the last six to 12 month in terms of risk approach. As you know the market has been seeking yield and has been less concerned about risk so margins have been going down in general. In large corporates as I mentioned as well in terms of Manus' question, a bit as well in Consumer Finance, given this general approach. But we measure very clearly volumes versus margin. And the impact of the increase in volumes and market shares versus margins is clearly positive. We expect this to continue to be so, obviously depending on competitor behaviour which I cannot anticipate.

And the final point which is quite important is we have as I have said many times, by strategy a prudent risk appetite and when we see markets expanding very much we always will keep a prudent risk appetite so these are the three points which will be important to how we will react in the future.

Question 5: Chirantan Barua, Bernstein

Morning, this is Chira from Bernstein, two questions for you. One is if you could just walk us through the dependencies on the Scottish Referendum that is coming up in September for the business assets and liability side? That is number one.

Second, it would be great to get some colour on capital and financial markets, it still takes a significant amount of capital balance sheet and cost, right. How is it, the capital and financial market side of the business and the wholesale and the high end. So what kind of capital and balance sheet does it consume right now? You have highlighted it hasn't done well. And what are your plans in turning around that side of the business?

António Horta-Osório

George you take the first and I will take the second.

Answer: George Culmer

On Scotland I think, we have said previously and will say again it is a matter for the Scottish people and we will look with interest in terms of how they vote on 18th September with the outcome on the 19th. As a Bank we have looked at various contingency plans and we are sort of comfortable with those plans. Should the Scots vote 'yes' for separation etc, should the vote lead to

single currencies, out of EU etc, there will be disruption. But we feel comfortable in the sort of time period and the transitional arrangements that will be in place that we will be able to effect the necessary actions in a sort of ordered way. So it will be upheaval, there will be an element of disruption but we feel we will be able to manage with it.

Answer: António Horta-Osório
On your second question. We are at heart a retail and commercial bank and within the Commercial division as you correctly said we have a small activity of capital markets and financial markets which is basically orientated at serving our customers in terms of the needs they have on foreign exchange, in terms of debt capital markets, credit products etc. As you can see from the numbers we reported, this is small in the sense that our RWAs on the division continue to go down and this shows that the change in RWAs through the new methodology and new regulation that is impacting on wholesale and universal banks is not a factor for us because we really, number one, work on a customer approach. So we serve our customers in terms of their needs. In that sense we have some of these activities I told you, but quite small. And altogether and also because our large corporates have gone down in the half as I have previously answered, our RWAs on the division went down and will continue to be tightly monitored, that is why RWAs have improved so much and the division in very tight conditions in the market in terms of income as I said, is performing ahead of the plan in terms of the target that was set last year for a 2.0 per cent or above return on RWAs. We are now at 1.96 per cent in very difficult conditions on the markets and I am quite pleased as I said about the performance of the Commercial division.

Question 6: Claire Kane, RBC
Hi there it is Claire Kane from RBC. I have got three follow-up questions please. The first is relating to the capital composition. Can you give us an update on when you expect to find out about the eligibility on the residual ECNs and is it fair to assume that once you get the all clear that they are no longer recognised, you can redeem these and you would not need to issue any AT1 in their place?

Then my second question is on your guidance for capital generation. You previously said you thought you could do 2.5 percentage points through to the end of 2015 and you have done 0.8 so far, even with £3 billion of below the line items. So is it may be time to update the guidance on that?

And my final question really is on the provision coverage. I think we can see that there is high coverage ratios in Ireland, you have £6 billion of balance sheet provisions there. Can you talk us through the trends you are seeing and what the likelihood is for provision release in Ireland and can we maybe expect that you have to wait for those assets to be disposed of first? Thanks.

Answer: António Horta-Osório
Thank you Claire, so George will take the first two and Juan will answer the third one.

