LLOYDS BANKING GROUP PLC – 2016 HALF-YEAR RESULTS PRESENTATION

THURSDAY 28 JULY 2016

António Horta-Osório, Group Chief Executive

Good morning everyone and thank you for joining us for our 2016 half year results presentation. We have seen another period of good financial and strategic performance. I will outline the progress made and how our transformation and differentiated business model position us well to withstand the uncertainty facing our sector and the broader economy. George will then cover the financial results and guidance and Juan will highlight some of the key elements of our prudent risk appetite. After this, we will take your questions. Turning then to the highlights for the first six months.

In the first half of 2016 our differentiated business model has continued to deliver, with robust underlying profit, a doubling of statutory profit and strong capital generation along with further progress against our strategic initiatives. Following the vote to leave the European Union, the outlook for the UK economy is uncertain. While the precise impact is dependent on a number of political and economic factors, a deceleration of growth is anticipated. Given the sustainable recovery in recent years, the UK enters this period of uncertainty from a position of strength.

As a simple, UK focused bank we have also benefitted from this recovery and from the simplification of our business in the past five years. This, along with our prudent approach to risk and the lowest cost structure of the major UK banks, position us well to continue to serve our customers and to deliver strong returns to shareholders. Our strategy therefore remains unchanged. We are committed to supporting the UK economy and helping Britain prosper. We are not, however, immune to the recent market volatility and our capital generation guidance for 2016 has been updated to reflect the impact of the referendum result. Our remaining 2016 guidance is unchanged, except for our AQR guidance, which we are upgrading. George will cover these points in more detail shortly.

Considering the updated guidance, and the fact that our underlying capital generation remains strong, the Board has approved an increased interim dividend of 0.85 pence per share, in line with our progressive and sustainable ordinary dividend policy. Before looking more at the transformation of the business and our strategic progress, let me first cover the financial highlights.

We have delivered another good financial performance in the first half. Underlying profit was a robust £4.2 billion, with a slight fall in income and higher impairments offset by lower costs, whilst statutory profit more than doubled to £2.5 billion. Our market-leading cost income ratio improved by an additional 50 basis points to 47.8 per cent on the back of additional cost reductions. And, given our accelerated progress on costs, we are today announcing a £400 million enhancement to the Simplification target we outlined in the 2014 strategy update. On the balance sheet, we have once again demonstrated the capital generative nature of the business, generating 50 basis points of common equity tier one in the quarter. Our balance sheet remains strong, with our CET1 ratio of 13.0 per cent, or 13.5 per cent pre-dividend, and leverage ratio of 4.7 per cent, amongst the strongest of our major banking peers worldwide.

As I have already mentioned, following the EU referendum the outlook for the UK economy is uncertain, and we expect a deceleration of economic growth. However, the UK is well positioned as it enters this period of uncertainty, given the strength of the recovery in recent years. Since the 2008/09 recession, both households and corporates have been deleveraging, which is reflected in the reducing ratios of debt to GDP. Mortgage market activity, and growth, are also low by historic standards, and transactions are well below the levels seen in the build up to 2008.

House prices have also improved, which has led to much healthier LTVs on the balance sheets of the banks and our customers now have mortgage debt which is less than half the value of their homes, on average. Mortgage affordability has also improved, and is significantly better than the long term average. In addition, unemployment, now below 5 per cent, is at its lowest level in over 11 years. Therefore, although a deceleration is likely, the nature of the recovery over the past few years puts the UK in a strong starting position.

In terms of the Group, we are also in a strong position. Over the past five years we have substantially strengthened the balance sheet and de-risked the business through the successful execution of our strategy. In de-risking our lending portfolio, and simplifying the business, since 2010 we have reduced run-off assets by over 90 per cent in a capital accretive manner and have reduced risk-weighted assets by over 45 per cent, one of the largest reductions among the top 25 banks in the world during this period. This progress, coupled with the improvement in the UK economy in recent years, has also led to a significant reduction in impaired loans, which now represent only 2 per cent of lending balances, and we remain prudently provisioned.

At the same time we have significantly improved our funding position, having reduced our wholesale funding requirement by almost £170 billion, while fully repaying almost £100 billion of emergency government funding. And, we have also increased our pool of liquid assets by over £40 billion. As a result, our liquid asset portfolio now exceeds our wholesale funding requirement. Cost leadership has also been an important element of our transformation. We have reduced our cost base by over £2 billion and have improved our already market leading cost to income ratio to less than 48 per cent, significantly ahead of our major UK peers.

Over this period, our prudent approach to risk has resulted in a substantial improvement in the quality of our portfolios. The average loan to value of our mortgage book has improved significantly to just over 43 per cent, and more than 90 per cent of the book now has a loan to value of less than 80 per cent. We have also restricted our share of new mortgages in London and, as I have mentioned before, we have been growing below the market in buy-to-let. On commercial real estate, our exposure is now less than a third of what it was in 2010, and represents less than 5 per cent of total lending.

