LLOYDS BANKING GROUP PLC – 2015 HALF YEAR RESULTS PRESENTATION

FRIDAY 31 JULY 2015

António Horta-Osório, Group Chief Executive

Good morning everyone, and thank you for joining us for our half year results presentation. I will start with the key highlights for the first six months of the year, before setting out the trends we are seeing in the UK economy. Then I will turn to our strategic priorities and the progress we are making against them. George will then present the financial results in detail, after which we will take your questions.

Turning to the highlights of the first six months of the year. The first half of the year saw us make further progress on our strategic journey to become the best bank for customers and shareholders. We have delivered significant improvements in both underlying and statutory profitability and balance sheet strength, while at the same time improving our customers' experiences and continuing to support and benefit from the UK economic recovery.

The completion of the sale of TSB to Sabadell was a significant milestone for the Group, enabling us to deliver our commitment to the European Commission, well ahead of the mandated deadline.

Our proven track record of delivery, both strategically and in terms of financial performance has allowed the UK government to make further substantial progress in returning the Group to full private ownership in the first half of the year. Today its holding stands at less than 15 per cent, around a third of its original stake, returning more than £13 billion to taxpayers to date.

And, following the resumption of dividend payments at the 2014 full year results, today we are announcing an interim dividend of 0.75 pence per share.

Turning briefly to the financials. As you can see, underlying and statutory profits have continued to increase, with underlying profit up 15 per cent to £4.4 billion, compared with the first half of 2014, driven by increased income and lower impairment charges. At the same time our underlying return on required equity increased to 16 per cent, and our statutory profit before tax of £1.2 billion, is up 38 per cent, despite additional conduct charges, including £1.4 billion for PPI, which was disappointing. The additional provision mostly reflects higher than expected reactive complaints with higher associated redress. George will cover this in more detail shortly. This increased profitability, coupled with a reduction in risk weighted assets has led to the strengthening of our balance sheet, with a common equity tier 1 ratio of 13.3 per cent, and a leverage ratio of 4.9 per cent, both post dividend.

Turning to the UK economy. As a UK centric bank our future is inextricably linked to the success of the UK economy. The economy continues to recover in a steady and sustainable way, providing a solid foundation for the Group's future prospects. UK GDP has increased strongly and has outperformed the Eurozone.

At the same time unemployment has fallen significantly to its current low level, business confidence has recovered over the past 3 years and wage growth is at its highest rate in over 5 years. Most importantly household and corporate debt as a percentage of GDP has continued to fall to more sustainable levels. Against this backdrop, bank base rates are expected to rise slowly and remain lower than pre-crisis, which should support a continuation in the economic recovery.

From a retail perspective, the strength and sustainability of the recovery is further evidenced by the fact that consumers are spending more, yet household debt as a proportion of disposable income is reducing.

UK house prices continue to recover and are broadly at the same level as the previous peak of 2007. It is important to remember though that this recovery has occurred in a gradual manner, and given inflation over this period, house prices remain below the previous peak in real terms. This increase in house prices, together with the proportion of our new mortgage lending versus stock, which has reduced from almost 34 per cent in 2006 to 11 per cent today, have contributed to a significant improvement in the quality of our mortgage portfolio. The average loan to value of the portfolio has reduced from around 56 per cent in 2012 to less than 46 per cent today, and the proportion of our book with an LTV in excess of 100 per cent reducing from 16 per cent in 2008 to only 1 per cent at the end of June 2015.

Now turning to our UK focused business model and how this is supporting the economy. As you know, we have created a simple, low-risk UK retail and commercial bank. We have a clear strategic focus and differentiated business model which in turn provides us with a number of competitive advantages, including a market leading cost position and a lower cost of capital, due to our disciplined approach to risk.

Last October we outlined three strategic priorities to take us through to the end of 2017: creating the best customer experience; becoming simpler and more efficient and delivering sustainable growth, which I will cover in the next couple of slides. Starting with creating the best customer experience. During the first six months of the year we have made a strong start to the next phase of this strategic journey to become the best bank for customers and shareholders.

Our multi-brand, multi-channel approach allows us to meet customer needs more effectively, allowing them to choose how and when they wish to interact with us. We are adapting to the digital revolution and today we have more than 11 million online users and nearly 6 million mobile users, numbers which have increased by around half a million each since year end. This provides significant opportunities for serving our customers in new and more efficient ways. A recent example of this was the launch of our Halifax Motor Finance offer. This is the market's first digital direct-to-consumer, secured car finance proposition. In addition we continue to streamline our processes and have reduced the average intermediary mortgage application to offer time from around 25 to 14 days, with further improvements targeted.

Our progress in creating the best customer experience has been reflected in our net promoter scores which have increased by an additional 3 points in the first six months of the year, and by 60 per cent cumulatively since 2010. Despite these scores, we are not complacent and recognise that we, together with the industry, have more to do in order to rebuild customer trust. And on becoming simpler and more efficient, we have continued to increase our investment in IT in the first half, resulting in simpler, more efficient processes, more resilient systems and better digital experiences for our customers as well as cost reductions for the Group.

In the first six months of the year we have delivered run-rate savings of £225 million against our target of £1 billion of savings from the new Simplification programme by the end of 2017. These reductions, together with our strong underlying financial performance have resulted in further strengthening of our already market-leading cost:income ratio, which is now 48.3 per cent, providing us with strategic differentiation and competitive advantage. And we continue to target a cost:income ratio of 45 per cent as we exit 2017, with reductions every year.

We are committed to supporting the UK and its communities. We remain focused on becoming the best bank for customers and shareholders, by helping the people, businesses and communities of Britain to prosper. Over the last 12 months, lending excluding TSB and run-off, grew 1 per cent. This included growth in the mortgage book of 1 per cent, against a market that has grown around 1.5 per cent in the same period. We have provided gross new mortgage lending of £16 billion in the first six months of the year, and we continue to be the number one provider of mortgages to first time buyers, providing one in four.

At last year's strategic update we outlined that we would grow our mortgage book in line with the market. Given our focus on preserving margin and the fact we are in a low market growth environment, our share in the first half has been slightly below this level, a position we are comfortable with. On the other hand, we have built on the strong progress made by Consumer Finance in 2014, achieving UK loan growth of 17 per cent year-on-year, which is significantly above our expectations of high single digits. This has been delivered through new business growth of 34 per cent in motor finance and 5 per cent growth in credit card balances.

Commercial Banking continues to take a lead role in supporting the UK economic recovery. We have maintained our lending to our Mid Market clients in a declining market, and have supported 1 in 5 new business start-ups. At the same time our SME lending has continued to outstrip the market, with growth of 5 per cent year-on-year. We have now seen 4 years of delivery since our first strategic review, and we have increased our SME net lending by 23 per cent in this period, while the market has fallen by 16 per cent in these 4 years, whilst maintaining our prudent approach to risk. We also remain a leading participant in the Funding for Lending scheme, having reported the largest increase in net lending to SMEs under the scheme in the first quarter.

In conclusion, as a Group we are focused on supporting our customers and the UK economy through the successful delivery of our strategy. We have made a strong start to the next phase of our strategic journey, with further increases in profitability and returns, despite additional conduct charges. We have strengthened our customer proposition, achieving improvements in customer experiences and efficiency, while supporting the UK economy with growth in our key customer segments.