Answer: George Culmer
Hi Claire, so in terms of eligibility, we obviously have not seen anything that constitutes a capital disqualifying event, came close to it in terms of the stress test assumptions that came out, but that was not categoric. It is still our firm belief that it is likely that the ECNs will not apply as we move forward. I can't give you the date on which I expect that event to occur, but it is still my strong presumption that they will cease to apply. In terms of what we do with them at that point, I can confirm that I will not be moving them into AT1s, but in terms of whether there is redemption or move into some instrument, it goes back to the earlier question in terms of GLAC and total capital stack. They do count towards that overall 20 per cent and I would expect to be staying at around about that 20 per cent level. So if I was purely to redeem my ECN I'd drop down so it is more likely it is going to turn into something else, but it will not be AT1s.

On capital yes you are right, as you said, we previously disclosed that we thought that the capital generation would be about 2.5 per cent for this year and next year and then 1.5-2 per cent thereafter. And when we said the 2.5, we always said there are certainties when we look at that number and those certainties include things like strong underlying profit generation which we know is going to come through. When we gave that amount as well we also knew there was some uncertainties out there. Some of those have passed for example the capital cost of doing the ECN conversion, we knew that lay ahead of us. Some of them such as things like the TSB which actually when we come to deconsolidate the TSB we have to recognise some of the costs that we will be committed to as part of that, that will flow through. So that is an uncertainty. All that said, your basic maths is dead correct. We said 2.5, we are currently at a run rate of about 3. I am not going to change my 2.5 per cent guidance today, but what I will do is tell you I am pretty confident of beating it!

Answer: Juan Columbas

For Ireland, the way we are managing our provisions in Ireland is very similar to the rest of the portfolio, so you know we try to be conservative in the way we provision our portfolios and the write-backs that we have seen in the past is a consequence of it. And so it is not different. In Ireland we feel very comfortable in our situation there because the profit is £2 billion net in the wholesale and commercial book, and £5 billion in the mortgage book. You know the last year we sold portfolio in non-performing loans and mortgages and you asked the question about the releases. And we had some write-backs in this sale. But we prefer to be cautious on our forecast on Ireland. It is true that prices in Ireland are improving so the year on year house prices in Ireland at June was 12 per cent up and last year was 6 per cent in December. So the situation in Ireland is improving and we will see the result.

Question 7: Edward Firth, Macquarie

Good morning, it's Edward Firth here from Macquarie. I have got a couple of questions. I guess the first is back on the margin because I am quite struck by your reasonably optimistic outlook on that. And I guess if one looks at the broader context, we have got what now looks like a competition commission investigation into the SME market, we have got people looking at the personal current account market, the FCA are talking about pricing on savings, you have got quite a lot of new entrants coming in who are all talking about growing market share. So I am not so much talking about looking into this year, but as we look out into the next two or three years it seems to be there is a lot of reason why one might expect some of that pressure to come through in the overall margins. So just sort of some comment from you about how you think that is going to play out in terms of the business in the wider market over the next year or two?

And the second question is on the restructuring charges as a whole. Again I was struck listening to TSB this morning that they are talking about £79 million of profit and you are taking of £200 million and I can see where the difference is in terms of mathematically, but as we look into next year and this restructuring programme has finished, what sort of assurances can you give us that we are not going to just have a load more restructuring charges next year?

Answer: António Horta-Osório

George will take the second question, although I think we have already said publicly that below the line restructuring will finish this year, but George will elaborate on it.

On the first question, I don't think we gave any, I did not mention any optimistic guidance in terms of margin unless you find the 2.45 per cent optimistic. I basically elaborated on the loan growth but not exactly on margin. What I said is we have a competitive advantage on managing margin and that would happen either up or down. So competitive advantage versus the sector, but I was not trying to be optimistic. Unless I repeat, you consider 2.45 per cent optimistic, which as George says only implies that we keep margin where it is now.

I had said last year that as the Bank was turning into a growth phase, we would no longer, you should no longer expect significant margin uplifts as we were targeting market share growth in all divisions and I added that it is normally not a very good recipe to try to gain market share and margin at the same time. In spite of that and although we have been gaining market share in all the target segments as I described before, we have been able to increase margin more than we thought. And that is why we have upgraded the guidance from 2.28 per cent to 2.45 per cent.