Elsewhere, in Commercial Banking we have reduced our exposure to higher risk segments through selective participation, while in our higher growth motor finance business we have maintained tight underwriting criteria, with over half the growth in this area coming from our Jaguar Land Rover partnership, which we initiated in January 2014. And our resilience to severe stresses in all these portfolios has also been seen in the PRA stress test results in both 2014 and 2015.

Turning now to our strategic priorities. Our strategy remains unchanged. We are a simple, low risk, customer focused, UK retail and commercial bank. This differentiated business model continues to provide competitive advantage. And we are making good progress against each of our three strategic priorities: Starting with 'creating the best customer experience'. We continue to invest to ensure we meet the evolving preferences of our customers through our multi-channel approach. We operate the UK's largest digital bank, with a 21 per cent market share. With over 12 million online users and more than 7 million mobile users accessing our top rated mobile banking app, we now meet 60 per cent of our customer needs digitally.

And this progress is reflected in the Group's customer satisfaction metrics. Our net promoter score is over 50 per cent higher than at the end of 2011, and has improved across all brands and channels. Also, our Group reportable banking complaints remain significantly lower than our major peer group average.

Turning to 'becoming simpler and more efficient'. We announced in February with the 2015 results that we have been accelerating the delivery of cost initiatives in response to changing customer preferences and the lower for longer rate environment. We also previously said that we would complete our existing branch closure and role reduction plans, ahead of schedule.

As a result of this progress and evolving customer behaviour, we are today announcing additional initiatives including further branch closures and role reductions to be completed by the end of 2017. These initiatives will generate significant additional cost savings, taking our run-rate target for the end of 2017 from £1 billion to £1.4 billion. We will also be undertaking a rationalisation of our non-branch property portfolio. George will detail these points shortly.

Turning to 'delivering sustainable growth'. We have continued to deliver growth in our key customer segments, within our prudent risk appetite. In Retail we have maintained our leading market shares of key product lines, including personal current accounts. In mortgages, we remain committed to supporting first time buyers and continue to be the largest lender to this customer segment, although we continue to balance margin and risk considerations with volume growth, and have therefore continued to grow below the market, especially in the buy-to-let segment. In SME, we have once again outperformed the market, growing lending by 4 per cent in the last 12 months, although slightly less than in previous periods. SME and Mid-market net lending growth was £2.2 billion in the period, in line with our £2 billion commitment for the year.

In Insurance, we have continued to support our corporate clients in de-risking their balance sheets, with the successful completion of a further three bulk annuity deals in this period, following our entry to the market last year. In addition, we have further strengthened our general insurance proposition through the launch of our flexible online home insurance offering. And finally, in UK Consumer Finance, we have continued to exceed our £2 billion annual growth commitment, delivering year-on-year customer asset growth of £2.6 billion, predominantly across our motor finance and credit card businesses. I will now hand over to George who will cover the financials.

George Culmer, Chief Financial Officer

Thank you António and good morning everyone. Starting with the underlying results. The first half saw a robust underlying profit of £4.2 billion and a strong underlying return on required equity of 14.0 per cent. Underlying profit was 5 per cent lower than a year ago and down 2 per cent excluding TSB, with a slight reduction in income and increase in impairments partly offset by

3 per cent lower operating costs, as we continue to simplify the business. Positive operating jaws of 1 per cent demonstrate our continued ability to manage the cost base in a challenging environment and this has driven further improvement in our cost:income ratio to 47.8 per cent.

Looking at net interest income. Net interest income was up 1 per cent at £5.8 billion, reflecting the continued improvement in the net interest margin, which at 2.74 per cent was up 12 basis points on a year ago. Lower deposit and funding costs, including the benefit of the ECN redemption, continue to more than offset lower asset pricing and, as mentioned at Q1, the first half margin also includes a small one-off benefit from credit cards. In terms of divisional performance, Commercial saw a 3 per cent increase largely due to higher deposit balances, while Retail a 2 per cent decline due to lower mortgage lending as we continue to focus on protecting margin and risk profile in a highly competitive pricing environment. Looking forward, we expect the full year NIM to be in line with our existing guidance of around 2.70 per cent.

Other income was £3.1 billion, which reflects a 9 per cent improvement in Q2 compared to Q1 and the year to date run rate is in line with full year expectations. Year-on-year other income is down 5 per cent with Retail in line with the prior year and Consumer Finance down marginally due to the continued drag of reduced credit card interchange fees. Commercial Banking delivered a resilient performance in tough market conditions, while in Insurance we completed a further three new bulk annuity transactions but this was more than offset by adverse economic impacts and weather related claims.

On costs. operating costs of £4.0 billion were down 3 per cent, with efficiency savings from our current Simplification programme more than offsetting the increased investment in the business. Simplification has now delivered £640 million of run rate savings and we are ahead of our original schedule to deliver £1 billion of savings by the end of 2017. At Q1 we said that, given our customers' evolving behaviours and the expected lower for longer rate environment, we would be looking again at our efficiency programme. We are now extending the scope of the current programme by targeting an additional 200 branch closures and a further 3,000 role reductions by the end of 2017. These actions will increase our run rate savings by £0.4 billion to £1.4 billion, for a total cost of £2.2 billion, compared with the original £1.6 billion. Total spend to date is half of this at £1.1 billion, with a further £1.1 billion to be incurred by the end of 2017, of which around £350 million is for role reductions which will be taken below the line.