Through the strategic initiatives we announced last year, improving on our key competitive advantages of having a leading cost:income ratio and a low risk business model, we continue to target a sustainable return on required equity of between 13.5 and 15 per cent at the end of the strategic plan period and through the economic cycle, and on an underlying basis we currently stand at around 16 per cent. As a result of this progress, we are today improving our guidance for 2015 and announcing an interim dividend of 0.75 pence per share, and also providing further clarity on the distribution of our excess capital.

Our aim is to have a dividend policy that is both progressive and sustainable, and as previously indicated we expect ordinary dividends to increase over the medium term to a dividend payout ratio of at least 50 per cent of sustainable earnings. In addition the Board will give due consideration, subject to the circumstances at the time, to the distribution of surplus capital through the use of special dividends or share buy-backs.

I will now handover to George who will present the financials in detail.

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.

Starting with a brief summary of the P&L. As you've heard underlying profit increased by 15 per cent to £4.4 billion, driven by a 2 per cent increase in income, flat operating costs and a significant improvement in impairments, with an AQR of just 9 bps.

Within income, NII continues to be strong, increasing by 6 per cent, while other income was down 4 per cent, due mainly to prior year disposals and the impact of the run-off portfolio. With increased total income and flat operating costs, we have positive JAWS of 1.5 per cent and a market-leading cost:income ratio of 48.3 per cent.

Going through the P&L. The 6 per cent increase in net interest income was mostly driven by a continued improvement in the net interest margin, which at 2.62 per cent was 27 basis points higher than the first half of 2014 and 17 basis points higher than the second six months. As in previous periods, these trends continue to reflect improved deposit pricing, lower wholesale funding costs, and the disposal of lower margin run-off assets, partly offset by ongoing asset pricing pressure.

On a divisional basis, the improvement in NIM was the main driver in the 7 per cent increase in Retail's result, while in Commercial NII was flat, with an 18 basis point NIM improvement offset by a slight reduction in interest earning assets. Looking forward, we expect these drivers to continue and are improving our guidance for the Group's full year net interest margin to around 2.60 per cent.

Other income is, as mentioned, down 4 per cent largely due to disposals and run-off, although Q2 was up 4 per cent on Q1 and broadly in line with last year.

Retail remains challenging due to the current conditions and regulatory environment, but this has been offset by improved performances in Commercial and Insurance. Within Commercial, this has been led by capital markets.

In Insurance, we flagged at our strategic update in October last year our intention to enter the bulk annuity market. And the improvement in OOI reflects the execution of our first such transaction with the Scottish Widows with-profits fund, as well as the absence of the one-offs that we saw in 2014. Looking ahead, we continue to expect other income to be broadly stable for the full year.

On costs, operating costs of £4.2 billion were flat, with efficiency savings from our Simplification programmes more than offsetting increases from pay and inflation and over £190 million of additional investment in the business. On our new Simplification programme, we have already achieved run rate savings of £225 million, led by savings from organisational design changes, and are on track to deliver our targeted £1 billion by the end of 2017.

Our market-leading cost:income ratio of 48.3 per cent continues to be a source of competitive advantage and, looking ahead, we continue to expect our full year ratio to be lower than the 49.8 per cent we reported last year.

Moving on now to asset quality. On impairments, we've seen a further 75 per cent reduction in the P&L charge to £179 million, with the AQR improving to 9 basis points compared with 30 last year.

This improvement was seen across all divisions, with Run-off better by more than £300 million and our ongoing businesses by some £170 million. As in previous periods, the low charge reflects the improved economic environment and our effective risk management, as well as provision write-backs and releases, which totalled approximately £400 million compared with £500 million in 2014.

The quality of the Group's loan portfolio also continues to improve. Impaired loans are 2.7 per cent of total advances, compared with 5.1 a year ago and 2.9 at the start of the year. Coverage also remains strong at 55 per cent, with the slight reduction from the end of 2014 largely due to the sale of heavily impaired assets from Run-off as well as further disposals within Commercial.

As you may have also seen, yesterday we announced the sale of a £2.6 billion portfolio of Irish commercial loans, which effectively eliminates our exposure to the Irish commercial market. And, adjusting for this transaction, impaired loans would reduce to 2.2 per cent, with a revised coverage level of 48 per cent.

Finally, and returning to the P&L, given the low impairment charge in the first half and our future expectations, we have improved our AQR guidance for the full year from around 25 to around 15 basis points.

Looking briefly at financial performance by division. We've delivered underlying profit growth across all divisions, driven by income and reduced impairments.

In Retail, we continue to deliver strong profits and returns, achieving an 8 per cent increase in underlying profit to £1.8 billion, with the reduction in other income more than offset by NII and a 41 per cent reduction in impairments.

In Commercial, underlying profit was up 3 per cent to £1.2 billion, driven by the improvement in other income and another significant reduction in impairments. The Return on Risk Weighted Assets was 33 basis points higher at 2.29 per cent, and we remain on track to deliver our new targeted return of at least 2.4 per cent.

Underlying profit in Consumer Finance was 1 per cent higher at £0.5 billion, with increased investment in future growth more than offset by income from Asset Finance and, again, reduced impairments.

And in Insurance, the bulk annuity transaction and the absence of one-off charges were the main factors in the 27 per cent increase to £0.6 billion.

In Run-off and Central, the improvement mainly came from a significant reduction in the run-off portfolio with improved credit charge.

And finally, the £0.1 billion for TSB represents the 3 months' profit ahead of the sale to Sabadell, compared with a full 6 months last year.

Looking at statutory profit. Asset sales and other items were £578 million and include a £390 million mark to market charge from the ECNs, reflecting the change in the value of the equity conversion feature. While the prior year included the £1.1 billion charge from the ECN exchange.

TSB costs of £745 million are unchanged from Q1 while on conduct, as you've already heard, we have taken a further £1.4 billion on PPI, which I will cover in a moment.

Other conduct charges were £435 million which includes the £117 million settlement relating to PPI complaint handling, which we announced in June as well as a further £318 million relating to claims and remediation for products sold through the Retail, Commercial and Consumer Finance Divisions.

And finally, the tax charge of £268 million represents an effective rate of 22 per cent. As you know, there have been a number of recent changes to our tax position and, given these, looking forward, we now expect our medium term tax rate to be more like around 30 per cent.

On PPI, as António has already mentioned, we are disappointed that we again, have to increase our provision, with increases in the period due to reactive claims trends as well as revisions to the costs and scope of the remediation programme. Our Past Business Review (PBR) activity is, however, now close to completion and required no increase to existing provision levels.

On remediation, we have increased the provision by £0.4 billion. This reflects higher overturn rates and average redress, as well as changes to the scope of the programme, with total expected cases increasing from 1.2 million to 1.4 million. We now expect to have substantially completed remediation by the end of the year, which is later than originally envisaged, due to the revised scope. And, as both PBR and remediation draw to a close, the costs of these programmes will fall away with the current monthly run rate of around £140 million to be more like around £30 million by the end of the year.

On reactive complaints, these accounted for the remaining £1.0 billion of the provision increase. This is clearly in excess of the £0.7 billion risk that we highlighted at year-end. This is due to higher than expected average redress and, while complaints are down 8 per cent year-on-year, they remain stubbornly high and above the level seen in Q4 last year. For the overall PPI provision, a number of risks and uncertainties remain, including the outcome of the current FCA review.