In terms of your second part of the question, so how do I see it going forwards not for this year but for the following years? Although the more in the future we go, the more obviously obscure the situation will be because it depends exactly on, as you mentioned, competitive behaviour. And exactly as you said with new competitors coming into the market etc. My view would be the following. For this year as we said, margins should be 2.45 per cent. You should expect our loan growth in our core segments to accelerate in line with an improving economic situation. I see the economic situation in the UK getting more and more robust. We have 20 per cent of the market overall in terms of the corporate sector and in terms of retail and we see that happening, not through all segments, but through the whole of the country confidence is improving., business investment is now starting to pick up, we continue to have calm and stability in the Eurozone so in terms of net trading we do not expect any significant changes. And this additional business confidence, sorry this additional retail consumer and business confidence which is translating into more investment, is exactly what the economy needs in terms of having investments for future supply and healthy growth. So I see the UK economic recovery continuing to gather pace and I think the growth will be around 3 per cent this year and the risks are on the up side.

In terms of the specific behaviour within this environment, I think you are absolutely right, that competition is increasing in terms of numbers of players. We have TSB for example which we just referred to, which I think has very good conditions and a great infrastructure in order to be able to grow in the market. So it is as you know, in terms of loan to deposit ratios, capital position, a number of customers market share and I am not going to elaborate because they are announcing results as well today. So

absolutely right, you have Virgin Money, you have other banks applying for licences etc. But my opinion is that the retail market is already very competitive and I don't see that situation deteriorating margins. Why don't I see it deteriorating margins? Because I do believe that the biggest impact over the next two years will be the leverage ratio. And the leverage ratio by definition will change and will impact behaviour of the mortgage orientated players, i.e., building societies or similar and you have several important players in the country which have leverage ratio of around 3 per cent. And we have 4.5. So it is 50 per cent more or 40 per cent more. So the leverage ratio impact may be so significant that I think that impact will probably be the major impact when you think on a two to three year view. But again two to three year view is very much into the future and it will depend on competitor behaviour and it is a very competitive retail market out there.

Second question on restructuring charges George?

Answer: George Culmer
I will give you a one year view. Yes as you have seen in the results at the half year, we continue to have a number of you know below the line items as we have over the last couple of years. Some of those are forced upon us such as the TSB build costs, some our choice in terms of the simplification which has been a great success in terms of driving down the results. As I said in my presentation, in terms of the shape. Actually if I start with this year I would expect a number of those to not repeat in the second half of 2014 or at least reduce. So ECN charge won't repeat. I would see a reduction in the simplification. I think we have got a couple of hundred million spend as that completes. TSB I would have ongoing running costs, but no longer building, so there may be a couple of hundred million there in terms of TSB for the second six months. So you will see a reduction and a non repeat. And then as we go into next year, to repeat what António said at the outset of your question, you are into a clean year. So absolutely there is no intention of perpetuating restructuring charges below the line so there is no further simplification charges below the line. TSB build costs have gone and so at that point you are seeing the full impact of that underlying profit that will come through, flow through into the statutory profit obviously and then into the capital position.

Question 8: Chris Manners, Morgan Stanley
Good morning everyone, it's Chris Manners from Morgan Stanley, just three questions if I may. Firstly just on the leverage ratio. You have got 4.5 per cent currently, we have got consultation out there. Do you think you have actually got excess leverage ratio there or do you think it could be tipping towards more like a 5 per cent and how high do you think the leverage ratio should go in the UK?

Second point, I don't know if I missed it, but did you put the Pillar 2A requirement out in the document there? Because obviously that would be quite interesting just to help us realise exactly how much surplus capital you have?

And the third one was on interest rate sensitivity. Interest rates should be going up towards the end of this year or start of next. In the Annual Report it looks like your interest rate sensitivity has been quite a lot reduced and that looks like a static analysis. So how should we think about interest rate sensitivity for Lloyds if the Bank of England starts hiking? Thanks.