In addition, in our continued drive to reduce costs and improve efficiency, we are now targeting a 30 per cent footprint reduction in our non-branch property portfolio over the next two and a half years. This initiative will cost around £300 million over this period, which will also be taken below the line, and will deliver one-off savings of around £100 million and annual run-rate savings of around £100 million by the end of 2018.

On credit, our asset quality remains strong. The charge for the half year was £245 million, which represents an AQR of just 11 basis points, with the increase on prior year reflecting lower releases and writebacks, and a stable gross AQR of 26 basis points, compared with 25 a year ago. The quality of the Group's loan portfolio also continues to improve and non-performing loans as a percentage of closing advances now stand at 2.0 per cent, compared with 2.1 per cent at the end of 2015, and over 10 per cent in 2010. In terms of guidance, while we expect slightly lower releases and writebacks in the second half, we now anticipate the AQR for the full year to be less than 20 basis points.

Moving on to statutory profit. Statutory profit before tax more than doubled to £2.5 billion in the first half, boosted by the robust underlying profit and a low level of below the line items in the second quarter. Looking at the individual line items. Firstly, as previously reported, the Group took a £790 million charge in Q1 for the redemption of the ECNs. The Supreme Court has since found in favour of the Group, which supports the decision taken to redeem these notes and means there are no further charges in respect of this item. Market volatility and other items totalled a charge of £150 million. This includes a £484 million gain on sale from the Group's stake in Visa Europe, and this offsets the fair value unwind charge of £110 million, the amortisation of intangibles of £168 million, as well as negative insurance volatility of £372 million, primarily driven by lower interest rates and a widening in credit spreads.

On restructuring, the £307 million charge mostly reflects the Simplification programme's severance costs relating to the accelerated role reductions and also includes around £60 million of costs for the implementation of the Group's non-ring-fenced bank. Other conduct was £460 million, with £345 million recognised in the second quarter. The charge for the half includes a range of conduct issues including arrears handling activities, packaged bank accounts and legacy German insurance products. On PPI, no further provision has been taken, with complaints in the first six months averaging around 8,500 per week, although this has dropped to around 7,500 over the last six weeks. We are currently still awaiting the final outcome of the FCA's consultation on a potential time bar and treatment of complaints relating to the Plevin case.

Finally, our tax charge was £597 million, representing an effective tax rate of 24 per cent and reflects the impact of tax exempt gains and capital losses not previously recognised. We continue to expect a medium term effective tax rate of around 27 per cent.

So briefly on the balance sheet. Average interest earning assets excluding run-off were broadly flat in the first half at £426 billion, with growth in Consumer Finance and SME lending offset by lower mortgage lending as we focus on risk profile and margin preservation. Risk-weighted assets were also flat in the six months, at £222 billion. Reductions from optimisation and disposals were offset by around £3.0 billion of increases due to adverse FX movements following the outcome of the EU referendum.

Finishing then with capital. The business remains well capitalised and continues to be strongly capital generative. In the second quarter the Group delivered 50 basis points of capital, after a 30 basis point adverse impact on the EU referendum primarily relating to FX movements on RWAs. Given the referendum impact, we now expect to generate around 160 basis points of capital, pre dividend, for 2016. Given the current uncertainty, it is too early to determine the impact on our formal longer term guidance at this stage. However, while the business will remain highly capital generative, it is possible that this capital generation maybe somewhat lower in future years than previously guided. We will formally update guidance when we have a clearer view of the likely outcomes.

Finally, on net tangible assets, TNAV has increased by 2.7 pence since the 2015 year-end to 55.0 pence per share, driven by statutory profit and positive reserve movements, partly offset by the cash payment of the 2015 full year dividend of 2 pence per share.

I will now hand over to Juan who will cover some of the credit portfolios in more detail.

Juan Colombás, Chief Risk Officer

Thanks George, and good morning everyone. Given the current market concerns, we thought it would be useful for me to talk through some of our key portfolios and demonstrate how our low risk business model and prudent risk appetite have ensured that the Group is well positioned.

Starting with the mortgage book. The risk profile of the mortgage book has improved significantly over the last five years, with a current average LTV of 43 per cent, which is down from 56 per cent in 2010. In addition, the proportion of the portfolio with an LTV of greater than 100 per cent is now less than 1 per cent, while only 9 per cent of the book has an LTV greater than 80 per cent. Impaired loans are also significantly lower and are down 43 per cent compared to 2010, with improvements across all portfolios. Our new business quality is strong due to our prudent lending criteria. For instance, we do not lend to owner-occupied borrowers at an LTV above 90 per cent without risk mitigation, we do not participate in buy-to-let lending over 75 per cent LTV, we do no sub-prime nor self-certified new lending, and we have a loan-to-income multiple cap of 4 times, for loans over £500,000, which we voluntarily introduced ahead of the FPCs recommendation for the sector. These prudent criteria mean that, in London for instance, our share of flow has been significantly below our market share at just 14 per cent over the last 12 months.