And, as you have seen from the charge today, reactive complaint trends remain hard to forecast as they are dependent on the volume of complaints we receive, which are, in turn, mostly driven by CMC activity.

Our current provision assumes a significant reduction in reactive complaints over the next 18 months. If this decline does not happen and complaints in the second half remain at the same level as the first six months, we would expect to take a further provision of around £1 billion at year-end, with a similar level of provisioning required for each six months if complaint volumes continue to remain flat in 2016.

Turning then, to the balance sheet. In terms of assets, our average interest earning assets were £456 billion in the first half, 6 per cent or £28 billion lower than 2014. This has been driven by a £13 billion reduction in Run-off and £12 billion from TSB, with average assets in our ongoing businesses broadly flat, with reductions in Commercial, offset by strong growth within Consumer Finance.

On risk-weighted assets, the Group continues to make good progress in de-risking the balance sheet, with RWAs reduced by £13 billion, or 5 per cent, with an improvement in credit quality across the business, the continued reduction in the run-off portfolio, active portfolio management within Commercial, and, of course, the sale of TSB.

On capital, the business continues to be well capitalised and strongly capital generative, with a 70 basis point strengthening of our CET1 ratio in the first half to 13.5 per cent before the dividend and 13.3 per cent after. This increase is after PPI and other conduct charges, as well as a 0.3 percentage point decrease from the TSB disposal, with the overall improvement primarily driven by underlying profit and the reduction in RWAs.

The Group also remains well-placed in terms of leverage and total capital, with ratios of 4.9 and 21.7 per cent respectively positioning us well for current and evolving regulatory requirements.

And, we also continue to generate strong returns, with an underlying return on required equity of 16.2 per cent in the first half: an improvement of 2.2 points over the prior year. On net assets, our TNAV per share before the dividend of 54.3 pence is slightly down from the year-end, with an increase of 4.9 pence from underlying profit offset by conduct, the impact of TSB and movements in other reserves, mostly the cash flow hedge reserve. Post payment of the dividend for 2014 our TNAV was 53.5 pence.

On the dividend, as António has already mentioned, the Group is today announcing an interim dividend of 0.75 pence per share. Looking ahead, as you know, as António mentioned, the Group's aim is to have a dividend policy that is both progressive and sustainable, with the ordinary dividend increasing over the medium term with a payout ratio of at least 50 per cent of sustainable earnings. In addition, given the expected strong capital generation, going forward the Board will give consideration, subject to the circumstances at the time, to the distribution of surplus capital through the use of special dividends or share buy-backs.

Surplus capital represents capital over and above the amount we wish to retain to grow the business, meet regulatory requirements and cover uncertainties. And while this amount is likely to vary from time to time depending on circumstances, it is currently around a 12 per cent plus an amount broadly equivalent to a further year's ordinary dividend.

So, to sum up, the Group has a clear strategic focus and a differentiated business model, and in the first half of 2015 delivered another strong financial performance, with increases in profitability and returns and a stronger balance sheet. And for the full year we are improving our guidance for net interest margin and impairments.

At the same time, the Group has made a strong start to the next phase of its strategic journey, progressing its three priorities of creating the best customer experience, becoming simpler and more efficient, and delivering sustainable growth. Through these initiatives, the Group is well-positioned to become the best bank for customers while delivering strong and sustainable returns to shareholders.

That concludes my review and today's presentation and we are now available to take any questions.

End of Presentation

Question and Answer Session

Question 1: Fahed Kunwar, Redburn
Hi it's Fahed Kunwar from Redburn. The first question I had was on NIM and your mortgage market growth. So on your current guidance of 260bps, it looks like in the second half of the year NIM will be coming down. Is that how you guys see it?

And then going forward with your guidance on mortgage market growth being in line with the market, your peers are still looking to grow their share of mortgages. Is there a case that if they are continuing to grow, then to protect your NIM, you are willing to let your mortgage growth kind of slip below the market level and actually have that growing lower now going forward. Would that be a change or would you protect your margin at that point? That is the first question.

António Horta-Osório
So by parts. In terms of the NIM guidance, we are not foreseeing NIM to go down, we are at around the level that we guided for and we think we will be around that level for the end of the year. So we have said in the beginning of the year, we will be above 255. We have now confirmed that it will be and we are giving more precise guidance of around 260. And the level in the first half is around 260, so we are not thinking that we will go down in the second half. We will be around the levels which we are out at the moment.

In terms of the mortgage market, we have said for 3 years now that we would grow reasonably in line with the market. As I said in my remarks, the market is growing at 1.5 per cent. A year ago when we presented the Strategic Review, the market expectation was for a growth this year of around 2.5 per cent. And given that the market is at 1.5 per cent and our growth is around 1 per cent, so we are slightly below the market. We are comfortable with that level as I said, because we have been able to offset the asset margin pressure which is continuing as it was before, no more, no less. We have been continuing to be able to offset it with the margin of the deposits and the lower wholesale funding costs. We think this picture will continue and that is why we are giving you the same margin for the year. But given that our focus is on preserving margin, we accept to raise our mortgage volumes a little bit lower than the rest of the market. In a low market growth environment which is the case at 1.5 per cent, to grow it around 1 per cent is not significant. For example on the consumer finance side where we are growing significantly above the markets at 17 per cent, with 34 per cent growth in car financing for example. And the car finance market is growing 11 per cent, the market share is much more relevant, given the weight of new business versus the stock. When new business is very slow, it is very low in terms of the stock, those small trade-offs in our opinion are irrelevant and it is the right thing to do in order to preserve margin.

Fahed Kunwar
And the second question just on the dividend. When you think about the capital threshold, it looks like you have increased your guidance on what you think your minimum capital level is by putting in the line about saying you want this year's dividend in there as well. How likely is the PRA, I guess seeing as you picked up your capital guidance, but also the PPI charge likely that you pay a significant dividend with the buybacks in the event that PPI and the reactive claims don't come down and your threshold is picking up. How do you see that over the next year to year and a half I guess?

George Culmer
Okay, we don't see it in terms of increasing our requirement. I mean that is why we have described it the way that we have and talked previously about sort of around 12. That remains the case and we have now talked about holding back an amount broadly equivalent to the next year's dividend. If you put that together you get to about a figure of about 13 per cent. So that is what we are sort of working off and that is what we look at.

In terms of processes, that is the Board's decision, that is the Board's judgement in terms of liaison with PRA, of course we would expect, we would share with them the interim dividend and what we would be saying about the dividend, but it is very much you know, this is the Board's decision, this is what we are proposing. But as the PRA, they see this of course.

In terms of the go forward and how the modelling and interactions with PPI, look, the separate elements are that yes we have increased the PPI provision today, but what you have also seen is that in the first half we continue to be strongly capital generative even if those PPI claims persist. So in terms of that growth from the 12.8 to the 13.5, you know that has not just 0.3 from TSB, as I say you have about 0.9 in terms of conduct costs. Now obviously we want to see the end of PPI etc, but what we are able to demonstrate is that given the financial condition and the financial position of the business, we are able to grow that base and should we have to, live with a certain level of PPI complaints.