Answer : António Horta-Osório
I will take the first one and George will answer number two and three. On the leverage ratio, as I say, the consultation paper is just out and given it is a consultation paper and it is very recent, I think it is too early to speculate about what that will imply in terms of specific numbers. What is clear for me is that the 3 per cent will increase and it is clear as you know from previous discussions we have had. And therefore we have prepared our strategy well ahead in order to have a substantially higher leverage ratio than the 3 per cent, therefore the AT1 exchange we did which in a sense decreased our fully loaded core tier one ratio, although it is at 11.1 per cent it had a negative impact, but substantially improves the leverage ratio.

And I think that my point was, given that in the UK banking sector you have at least three important players with leverage ratios around 3 per cent. And we are at 4.5. The difference is so big that whatever happens in my opinion will imply a change of behaviour on those players. The product which is most effective by the leverage ratio versus the fully loaded core tier one ratio are mortgages by definition because they have one for one in leverage and much less RWAs. And therefore I think the behaviour in that space is going to be very much orientated at the higher capital requirement that mortgage will imply through the leverage ratio. And also the mix allocation that those banks will have to do in terms of mortgages versus the others. And that is why I think it will imply that is a very strong point to consider in terms of your longer term margin evolution in the UK. But we are absolutely in a very good position given the difference that we have versus the minimum. And our balanced mix between the corporate bank which is growing very well and above the market, mid markets and in SMEs, versus mortgage which were growing in line with the markets, will continue to balance the leverage ratio and make it grow with underlying profits in a very healthy way. That is the context and I don't want to go into very much detail because we will have to see what comes out of the consultation.

Answer: George Culmer
Hi Chris. On the other, your second and third questions. No you didn't miss the P2A, it is not buried in there or anything like that. We haven't disclosed at the moment, we haven't disclosed for a couple of reasons. One, as you probably know, the PRA are going through consultation in terms of disclosure. I know a number of our peers do, but they are going through consultation at the moment on this subject. And secondly, we have a submission that is working its way through the PRA on the Pillar 2A. So my expectation would be that we will be disclosing by the end of the year when the PRA have decided and once we have had our submission looked at and review. So that is the reasons for not now.

And in terms of the interest rate sensitivity, I mean the bank is essentially set up not to be too much hostage to interest rate movements. So our expectation because of things like pass through to customers and because of our position on things like the structural hedge is that for the first sort of 225 basis points movements for example, you will see relatively little if any movement on reported earnings. And it is only when you get to sort of subsequent to that will you start seeing net benefits come through. So in the early days and the early moves, because we are passing through, because of how we are set up, you are not going to see a big impact on earnings.

Question 9: Mike Trippitt, Numis
Thanks, it's Mike Trippitt at Numis. I just want to ask a follow-up on the margin question. There is obviously a hefty sort of billion benefit in net interest income that has come from liability mix and spread. And obviously I think we understand what is happening or has happened in the retail deposit market. But I guess you have also benefited from wholesale funding reduction and refinancing. And I am just wondering if you could help quantify that and give any guidance on whether you think there is further benefit to come in H2 from that reduction and refinancing in wholesale?

Answer: George Culmer
The answer is yes, we have seen a couple of basis points come through and I would probably expect a sort of repeat of that as we move into the second half. Thereafter again some of that more expensive, wholesale funding continues to roll off, it will be a continued supporter of the net interest margin. So as I say helped us by a couple of basis points Q1, a couple of basis points Q2, so a continuation of that. You are not seeing a vast amount of refinancing in terms of the second half, but what you will probably see is a steady support as I say, some of that older financing rolls off.

Answer: António Horta-Osório
Mike I would just say on top of what he said on the retail market that our overall cost of funding going down is also a function of the commercial division where as I told you, our transaction banking deposits. So our relationship core part of the commercial division, transaction banking deposits are going up by more than 11 per cent and the fact that our rating has been upgraded, our credit default swap level is now around only 60 basis points, that has a very big impact as well on the funding costs of the commercial division. We are attracting deposits from corporates in a very healthy way. And to your point, George, this one the fourth point is as I mentioned online deposits which are also managing downwards, given that we have if you want in a sense excess deposits and given it is not a relationship brands, we manage them for value as well as I mentioned at the beginning. So you should consider those factors as well.