Over half of the outstanding £300 billion mortgage portfolio has been written since the last recession under these low risk criteria and the pre-2009 lending is now well seasoned, with an average LTV of less than 50 per cent. In addition, in buy-to-let, we have taken the conscious risk appetite decision to grow significantly below the market in recent years, with growth of just 1 per cent over the past 12 months, compared to a market of 12 per cent.

Finally, it is important to note that our provisioning approach is prudent and we have taken a conservative view of recent house price increases in our provisions.

Turning to Commercial Banking. Since the financial crisis, much of the Group's restructuring has focused on de-risking the corporate lending and commercial real estate exposures. The risk profile of the Commercial book has benefitted from a significant decline in corporate gearing since 2008, which has eased debt burdens and reduced debt servicing costs for the sector. Our Commercial Banking business model is now focused on delivering sustainable returns through a client led, low risk, selective participation strategy and this approach means that we have limited exposure to higher risk segments. For instance, oil and gas, mining and commodities, in total, account for less than 1 per cent of the Group's loans and advances and around 75 per cent of this exposure is investment grade.

In commercial real estate, our exposure is now less than a third of the level of 2010, down at £20 billion, and accounts for less than 5 per cent of Group loans and advances. This figure of £20 billion includes around £5 billion of residential property lending.

The reduction has been achieved through exiting higher risk Commercial Real Estate business and focusing on our core UK clients. Indeed, overseas CRE has reduced from £20 billion in 2010 to de-minimis levels in 2016. As in other sectors, we also have prudent lending criteria in place for CRE. For instance, we do not hold junior debt and only lend at senior level, we do not lend for speculative commercial development, and we have restrictions on the maximum single hold positions. This approach results in a high quality CRE portfolio where around 90 per cent of the book is investment lending supported by rental cashflows. In addition, the book has a strong LTV profile with over 95 per cent of CRE secured lending over £5 million having an LTV of 70 per cent or less.

Finally, looking at UK Consumer Finance. Back in 2014 when the Group announced its strategic plan we identified Consumer Finance as an area for targeted growth as it was a segment in which we were under represented. The Group has been delivering on our growth ambitions; however, the focus has been on doing this within our prudent risk appetite and the 73 per cent decline in impaired loans since 2011 is testament to this approach. The quality of the Consumer Finance new business is strong. We do not participate in sub-prime, we do not provide credit repair cards and we operate robust affordability and indebtedness checks to ensure that lending is sustainable for our customers.

Finally, as you can see, the majority of the book's growth over the past few years has come from motor finance, and of this, more than 60 per cent has come from our relationship with Jaguar Land Rover that sources high-prime quality lending.

So, in Summary, we have de-risked the book significantly over the past five years and at the same time ensured that the new business written since the crisis has been of the strongest quality. We are now a simple, low risk, UK focused, retail and commercial bank, and the Group's low risk culture and prudent risk appetite mean that our portfolios are well positioned in the face our current uncertainty.

I will now hand back to António for his closing remarks.

António Horta-Osório, Group Chief Executive

Thank you Juan. So to conclude, we have delivered a robust financial performance and have been successfully executing against our strategic priorities. Our simple, UK focused business model remains the right one. Our cost discipline and low risk approach continue to provide competitive advantage. Whilst the outlook for the UK economy is uncertain, and a deceleration of growth is expected, the UK is well positioned to face it.

Regarding Lloyds, the successful transformation and simplification of the business, together with our low risk appetite, also position us well to weather this deceleration and continue to deliver for our customers and our shareholders. Looking ahead, we will not be immune to the consequences of the EU referendum result, and regarding 2016 specifically, we expect to generate 160 basis points of capital, are re-affirming our NIM and cost:income ratio guidance, and are improving our AQR guidance. Our strategy of becoming the best bank for customers and shareholders hasn't changed. We are open for business, have a strong financial position and remain committed to doing the right thing for customers and helping Britain prosper.

Thank you. We will now take your questions and I would appreciate if you say your name and institution for everybody in the room.

Question and Answer Session

Question 1: Chris Manners, MORGAN STANLEY

Good morning everyone, it's Chris Manners from Morgan Stanley here. Two questions if I may. The first one was on the dividends and payout potential. I guess it looks like a conservative stance the Board has taken with 0.85p dividend at the Interim. But you printed a 13 per cent CET1 ratio, counter cyclical buffer has been cut and as I look at your guidance of 160 basis points of generation for the full year, that means we might get another 110 basis points capital formation in the second half. How do we think about that 13 per cent for the baseline and are we still going to be comfortable paying out everything above the 13 per cent?

Answer: George Culmer

In a world that is changing, some things haven't changed, so our dividend policy very much has not changed and I think how the Board goes about considering that and when the Board considers that has not changed as well. So as of last year where the Board will make full consideration at the end of the year in terms of both the final dividend and should there be any surplus capital, what to do with that surplus capital at that particular point.