Question 2: Tom Rayner, Exane BNP Paribas
Thank you very much. Tom Rayner from Exane BNP Paribas. Just on the same themes really. If I just push you a little bit more on the margin guidance. Excluding TSB from Q1 to Q2, the trend was still upwards 260 to 264. Even if around 260 means the second half is 262, so in line with the first half, it still implies a bit of a change in the trend from rising to possibly declining. And I wonder if you could add any colour to the underlying drivers here, the asset spread, the liability repricing, the churn on the back book? Could you add a bit more colour because it does sound a bit like the trend is changing even if the guidance for the full year is not particularly different?

António Horta-Osório
As you are pushing me a little bit more, I shall turn to George.

George Culmer
You are dealing with small degrees, you really are Tom. When you look through what has caused the increase Q2 on Q1, we continue to get the same old themes, a few basis points of asset pricing and a few basis points, that we are able to offset it through pricing of ISAs etc, fixed deposits, instant access, we are able to do that. We will still get benefit from wholesale funding, we will still get benefit from structural changes.

Things like the SVR book remain in place, we see a slight pickup of attrition, but that is about maturities as opposed to anything else. So trying to derive the movement between one or two basis points, up and flat, is you know, it will move around that space.

Tom Rayner
And I guess the reason I ask, I am thinking a little bit further forward, so if we start thinking about next year's margin, if the trend is down rather than up in the second half, will you extrapolate the trend or at the rate the environment is changing, does the whole thing change again when we think about next year and beyond?

António Horta-Osório
Extrapolating on a longer term view, I think we left this clear in our Strategic Review last year, we believe that interest rates will start to rise soon, we think they will rise slowly and they will stay lower than pre-crisis level for some time to come. And in that environment as we said last year in the Strategic Review, our margin would go up. We even gave the sensitivity of how much, by 25 basis points after the first two rises. So obviously, and to be very clear as well, an interest rate environment close to zero is not the ideal environment for a retail and commercial bank like us and we have told you repeatedly, compared to what happened to other banks in the sector, that given our multi-brands, multi-channel strategy and the way we manage assets and liabilities in a combined basis, we manage the difference of the two and we do this at the highest level of the organisation on a weekly basis. We have been able to offset the asset pressures with lower impairments in the market.

Asset margins have been coming down. We have been able to offset them with better liability management, as you said, both in terms of the cost of deposits and the fact that we have less wholesale funding costs. Now we have the lowest credit default swap of any UK bank. But obviously we cannot do this forever if interest rates were going to stay at zero. So if in your assumption, interest rates will stay at zero at current levels for a long time, obviously that is not the ideal environment for us. If you assume this, which is our assumption, that interest rates will start to increase by the end of the year, slowly as I said and progressively, this will drive our margin up in the future along the lines of the plan, as we said in October of last year. So these are what you have to consider and obviously depending on your own assumption of interest rates, you have the different implications.

Tom Rayner
May I have a second on the capital generation? One of your peers set a sort of guidance where they would distribute everything above a certain level and have subsequently ruled out any such distribution for at least until 2017. I am just wondering, in this guidance which sounds a bit like anything above 13 per cent will be distributed, are you thinking also about future RWA inflation, the UK stress test and all these potential caveats? I mean are they all at play? I mean we can't mechanically do our numbers and assume that everything is getting paid out I guess at the earliest opportunity?

George Culmer
I think we have been quite clear that the Board will give due consideration at the time, in terms of what we do with surplus capital, but just to reaffirm the point, we would see that anything above 13 would constitute surplus capital, but we would give due consideration. So I am not going to give you a date, but I will give you an amount, but I will give you, it will be considered based upon the circumstances prevailing at that time. In terms of things that you allude to, you know I can talk about head winds and tail winds, I mean there is some upward pressure on RWAs, we don't see it in the more extreme ends for example. We have talked a bit earlier about impacts of things like conduct charges etc, but I would point again to repeat my earlier answer in terms of our capital generation, even when one has to absorb those forms of cost. So we think that what the guidance gives to people is a clear view as to where we see what our capital levels will be and how we will approach it and as I say we will give consideration to how we will deal with the surplus at the particular time when we are north of that 13 per cent.

Question 3: Raul Sinha, JPMorgan
Hi, it's Raul Sinha from JPMorgan. Thanks for taking my question Antonio. If I can ask you a broader one on NIM please just to follow up from the first two. Essentially the gap between your mortgage growth and the market is 50 basis points, you are growing at 1 per cent, the market is growing at 1.5. If over the next 12 to 18 months, the pace at which mortgages are growing in the UK starts to accelerate, let's say it goes back up to 2.5 or 3 per cent and that is accompanied by significant margin pressure as you would expect because everybody has got a growth plan out there based on mortgages, would you be comfortable letting that gap to the mortgage market effectively expand or would you feel compelled, given you are the market leader, to chase that margin dilutive type growth ahead? Essentially my question is, are you going to choose capital return to shareholders or will you continue to grow balances at the expense of margin?

António Horta-Osório
I understand the question, it is a fair question, but it is a bit theoretical question because we have to decide at each moment in time depending on the circumstances at the time, depending on what competitors do, what interest rate outlooks are etc. I do think that the mortgage market will stay around this level for the year. So it is growing, Bank of England numbers two days ago state it is growing in the 12 months exactly 1.6 per cent. It is going to be around this level, 1.5 in my opinion. You have seen in the press a lot of comments about acceleration of approvals. You have to take into account seasonality. So we think the level will be 1.5 per cent. There was some impact from the mortgage market review last year which has decreased a little bit to growth. It is correct as well that review has significantly improved underwriting standards, which was a very good thing. We are, as I told you, given all the circumstances, willing to go slightly below the market given everything else I told you, but it is slightly below and that is what we intend to accept, not more. So to be very clear, given that it is a slight thing, we have accepted it. Our continued guidance is to grow reasonably in line with the market and I don't think the market is growing to shoot to the 3.5 per cent that you say this year, so we have several quarters to be able to discuss this going forward.

I would like to raise one point which is quite interesting by the way, and this is quite important because it connects to your question in a separate aspects. The fact that the UK economic recovery is taking place as I showed with less debt, which is quite unusual, so the economy recovers but this is on higher consumer spending, given the successful decrease on interest rates given the monetary policy and the FLS, people were able to increase consumption but at the same time, save more as a percentage of disposable income.

This is a very powerful argument for the economic recovery to have a long way to go because debt consumption recovery has led to additional business confidence. Now you have additional business investment and this is a virtuous circle going forward, where the household debt which was a problem in the UK is decreasing, as the economic recovery takes place. This is very positive for the UK economic recovery and in my opinion the trends that you are seeing in NPLs and GDP, apart from any external shock, are quite sustainable and this is quite important.

Rahul Sinha
Thanks António, just a quick clarification for George if I can please. The PPI charges you took in the first half George, were they tax deductible or not?

George Culmer
Yes it is our understanding that they are tax deductible. As you may know the Government came out with the changes to the tax deductibility of redress payments and they were initially thinking of doing essentially on a pro rata basis, but then a couple of weeks back it is more on what is defined as a "just and reasonable" basis. So our assumption and our numbers reflect tax deductibility for the PPI.

Raul Sinha
Thanks very much.

<u>Question 4: Chris Manners, Morgan Stanley</u>
Thanks. Good morning everyone, Chris Manners from Morgan Stanley, two questions if I may. The first one was on the Commercial Banking business. I saw you have reduced the RoRWA target to 2.4 per cent from 2.5 per cent. When we wash that through, obviously the tax rates have gone up as well, it is actually quite a big drop in the expected ROE from roughly 16 per cent to maybe 13 per cent on allocated equity. I am just trying to understand the drivers behind that and why you aren't holding the team to higher RoE, given where you can get returns on the rest of your business?