Question 10: Fahed Kunwar, Redburn
Hi, it's Fahed from Redburn. A question about PPI and then just thinking about litigation and legacy issues. On the PPI you have let your utilisation rate go up to 78 per cent I think now and I think you have always been in a kind of high 60s or low 70s. You've only previously disclosed in the low 70s. So considering the kind of pre 2005 claims that seem to be coming through now, why were you confident in doing that?

And the second question as well, just thinking about your significant head comment on statutory profits, there's still interest rate mis-selling out there. PPI still seems to be increasing and the FX charge could come through this year as well. So how do you get confident, how do we get confident that you will be significantly ahead? And I appreciate there are things you can control won't be coming through, but there are a lot of things you can't control out there. Thanks.

Answer: George Culmer
I am not sure of the stats in terms of utilisation and history. When you look at the utilised balance on PPI, with the action we have taken at the half year, that takes it to £2.3 billion which is actually a similar number to where we came into this year. And I think the outlook as we look now is actually slightly different. And the reason for that let me explain. First up the £600 million we have taken about two thirds of that relates to basically reactive complaints that have come in, together with associated expenses of dealing with that. And a third to the PBR. On the reactive, as we disclosed at Q1, you know complaints are running slightly higher, they came down in Q2, down 7 per cent but still slightly ahead of our forecast so we have re-projected that and on the PBR, past book reviews as I said, slightly higher response rate than certain cohorts and slightly more policies. What,

when you look at the spend, the cash spend on PPI, we currently spend about £200 million per month and have done for a while. When you look at the three elements of that, they are on slightly different trajectories which I think is important. So if you take those three elements of PBR, remediation activity and the reactive complaints, PBR as we disclosed was essentially through the mailings. We have mailed 95 per cent as I said in my presentation and we would expect cash payments out with regards to PBR to basically cease in the first quarter of next year. And so I can see you know the end of the tunnel with regards to past book reviews. Remediation, we are going to belt and brace it. And we are going to make sure that we have dealt with all customers fairly and go back and look at the book and I would expect that would be completed in about the first half of next year. So there are still some variabilities around those two. But I can see how the story ends and I can see the end.

The most uncertain, the most volatile obviously remains the reactive complaints and that is where the CMCs play. A couple of points to make, first, when I have dealt with PBR, when I have dealt with remediation, when I am left with predominantly just those reactive complaints the monthly cash payment is going to be very significantly less than the £200 million that I pay out at the moment. And at that point PBR I am into a different league, I am into a different paradigm with regards cash payments, with regards provisioning etc. On CMC activity, we haven't seen any step change in CMC activity over the last few months. They remain there, but they have been there. So in terms of reactive complaints that come in, we see about, it is about, anywhere between 55 to 58, 59 per cent of those reactives come from CMC activity. And their participation has been pretty constant so I haven't seen a step change. Similarly when I look at age of policy that has come in. Pre 2005 is probably anywhere between about 65 to 68 per cent. And whilst that has slightly ticked up again, we haven't seen a step change in that. So I have £2.3 billion set aside for PPI. I see different trajectory for those three components, two I can see where it is ending. Reactive is uncertain, we are dependent on behaviours, we are dependent on CMCs but I as I say when I move to where it is just reactives, I am into a different league in terms of that PPI provision.

In terms of overall conduct, yes of course we continued to work through things and I think what matters most is that on a perspective basis we are doing the right thing by our customer, making sure that the sales process, the culture of the business is fit for doing the right thing with the customer and regulatory environment in which we operate. On the legacy items we will continue to work through and we will continue to remedy in the way that we think is fit and proper. Yes we have taken a reasonable conduct charge at the half year but we will continue work and clear those things.

António Horta-Osório
Any more questions? So thank you very much for being with us and see you next time.

End of Q&A Session