As regards requirements as well yes, as impacts change on things like counter cyclical, but our view that 12 per cent is a requirement plus the management buffer on top of that coming to about 13 remains the right requirement.

Further question

And a second question if I may on net interest margin. I guess 2.74 per cent for the first half pretty good. I guess versus what we were looking for. If you are now saying 2.70 for the full year, that gets us to about 2.66 for the second half. If you could talk us through the other moving pieces there and how you get to that number and maybe I could ask for views into 2017, I know you shied away from it, but anything you can offer will be very helpful, thanks.

Answer: António Horta-Osório

Chris you have been very precise in your arithmetic. I think I have given the same guidance in Q1 which was reaffirming around 2.70 for the year, we came out with 2.74. It is correct, it's a little better than we expected but I don't think it is true 2.74 means 2.66 for the second half. It means around 2.70. We keep the same guidance. We think 2.74 is around 2.70 and of course there is small volatility that can happen. So we are reaffirming our guidance. Quarter 2 was a little bit better than we expected. This is a repetitive comment over the last few years. We manage margin we believe in a different way which provides competitive advantage as you know. We are the only bank in the UK that has a multi brand, multi-channel strategy which as I have said many times now is very relevant on managing deposit costs in a low rate environment, given different brands and customers preferences. We manage the difference between the asset margin and the deposit margin together and we do this on a quite timely basis every week on all prices of retail. And over time I told you this should provide competitive advantage, it is showing a different behaviour than other peers and I do not see with what happened with Brexit any difference in outlook for the current year. I also told this several times that I would never give guidance for more than one or two quarters because that is what we can see. And if there is anything, we were very open with you about Brexit uncertainty. We are only five weeks after the vote. It is very uncertain as to what will happen. It is very important to see the Government economic plan, the Government social plan apart from the negotiations with the EU, it is very important to see how other banks will react and therefore it is quite uncertain, we don't know. But we are very, very firm that our NIM guidance will be the same for the full year.

Question 2: Raul Sinha, JP MORGAN

Raul Sinha from JP Morgan. If I could focus on the impact of lower rates going forward just to get an understanding of how you are looking at the business. Firstly if you could tell us what proportion of the SVR mortgages would need to be priced lower if there was a Bank of England base rate cut in the second half?

And secondly if you could talk a little bit about what mitigating actions you can take within the business in terms of hedging or in terms of repricing? You previously talked about a £60 billion book of deposits, you are paying about 2 per cent. Any update on that which you could use to mitigate against for lower rates, that would be really helpful?

And the second question was if you are planning to change your strategy of growth towards consumer credit going forward at all? Thank you.

Answer: George Culmer

So in simple numbers, in terms of the SVR book, there is about £70 billion which is on a sort of automatic reprice so that is number one. Fact two, as Antonio was just talking about and as we have demonstrated in terms of mitigating that through taking action on the other side of the balance sheet, we have got a good track record of that and we would certainly be looking to offset that in terms of action taken.

And to your question in terms of sort of what has been happening on those cost to funds, on the Retail blended saving rate, is about 96 basis points, I think it was about 100 Q1 and I think about 106 at the start of the year. So we continue to manage that down and would back ourselves to be able to mitigate.

In terms of impact of rate cuts and people always want hard numbers but there are variables and what happens to swap rates, what the competition is likely, you know to decide to do, what we are able to do and all those sorts of things. I always couch these comments with that sort of guidance or warning around them. But we disclosed at the year end in the annual report and accounts we talked about 100 basis points being £600 million or something like that. I mean as it stands today a 25 basis point cut we estimate will be something like £100 million over the next 12 months. Now as you go out, numbers change etc, a bit like our NIM guidance, I am not going to speculate on what happens to that, but in terms of 25, that is the sort of number. If you go beyond that it is not quite linear, but it doesn't change dramatically, but that is how we look at it and we would again look to carry on in terms of what we have achieved over the last two years in terms of managing the spread between the two. So the lower rate environment makes things tougher. We would look to respond, that is the reason why some of the comments that we give, and I think as we say, we have demonstrated over the last few years that we are well placed to respond and that is both through

the margin management, that is through in terms of continued high quality on the credit portfolio and through being proactive and never being complacent in terms of the cost position. Again there are a number of things, additional items as I say. Those have their source back in Q1 and the start of the year where we assumed it was going to be lower for longer. We saw the changes in consumer behaviour and decided we had to act. And you are seeing the consequence of that now. But lower for longer makes things tougher, but we think we are in a good position to be able to respond to that.