And the second question was just trying to quantify what we could look at on the special dividend there. So if you can do 1.5 to 2 per cent of capital generation per annum, so take the midpoint, so 1.75 per cent of RWAs per year, £225 billion of RWAs gets you north of 5p. I mean is that a total dividend, is that the sort of thing we should be looking at for next year?

António Horta-Osório
I will answer the first question, which is the easiest one and leave the second to George. Look Chris we have not changed any targets for the Commercial division, so there must be some confusion there. Andrew is here in the first row and you can discuss with him at the end, Andrew has in his plan to achieve a 2.0 per cent return on risk weighted assets for the current year which we have achieved ahead of target, we are now above that target. And we had the strategic review last year, setting a new target of 2.4 per cent for the end of 2017. So not only is Commercial well ahead of the previous target, so they reached the target of 2.0 ahead of the plan, because it was for the end of this year. But now we have a more ambitious target of 2.4 per cent return on risk weighted assets for Commercial for the end of the planned period, which is 2017 and commercial is now already above the 2.0 per cent. We have had a huge transformation in our Commercial division which I am very proud of. We went from a product based strategy to a client led strategy with clear segmentation, as I told you in my introductory speech, we are now for 4 years in a row, increasing SME net lending by 5 per cent a year in a falling market, leading to 23 per cent net lending growth when the market fell by 16-17 per cent, it is a huge difference. We still have room to grow because our share of net lending in SMEs is only 17 per cent so this work has been in my opinion exemplar. We are also gaining market share in Mid-Markets where we held in this first half, but while the market came down (2) per cent according to the latest Bank of England numbers, the market fell in June significantly. And as a whole, we are well in line in my opinion. We had said in the Strategic Review that between Mid-Markets and the SMEs, we would grow around £1 billion net in each segment per year. So £2 billion every year. And if you look at year on year at the moment, we are around £1.6 billion, so well on target in my opinion to get to £2 billion in both segments year on year. So quite proud of work in Commercial in spite of difficult market conditions until the end of the first quarter.

George Culmer
And your second bit, I won't check your maths, but when you look at the numbers, we have disclosed today in terms of the first half. You know I have got 1.8 of underlying, there is about 0.4 of other which has things below the line, but if I have a net 1.4 which is pretty ongoing in terms of capital generation, the RWAs at 50 basis points, as previously discussed, there are some headwinds out there, but I would continue to expect to be able to derisk etc, in terms of the book which would offset that. The TSB 0.3 will disappear. If we park conduct to one side, if you just run the maths through as you obviously have then you know you can come to your own outcomes, but I won't comment on your number which might frustrate, but I am sure you anticipate. But what it does show is a strongly capital generative business.

<u>Question 5: Martin Leitgeb, Goldman Sachs</u>
Two questions please from my side. First on buy to let lending, which obviously is an important part of your overall loan book. How should we think, with the change as announced in the Budget, affects the volumes here going forward in that book?

And second question, just to follow up on your earlier comments on mortgage volume growth, you obviously have the £30 billion loan growth target, shall we still think this will be about £30 billion or so that the slight weakness in mortgage lending might be compensated by strong performance in Consumer Finance or elsewhere in Commercial? Or could this number potentially be lower now? Thank you.

António Horta-Osório
Juan will take your first question on buy to let and then I will tell you about the £30 billion and how we see it.

Juan Colombás
Yes on buy to let, there will be an impact on the business, but our understanding is it will not be material, but I think a big part of our BTL was done many years ago, the indexed rental income compared with how much they are willing to pay. So rental cover of the buy to let portfolio, in the index one is quite high. And even if you factor in the interest rate growth, potential interest rate growth over the coming years we think that the impact will not be material in our portfolio. We have done a first analysis of it and we don't think it will be material.

Martin Leitgeb
That is more in terms of risk, to be clear you don't think it will impact volume growth?

Juan Colombás
In terms of volumes we think that the buy to let is something that is a need from customers and what we are doing is to follow the customer needs and we think the market will adjust to cover this customer need.

António Horta-Osório
Just to add a few comments on what you asked to Juan, this is quite interesting. When we gave you two slides in the appendix, if you look at slides 23 which shows the mortgage LTVs and this is an aspect which I don't think has been very much highlighted recently. The fact that contrary to pre-crisis time, you have new business of mortgage volumes, slower than before and in this case this year, in our case, gross lending in our new business is only 11 per cent of the stock as I said in my speech, when in 2006, in the market it was 34 per cent. So the fact that you have a smaller proportion on new business versus the stock has an incredibly positive impact on the quality of our book and on the finances of our customers.

So if you look at these numbers, not only our average LTV as I mentioned in my speech, decreased by 20 per cent in the last 2.5 years, so from more than 56 per cent to 45.9, the amount of mortgages that we have below 80 per cent LTV was 60 per cent 2.5 years ago and is now around 90 per cent. So an additional 30 per cent of the mortgages of our customers are below 80 per cent LTV. This is roughly speaking on a £300 billion mortgage portfolio, like £100 billion more equity on our customers. This from a quality of the books point of view, number one. And number two, from a commercial perspective in terms of additional options we have in terms of serving our customers needs, is really amazing. And when you look at the LTVs, specifically of buy to let, you can see that it is around 56 per cent, so it has also decreased very significantly. It is above the average but only 56 per cent and the new business volumes at around 62.7, so that's why, as Juan says, we are quite comfortable about this segment and we think that the changes that are gradually going to be introduced will not have in our specific case a very significant impact. But I would draw your attention to the amazing improvement given that house pricing is increasing with low business volumes on the quality of our overall stock and of course of the mortgage stock of the UK and how that impacts risk and risk weighted assets and capital in terms of the banks in general.

To your second question. When we mentioned the £30 billion last year, it was basically divided into £6 billion I just mentioned between SMEs and Mid-Markets, £2 billion a year each year, which we are well underway to deliver. It was also based on £2 billion between credit cards and car financing every year. So another £6 billion, which makes £12 billion and £18 billion was what we thought at the time, would be the mortgage market growth and us keeping the participation of that market. So the fact that the market now is growing instead of 2.5 at 1.5, should the 1.5 be kept, this has an impact because we would be growing 1 per cent less per year just in terms of mortgages which would be, just doing the calculations, £3 billion every year, £9 billion. But we continue as I said before to target that we will increase our mortgage portfolio over three years reasonably in line with the market.

Question 6: Chintan Joshi, Nomura
Good morning, Chintan Joshi from Nomura. I have got one question on NIM and one on taxes. I am not yet worried about your NIM, but I still like to fuss about it. If we can talk about, you know as we get into the rate hike at the end of the year, start of next year, how do you see yourself and the industry passing that on mortgages and key deposit products? Is it in line with the base rate? Is it below, is it above? Can you offset this 8 per cent surcharge by being a little bit higher on that asset margin expansion?

And also if you can talk about, George mentioned attrition rate has picked up a little bit, how much just so that we are in the know there? And then one on taxes.

António Horta-Osório
So maybe I will just do a generic answer in terms of how we see generically, impacts of interest rates, impacting on margins and maybe you can go into detail on the two questions. The guidance that we have given is that we expect base rates to start increasing slowly around the end of the year and we said that in the first two base rate rises, we don't expect significant impact on our margin overall and from then onwards there should be positive impacts. And we said at the time around £100 million per 25 basis points on a discrete point in time. I think that is our overall view at the moment of what will happen. Of course everything depends on competitive pressures on what happens.

I think another quite important point in terms of how margins will evolve in the new future, will be the definition of ringfencing, because I personally believe that there are two important factors that you don't know yet in terms of the ringfencing. The first is; what is the leverage ratio for the ring-fenced bank, which in my opinion will be higher than the Group's leverage ratio. So I think the ringfenced bank will have the higher leverage ratio. And second, in our case, because we are basically going to be a ringfenced bank, but in other banks we don't know what will be inside the ringfence or outside the ringfence. And given mortgages lead mathematically to lower leverage ratio, if there are ringfenced banks with mostly mortgages inside, then you may have a competitive pressure for margins to increase because the restriction in terms of capital will not be the fully loaded ratio, it will be the leverage ratio.

So that basically doubles the cost of equity for mortgages, depending on how the ringfenced bank is constructed. So I am just giving you another impact of what might change in terms of the future apart from interest rates moving, which I think is quite important. But overall speaking, what we are counting on our plan, is as I tell you, that interest rates will start rising slowly by the end of the year, the first two base rate increases will basically be neutral and from then onwards it will be positive in terms of impact on our margin.

George Culmer
I am not sure I can add to that.

Chintan Joshi
On the Halifax book you said there was a slight pickup just wondering how much?

George Culmer
Right, sorry yes, when we talked previously there was about a 7 per cent attrition and that tipped up to about 9 per cent for the Halifax book and for the sort of overall SVR book. So I think we said that the Halifax book was about £56 billion at Q1 and that is probably about £54 billion at Q2. But as I said, what we have actually seen, is that part of it is the profile in terms of maturities and actually it is maturities into the book that are actually down, rather than people leaving the SVR book. So that is the reason for the change. So did you have a question on taxes?

Chintan Joshi
Yes on taxes, you have guided us to 30 per cent, I am just trying to reconcile that, so insurance profits won't face the surcharge and current corporate tax rate plus the surcharge gets you to about 28 per cent?

George Culmer
Yes obviously there has been quite a bit of change and there was prospective change as well as the corporation tax which is why we sort of had this medium term type rate. And there was actually going to be volatility as well within the rate. And so you are right, it is on bank profits, so excluding the insurance company, also excluding holding companies as well, that is quite an interesting thing people are talking to the revenue about at the moment in terms of their constructs and where they have debt etc. There are some interesting things being worked through at the moment. But we previously said, I think at the low 20s was our guidance. I do say around 30 and that around is quite important. There will obviously also be a bit of volatility. Should one get in the future any form of conduct type charges obviously they are not deductible so that will introduce some volatility into your result. But at the moment we said 22, add 7 or 8 to that, you will come to around the 30 number. But there is a danger in being too precise at the moment but around the 30.

Chintan Joshi
The conduct, that makes you a little bit cautious on the 30 per cent, okay. And DTA utilisation has not really picked up, it is £4.5 billion at the full year stage and at the half year stage. When do we start seeing that number come down? I mean it is good that the CET1 ratio is going up without needing help, but at some point, when do we start seeing that number come down?

George Culmer
It is stable now because of the conduct, but it has been coming down, you are right, I mean it can always go faster. I think we disclosed, we previously had about a 2019 expiration point which we pushed out to about 2022 or 2023, but again a change in terms of utilising some of our post crisis losses, so again we still stick by that. We would expect the losses to be consumed by about the early 2020s.

Chintan Joshi
And would the DTA number get impacted by this tax change, 30 per cent surcharge?

George Culmer
No you can't offset it, there are no offsets. As I said there are discussions now around what constitutes banks etc, and I know that there are people out there lobbying in terms of where limits kick in and things like that but some of the interesting stuff is around how you construct yourselves and what is a bank and non bank.

Chintan Joshi
So it impacts timing differences, so I guess that does not impact Lloyds, so you don't see any impact on DTA levels?

George Culmer
No we do not from the surcharge.

<u>Question 7: David Lock, Deutsche Bank</u>
Good morning. It's David Lock from Deutsche. First question, just to follow-up on PPI. A lot of your PPI charges for administrative cost. I just wondered if you could clarify, on non tax deductibility, because it obviously has quite a big impact when we think going forward if you are taking further PPI charges?

George Culmer
The way it is being constructed, they are doing an uplift. So rather than getting into the awfulness of trying to constitute what is cost and administration, the approach now is to take redress and I think it is to apply a 10 per cent surcharge which essentially is your expense allowance, so that is the way they are going to deal with the tax deductibility.

David Lock
And secondly on retail deposit costs, we have seen a slight pick-up if we look at the Bank of England data in deposit costs across the UK. I just wondered if you could update us on where you see your kind of back book retail deposit costs and where you see your front book deposit costs coming through at the moment? Thank you.

George Culmer
I mean in terms of the back book, we talked about some numbers I think in Q1. And what we have seen across the back book is again a few basis points shaved off those in terms of quarter on quarter. So things like instant access, was I think, a blended cost of about 57 basis points and that has come down to about sort of 56. Variable ISA at Q1 we had about 89, that is down to about 78 and in terms of fixed ISA which was about 260 is down to about 230. So again we have continued to see some shavings off the cost of those.

António Horta-Osório
We are not seeing any pressure on our deposits to go up, on the contrary as George says, they have continued to go down. Maybe the data that you saw is because some other banks may have a more price-led strategy in terms of pricing deposit or mix, but in our case we have been able to attract deposits at quite good rates and with lower costs. That is why our loan to deposit ratio is basically the same around the levels that we have before.

Question 8: Rohith Chandra-Rajan, Barclays
Morning, it is Rohith Chandra-Rajan from Barclays. Two as well please if I could. First one on the AQR guidance, so the 15 basis points full year, 20 basis points second half from 9 in the first half. Just wanted to check what the underlying assumptions were there? It looks like a continuation of the underlying cost of risk if you like and maybe a halving of the write backs from £400 to £200 million and I just wanted to check whether that was the case?

And then secondly, on the non interest income 4 per cent Q-o-Q growth. You highlight Commercial Banking and Insurance as a driver of those and you have reiterated your guidance for the full year for flat OOI. I was just wondering about sustainability of that Q-o-Q pick up if you can provide any more clarity there?

António Horta-Osório
Juan will tell you about the trends that we see on NPLs and AQR and George about OOI.

Juan Colombás
On AQR you are right, we have had a proportion of the AQR which is impacted by write backs, at which, some point we will see slowing and they will continue slowing. But what I can tell you as well is that the trends so far in our portfolios are pretty stable. We are seeing improvements in all portfolios so we don't anticipate any change in the trends of the gross impairment.

António Horta-Osório
And to collaborate on what Juan just said, if you look at one of the slides I presented, the fact that in this case, not only household debt as a percentage of disposable income is going down, but also corporate debt which in the UK has never been an issue, also goes down. These are two very good factors, also for the future. So not only the fact that interest rates should start to rise only slowly and stay lower than before for a long time, coupled with the fact the economic recovery is being joined by both household debt and corporate debt as a percentage of GDP decreasing are quite good leading indicators in terms of the trends that we are continuing to see.