Answer: António Horta-Osório

And before you go into the second question, two more points to what George said which are relevant. I don't think it is going to be like it was before. Before you had slightly lower asset prices based on expected lower AQRs, which the banks were matching with lower deposit prices and the fact that deposits were more and more being close to zero made it more difficult. I don't think it will be repeated. First we saw with the referendum for example in our case we saw ourselves as a refuge in terms of deposits. If you look at our loan to deposit ratio it has spiked down to 107 per cent because we had an influx of deposits which was more than we expected pre the vote. So we will be able to recycle these deposits going forward in terms of margin and volumes to go back to our loan to deposit ratio target which we told you would be closer to 110 than 105 in a low interest rate context. So I think this is the first point. How people perceive banks in terms of risk has changed and in our case the loans and deposit ratio shows that. And secondly I think that on the asset side banks are going to take stock to think about price and asset spreads because the lower AQR in the future will no longer be there. So as people decide how to price for mortgages they will have to decide what will be the AQR in the future. And the AQR will be higher, intensity to be known. So I expect a change in behaviour than from before given the vote. And therefore it is not clear to me that mortgage prices will come down. You have to differentiate here what is fixed rate because of the swap rates and floating rates, and some banks have commented on things but it depends where swap rates are, but I do expect a different behaviour on the market given the AQR expectations. And obviously as we say, we will continue as we have done for more than 12 months to produce low risk margin versus volumes which was already the right thing to do in a low growth environment. It is even more right to do in an uncertain environment.

To your second question on growth in Consumer Finance, I think it was clear and that is why we have tried to be more open and tell you more things about risk which I know you were not so interested before. Because our prudent risk approach, it was not that important in a high growth economy, our prudent risk approach has been a reality over time. We told you three years ago, look we are going to be less emphasising less large corporate loans because margins are lower, because covenants are more lax and our corporates loan book decreased. And we said two years ago London is booming in terms of prices and the Bank of England is worried and we are the largest lender and we should be prudent and reduce loan to income multiples. And more than a year ago we said buy to let, the regulator is worried again, we are the largest lender, we are going to de-emphasise buy to let. So our strategy has been a strategy in a very robust economy but always with the view this will one day turn and I think I told you last time, the longer we go, the closer the turning will be. I never thought it would be immediately with decision of the vote. And therefore the reason I am saying this is, we are not going to do, and I think it was clear from Juan's slides, we are not going to change our credit policy. We have been doing adjustments as we thought was appropriate. We might do small tweaks. We are completely open for business and we are not going to change it. But do we expect a slight deceleration of loan demand? Yes in the same way we expect some deceleration in growth. We expect some deceleration in loan demand. So our core book was growing 1-2 per cent a year, it will grow slightly less because there will be less demand, but our credit policy has always been prudent and therefore with hindsight after the vote, it was even more appropriate for the times and we are not going to change our credit policy and we will continue to grow in Consumer Finance. The quality of the Jaguar Land Rover joint venture is very high. Until four years elapse and there is still some time to go, all gross business is new business because there is no redemptions that is why we have grown so much in that area. We are very comfortable with it and we will continue to do so and the same in the SMEs.

Question 3 : Michael Helsby, BAML

Michael Helsby from BAML. I have got two questions if I can. Just on the incremental cost reduction. George you highlighted I think it was on slide 12 that there is going to be an incremental CTA to that. Previously you used to put all of that below the line and now obviously some goes above the line and there is £350 million now below the line. So I was wondering if you could help us understand how much of that incremental £400 million would fall into profit if you like in 2017 and maybe 2018, i.e. how much is the offset that is above the line if there is any?

Answer: George Culmer

I put it a slightly different way. As I said in the Presentation, there is about a sort of £1.1 billion of spend to come in terms of the simplification and about £350 million of that relates to redundancy and we take redundancy below the line. The reason for that is slightly clunky I know in terms of above and below the line, but for us managing that cost:income ratio and sticking to that cost:income ratio and reducing each year is very much core to how we run the business. And from a purely practical sense you know that gets messed up if I have got those large one-offs. So that is how we run it internally. Now that focus on reducing the cost:income ratio very much remains at the core of what we do and we have reiterated that that is our existing guidance that is

on the table that our desire and target to continue reducing that each year and that very much remains in place. So that continues to be the bedrock of what we do. As I say in terms of additional costs to come, there is about 350 that will go below. Quite separate to that, I know we have the non branch property that we talked about and I know we will take some of that below the line, again it is for the similar reason. This is how we manage internally in terms of getting that extreme focus on the cost:income and again this is going to be lumpy type costs so I put that below the line, which gives you that pure line of sight in terms of what the ongoing are and how we run the business internally. But as I said we have got this commitment in terms of reducing the cost:income ratio each year and that remains in place, that is how we focus and that is how we run the business.

Further question
I appreciate that, I guess of that £1.1 billion that is left, the £350 million, all of that is in the P&L in other words, none of it is being capitalised, there is no capex, it's all revex?

Answer: George Culmer
No there will be a proportion, I don't know what the number is, but a proportion of that that will be capitalised. Within that a lot of the simplification is around automation, automated processes, invested in digital and those sort of things and you would not be expecting to expense that. So there is a proportion of that. But within that £1.1 billion the bit that isn't below the line, we will absorb that above the line and do that and whilst keeping to commitments in terms of cost:income ratio.

Further question
The second question, the stuff on the risk was very helpful so thank you for that. I think the flip side of having an LTV position in the mortgage book that is dramatically changed if you like from where it was is that obviously a lot more people can refinance now. So George I was wondering if you could help us or give us an update on what is happening in the SVR book by brand and rate and the redemption pace that you have been seeing and if you would expect that to change going forward? Thank you.