Rohith Chandra-Rajan
Do you expect to see a well below normalised AQR next year?

António Horta-Osório
We expect to see the continuation of the present trends for some time to come, no doubt.

George Culmer
And on other income yes you are right, I mean at H1, Retail is down some 20 per cent, I think we have got 4 per cent growth in Commercial and as the slide showed, I think we are up 20 per cent in Insurance. In terms of continuation of those, yes Insurance has benefited by the bulk annuity deal we talked about, so that is a form of one-off, although we are looking to enter the market externally. So I would expect to see a continuation of bulk annuity deals as we move forward. In terms of OOI, I won't give a projection, but I would certainly expect Insurance to still be up year on year. Similarly Commercial was up 4 per cent and I would certainly expect to see at least that for the full year.

Question 9: Sandy Chen, Cenkos
Sandy Chen from Cenkos. Three questions and actually the first, just to follow George on the Insurance guidance. If I could get a bit more detail on it because ex the annuities book, LP&I looks like PVNBPs were down 26 per cent year on year and if you look at the profit again without the increased profit contribution from bulk, it was down year on year again. So I guess if you could just expand a bit further in terms of beyond 2015 and really excluding the bulk what the trends in the rest of the Insurance business are?

And the other questions were just, sorry for yet another question on the NIM guidance and thank you for that. If I heard it correctly, £100 million extra NII for every extra 25 bps in the base rate. What is the SVR attrition assumption in that and has that been revised because I think you were saying George, that ticked up as well?

And the last one was on PPI guidance. I noticed in the detailed notes that in the Q1 average monthly reactive complaints they were actually up quite a bit, whereas Q2 reactive complaints were down. So why in Q1 weren't we being guided in terms of PPI impairments provisioning might be going up?

George Culmer
Right a range of subjects there. On Insurance going back to the start, I will talk about Insurance, but I am afraid I am not going to exclude bulk annuities because bulk annuities are a key part of the proposition going forward and I think in terms of a business proposition, Scottish Widows have a good one.

We have got a great brand name, we have got the capital strength, we have got the expertise. And this has been a good market for a number of Scottish Widows' peers and it is something that we should be part of and we have started and we will continue to be part of. So it is very much part of their go forward story. So I won't exclude it. What also will be part of the go forward story is the corporate pensions business where we have a market leading proposition and we are experiencing above market, above GDP growth and will continue to do so. So that is going to be a massive part of this business going forward. And we have a great general insurance business and in the general insurance business, we have a great book. What we haven't mastered at the moment is distribution outside of the branches and that is something we are investing money in, in terms of direct propositions and something we want to see our new business flow much more closely matched our overall share of the market from a stock perspective.

So we have three great products that match our overall share of the market from a stock perspective. So we have three great product lines and very much part of going forward. Some of the deterioration in the terms of year on year would reflect some short term things around, as we talked about, withdrawal from things like selling of protection through the branches which we announced last year. But going forward those three key products as I say the bulk annuities, corporate pensions and general insurance will be the anchors, the cornerstones of the Scottish Widows proposition.

In terms of SVR, I can't give you precise numbers but when we talk about NIM guidance and when we look internally about our NIM expectations and we talk about expectations of rising interest rates, one of the things we assume in that is increased attrition in terms of SVR, but obviously we have offsets that go against that in terms of things like deployment of reinvestment on structural hedge, etc. that more than offset it. So it is part of when we look at the net impacts, SVR is one of the factors that we include within that.

And then on PPI, on guidance, if I heard the question correctly, I think it was that complaints were up in the first quarter and why didn't we guide then that things might deteriorate? Look, we have a very long tail in terms of PPI and the extent to which when one takes a short term trend and extrapolates it and the extent of which, the complaints coming in represent a trend or represent a blip. And I don't think people would want us amending provisions each time I see a weekly change in terms of our PPI numbers and we get weekly numbers in terms of what we are actually receiving. So we have had a risk out there in terms of what might happen, we amend our numbers when we think what we are seeing constitutes a trend and then we reflect that and amend our estimate, but one has to wait to see in terms of more than four weeks what constitutes a trend.

Question 10: Ed Firth, Macquarie
Hi it's Ed Firth here from Macquarie. I just have two very quick questions. The first one was bringing you back to your provision cover or rather your impairment cover which has fallen quite substantially since Q1. And I hear what you say about the mix, but if I look at the disclosure that you helpfully give us on page 32, you can see you have reduced your cover across most of the Retail book, most of the Commercial banking book etc. And I suppose I just wondered, what was your thinking behind that in the sense that I guess traditionally banks look I guess to build up cover in the good times rather than reduce it further. So I guess that was my first question.

And my second question was about the PPI guidance. There is a lot of talk in the market about the Plevin case. Are you factoring in some of that in your guidance? And if you are or not what is the sensitivity to your numbers around whether you have to pay out commissions or not have to pay out commissions?

Juan Colombás
The coverage is pretty much stable, so there have been some changes. There is some impact in the commercial book because of the difference of the coverage between cases coming in which are better quality and therefore the coverage is lower and cases which are being worked out. In the Retail space that you mentioned, the main impact on impairments is related to the fact that we have sold some run-off assets and these impact the average coverage for the portfolio. We have not changed the way we are calculating the provisions in the portfolio so it is just a reflection of the good quality of the portfolio.

Ed Firth
Do you have a sense as to where, I mean, is your coverage by book, I guess broadly where you think it should be now? Are we below? Will you have a chance to reduce that further going forward do you think? Should we see more releases into the second half or are you broadly comfortable?

António Horta-Osório
As Juan said before we have had some releases and there will be more to come although at a slower rate. But the coverage is absolutely done in light of our strategic aim of being a prudent and low risk bank. So if you look at our coverage at 55 per cent it is higher year on year from 54 per cent to 55 per cent. It is a bit lower in the summer from 56 per cent, but that only reflects as Juan was saying, the better quality of the book.

Let me give you a very specific example. I think this example will be enlightening. We just sold as you know, all of our commercial exposure in Ireland for £800 million with a small gain pre-tax and 7 basis points capital accretion. Given that they were heavily provisioned our coverage is going to go down. But we sold the whole book so is our book better today than it was two days ago? Yes. Has the coverage gone down? Yes because it is a better quality book.

George Culmer
On Plevin we have a disclosure on page 77 of the RNS where we talk about Plevin and you will see that we specifically say we have not included or made any allowance for Plevin as you would expect, along with the rest of the industry. We have but one case and we are actively trying to assess the consequences there of, but there is not much I would say over and above what it shown on page 77 but that is where it is.

Question 11: Chris Cant, Autonomous
Thanks, its Chris Cant from Autonomous. I just wanted to come back to you on dividend again. You are at 13.3 per cent at the half and I appreciate that it is going to be a point in time decision at Board level whether you distribute excess capital over 13 per cent. But if you think about conditions today and the fact that you are likely to accrete capital in the second half, are you aware of any conditions now which would dissuade you from distributing excess capital at the year end? Obviously things may change in the second half, but is there anything today that would, assuming no change, that would assuming no change would you be able to distribute over 13 come the year end should you choose to? Thanks.