Answer: George Culmer
Well regards the SVR book, that continues to be probably more sticky than we assumed in our plans and there is no dramatic change in terms of some attrition ratios. So overall I think about 9 per cent at Q1 it's about 8 per cent or 7.9 per cent at Q2 and that is the annual attrition rate and actually within that, the Halifax book which is now about £50.7 billion, was about 5 per cent in the quarter. So that is its annual rate. So it has actually dropped. Now it may pick up a bit. In terms of going back to some of the other questions, in terms of offset, when you look at base rate cuts and all those sorts of things and how it might develop, you know should there be a base rate cut, I would expect that book to be significantly more sticky and in terms of the offset, if I have got lower returns on cash on deposit and low returns on structural hedge etc, one of the offsets going the other way as I would expect that book to be significantly more sticky. So we have actually seen as I say a slowing down of attrition in Q2 and we will see what happens going forward, but it may be pretty closely linked to what happens on base rates I would have thought.

<u>Question 4: Martin Leitgeb, GOLDMAN SACHS</u>
Good morning Martin Leitgeb, from Goldman Sachs. Two questions please. The first one is to follow up on your NIM guide and comments on NIM and how you expect the market to behave going forward. Just to confirm, so your expectation is if there would be a base rate cut next week, you would assume that given that the banks factor in higher risk cost, you would assume a base rate cut not to be fully passed on in terms of asset spreads going forward. How could the Bank of England help alleviate some of the pressure on P&Ls from the lower rate environment, would an extension of funding for lending or activation of the contingent repo facility help going forward?

And the second question is more on consumer behaviour and new business post referendum and I appreciate it is an extremely short period of time, but equally you probably have one of the best visibilities given your leading market share on a number of products. Could you shed a bit of light in what you have seen in terms of consumer behaviour, new lending volumes, appetite, demand for new lending? And also in terms of property valuations, so if you have seen some of the valuers marking down residential real estate or commercial real estate? Thank you.

Answer : George Culmer
The extension will depend on actions at the time. I mean slightly naff answer to your question, but if there is a base rate cut next week, 25 basis cut or whatever, I mean for us we would be sticking to our guidance and within that going back to some of the effects that implies, that is the liability side to offset some of the automatic elements in terms of the assets, but we would be sticking with our guidance on that. In terms of the things the Bank might do. The counter-cyclical was nice but actually I think the sentiment was more important than the actuality of it and I do think that whatever, whether it is extensions of help to buy, FLS, announcement of infrastructure or whatever, irrespective of time periods and pounds, shillings and pence, I actually think the symbolism of action and being prepared to step in and being able to talk in a confident fashion and about standing behind the economy kind of matters more. It is morale, it is three to one to the physical type thing. So I actually think those indications of

support and willingness to do it is what will in turn drive confidence which in turn will drive investment, which will in turn drive the credit etc. So I think the symbolism and the communication is what matters most.

Answer: António Horta-Osório

And Martin to your second point on consumer behaviour and clients behaviour in general. It is very early days, five weeks from the vote. Trying to give you some colour, because as you said we have 25 per cent of the retail customers and 18-19 per cent of SME new market. On the retail side we basically see no change, so debit card transactions, credit card transactions, current accounts. The only movement that we saw which we think is Lloyds specific, we saw an abnormally high influx of deposits on us as reflected in our loan to deposit ratio going down to 107. I think the market in general, in retail we think it is very early days and we see no change in behaviour. In terms of prices of homes as you mentioned, we see London is going down, so the latest numbers from June are quite symmetric regionally throughout the UK and London has gone down in June, we haven't yet seen the numbers post-vote but I would expect that to continue. And on the corporate sector we have seen already pre-vote some holding of some investments waiting for the vote and we have continued to see some holding of investment in SMEs, mid-markets post vote, which is logical. But again it is very early days.

Question 5: Chris Cant, AUTONOMOUS

Good morning, it's Chris Cant from Autonomous. I just want to say thank you for giving us the notional value of the hedge on page 7 of your report, I think it is the first time you have given us it. So I was just trying to solve the riddle of how you have £120 billion invested with a three year average duration at a gross yield of 1.8 per cent at the end of 2Q? I am not sure whether you have some kind of very aggressive barbell strategy. I know you used to say you had reloaded in 2013 with 10 year gilts at around 2.2 per cent, but I don't see how you get to a 3 year duration with 10 year gilts at 2.2 and an average of 1.8. So if you could give some colour on that?

And a second question if I may. Your non banking NII was quite negative again in the second quarter, very negative overall for the first half, I was just wondering if you could give us some guidance on how that is likely to look going into next year. It feels like we are becoming structurally more negative in your non banking NII when arriving at your reported margin. Thanks.

Answer: George Culmer

I don't think I want to go into the detail of how the hedge is constructed. There is no mystery there. We have the benefit, you are right, we have come in and gone out at various times. But this is a strategy we have pursued for some time so we were able to buy in at significantly greater yields at the time. So we have the benefit of history but I don't think I am going to dissect it further for you in terms of duration and tenures etc. So those are the numbers. As I said, we have been asked numerous times to present them and we have done and I hope you do find them useful, but I don't think we will be dissecting the thing further.