George Culmer
You get full marks for the question. But no, look I am not going to answer that. I mean it will be a decision that the Board will take at that moment in time and I am sorry I am not going to say any more than that.

Chris Cant
One completely unrelated question then which hopefully you might have an answer. The tactical deposit book you disclose in the announcement – you still have £33 billion or so of tactical deposit balances that are down about £4 billion on the year end. But given some of the pricing action you took in the first quarter there that is not a bad result really and just wondering if you think you can extract further margin benefit from those balances? And maybe if I can frame it like this, if you were to replace all those £33 billion of tactical deposits with retail deposits or rather relationship deposits, how much NIM accretion might we realistically expect to see? Thanks.

António Horta-Osório
It's a fair question, it is a good question. It is difficult to comment on that question for the following reason. I think as I told you many times, that we have developed a competitive advantage in the way we manage margin. Because on top of the multi brand, multi-channel strategy we are the only one that has a multi brand strategy which I really believe is very useful in a low interest rate context on managing deposit rates. We have a way of managing margin which is considering it as a whole. So we look on a weekly basis at the highest level of the bank, to all of the asset margins on the retail space and at all of the liabilities, all of the deposits. And we manage this combined, having the whole picture, if you want in front of us on a weekly basis at the highest level of the bank. Given that most other banks manage this on a monthly basis separating assets from deposits and that difference ways of the organisation, we think this is a competitive advantage and we think this has been reflecting in a different behaviour of our margin in the latest quarter's versus the markets.

But exactly because we do it on a weekly basis, and looking at everything that the market is doing, and on your specific question, given they are tactical deposits, it is very difficult to anticipate a strategy about tactical deposits. So we really have evolved this competitive advantage depending on how the market unfolds and how the situation evolve, we will react. But we don't exactly know exactly what to tell you about the tactical deposits exactly because they are tactical. So while in all of the others we have additional restrictions because they are key segments, they are relationship etc, the tactical deposits as you correctly said, are more volatile, we look at them both from a value perspective and a funding perspective. You know that we want to keep our loan to deposit ratio between a 105 – 110 more tied to the 110 because of the low interest rate environment where we think it is the prudent thing to do, especially when our wholesale debt in net terms is now close to zero. Then we look at them in terms of value combined with overall picture and we will evolve depending on the circumstances.

So I don't want to at all frustrate you but that is exactly why we call them tactical deposits and they include not only the online deposits in Germany but they include Scottish Widows deposits, Birmingham Midshires etc so we have several of those tactical brands that we manage both for value and for funding.

Chris Cant
Can I ask then what is the average rate across those deposits currently if you are not willing to comment on what the balance might be going forwards?

George Culmer
Well the online are about 50 basis points. I don't know of a figure, we can come back to you on what a figure for Birmingham Midshires might be.

Question 12: Claire Kane, RBC
Thank you. It is Claire Kane from the Royal Bank of Canada. Can I have two questions please? The first really is trying to assess the tail wind you have from the sub-debt roll offs. So you have £23 billion outstanding, down 10 per cent from year end. Obviously part of that is the ECNs so perhaps you can give us an update on how you think that court case on 24 August will go?

And also really in respect of the residual amount of sub-debt that you have outstanding, that does not meet the Basle III fully loaded criteria. Is there any potential there for buying back some of that sub-debt? And if there is any timeline perhaps on that?

And then maybe my second question, a quick one, hopefully. In terms of your capital stack, two parts to that really. On Pillar 2, do you have any update or really a view on the new framework that came out a couple of days ago? Clearly your absolute buffer requirement is now a larger percentage of your RWAs at 2.2 per cent?

And then coming back to your comment on the leverage ratio requirement for ringfence banks, that would suggest that you think the systemic buffer for the ringfence bank would be closer to the higher end of the range which then when you add that all together, comes quite close to your 12 per cent capital surplus threshold, so from that should we then deduce that your management buffer is equivalent to one year's dividend? Sorry that was a lot altogether!

George Culmer
Okay so going back to the start, yes ECNs core judgement it was 24th/25th or 25th/26th when we go for our appeal. You know suffice to say we expect to win, we think we should win. We think there were flaws in the original judgement around the definition of the word 'any' as opposed to whether that is on the first occurrence of the CDE kicks in or whether it is any possible or any future, so we think it is quite clear, it is the first occurrence.

And then there is the small matter of an instrument that converts at 1 per cent would in no circumstances count towards a stress test which is a sort of review of a going concern capital position of a business and what actions one should take, for which we think 1 per cent has no place in such assessment in terms of management actions. But anyway the Court may see different but that is our view. And we will wait for the judgement on this on the 25th/ 26th.

To your very long subsequent questions I will probably give a shorter answer. In terms of buybacks, we continually scan in terms of relative pricing and in terms of perceived paybacks and where we think there is value and think it makes sense for the business then we have acted and will act, but I don't think you would expect me to tell you where we might see such opportunities lie.

Then in terms of capital stacks, we are in a good position versus our UK peers and certainly our European peers and certainly our expectation is that you are unlikely to see any form of reduction of the total size of capital stack that we currently hold as we move into the new regime. So that is a general question.

And you will have to help me with your specific last question which we can pick up afterwards as to what the specific question was around buffers.

António Horta-Osório
Can I just clarify one point that I am not sure we said, relating to your question on the ECN case. Obviously the guidance we have given is because we like to give it on prudent basis is although everything George said obviously is what we believe, we gave you the guidance on a prudent basis so assuming the present Court decision where we lost. So the NIM guidance that we gave you is assuming the present Court decision where we lost, although as George tells you we expect what you just heard. Just to be clear that is what is in the guidance is the present Court decision okay.

Question 13: Peter Toeman, HSBC
Peter Toeman from HSBC, I was going to ask you whether you had included the Court win in your guidance?

António Horta-Osório
I saw it coming!

Peter Toeman
So instead of that, could I ask you about the SVR book and why it is that the rate of attrition on the SVR book has been so low, much lower than sort of commentators have suggested, particularly at a time when your competitors see your SVR book as a prime source of new business for them?

George Culmer
It is a question we get asked and without privy to other people's books, it is hard to answer in terms of a relative assessment. So there are others out there with higher rates which presumably is a factor, there are some at 4.84 per cent and stuff out there. So one would expect that those would have greater attrition whether it is anything to do with LTVs, interest only, proportions, we can but speculate as to the reason, so I can't give you a definitive answer, but it is quite a long-term trend that we have observed.

António Horta-Osório
And we can tell you later on how our SVR is also split because a very significant portion of our SVR is in much lower interest rate which is also an important factor.

Question 14: Tom Rayner, Exane BNP Paribas
Sorry to be back again, I just fancied one last try at the capital guidance and distribution question. If I give you a hypothetical position, for 2016, at the end of the year, you are looking at a 14 per cent ratio before distributions. What is the sort of things that the Board might decide would prevent you from actually paying out everything to get you back down to your 13 per cent. I am trying to understand this guidance. Is it guidance or a kind of aspiration?

George Culmer
I don't think I can pre-empt or predict the Board's discussion. Tom, you could derive things that might be out there in terms of whether it is regulatory changes, whether we talked about things like that, whether it is what is going on in the external environment, how we are viewing our own internal capital requirements. So Tom I can't be precise.

Tom Rayner
Well I had a go, thanks.

António Horta-Osório
Thank you very much everyone for coming.

End of Q&A