Answer: António Horta-Osório

I think what you asked, is we have done a few years ago some 10 year gilts and why is average duration three years?

Further question

How do you get to a gross yield of 1.8? So you say it is 1.3 return over libor return, how do you get to an average of 1.8 with a three year duration? What have you invested in to get to a 1.8 yield?

Answer: António Horta-Osório

The answer is exactly what George said, we have invested over time. And if your question is if we have anything which is not gilts, we don't. It's three year average duration, it is all government security and it is just the weighting average of whenever we do the hedge. The only additional information we might tell you which you might find useful is that we have not been reinvesting the hedge since the end of last year because we don't think at present interest rates that would be worth it. So that is the only other information which might be useful for you. But George said, we gave you more information because you asked and there is nothing but the gilts on that portfolio and we have not done any reinvestments since the end of the year.

Answer: George Culmer

And the non banking NII trend in 2017, I would have to go back and have a look and make a more considered view in terms of what the trends might be but I don't think there is anything to particularly call out from that trend.

Question 6: Manus Costello, AUTONOMOUS

Thank you it is Manus Costello, also from Autonomous. I was a bit surprised by the RWA move due to FX this quarter. What proportion of your RWAs are not in sterling and why don't you hedge them?

Answer: George Culmer

In terms of raw data there is about 20 billion of US, about 12-15 billion of Euros of that order. And to hedge or not to hedge, the reality is you can't do a hedge on these so to speak in the sense that these are off balance sheet. If you think about it, I have got my balance sheet and I have got my assets and I have got my liabilities etc which I look to hedge and from a balance sheet perspective. But from an RWA calculation I just take the assets over here and calculate what the RWAs is and therefore I have to put my capital against that. So it is just taking the asset side of things. Now if I did decide to cover that, it is not a hedge per say. I would not be able to get hedge accounted treatment so I would have to take the volatility on that currency exposure through the P&L so that is how it would work from an accounting perspective. So you could take a deliberate view to "overhedge" and you just take the P&L volatility on the FX. So that is the sort of why you can't do a hedge, because it exists outside of my balance sheet. So that, what happened following the referendum in terms of the big movement in sterling, particularly against the dollar is I have to revalue the RWA and the only thing I put against that, is capital which is all sterling denominated. You could overhedge and take the P&L volatility as you move through it. But you can't do a 'hedge hedge'.

Further question

Just related therefore, that is sort of low teens of your total RWAs, is that inside or outside the ring-fence?

Answer: George Culmer

That is an interesting question.

Answer: António Horta-Osório

Maybe your doubt is because when you say why we don't hedge at this point. We completely hedge in terms of assets and liabilities, but given that we are domiciled in the UK, that dollar exposure and Euro exposure is from the UK, you cannot hedge at the equity level if we have, imagine a subsidiary level at which those are done. You have the equity as well and that has a different accounting treatment, because we are UK domiciled some assets are in currencies, and when sterling depreciates there is no P&L impact but you have higher RWAs because our equity is in pounds, that is why it is a small impact of 30 basis points because of the massive depreciation of sterling 11 per cent versus the dollar and close to that to the Euro.

Question 7: Rohith Chandra-Rajan, BARCLAYS

Thank you, good morning, it is Rohith Chandra-Rajan from Barclays, a couple as well if I could please. The first one is just on the motor finance business in the UK on credit quality. The NPL ratio and actually the total balance of NPLs have been improving in the first half, but the coverage has moved up from 67 per cent to 92 per cent so I was just wondering in a more uncertain environment how we should think about that coverage ratio going forward for that particular business and what the reason for the move in the first half was? That was the first question.

And secondly, you have been very helpful in giving some indication in terms of your London mortgage exposure in terms of 14 per cent of the flow. I was just wondering if you could give us a bit more detail in terms of how that sits in terms of the overall stock and any segmentation you might be able to provide on LTV or LTI? Thanks.

Answer: Juan Colombás

On the coverage we have not changed at all our policy on the way we do it. So there has been some something else in the lending related to the debt sales but there is nothing to call out as a change or the fact that we have not seen a change in the trend at all, the trends continue to be the same and so there is no reason to think of a potential deterioration of the portfolio at all.

On the profiling of our presence in London, I don't have it on the top of my head now so I will need to go back to that.

Further question

Can I just come back on the UK motor. So how should we think about, what is the appropriate coverage for that book going forward? I appreciate it might have been, and it is a small balance of NPL so I appreciate that small change is going to have a big impact on coverage ratio. But at the moment it is higher than you have got on consumer, on credit cards and UPLs, so what is the right level of coverage? So if the European book is covered at just over 50 per cent?

Answer: Juan Colombás
There is no right or wrong answer. We do our provisions based on the flows we see into arrears and recoveries and over that you apply adjustments, based on judgement and we tend to be on the conservative side. As soon as we see any reason to overlay provisions and you have seen in the past, we do it. There is not one single version of the truth on this.

Answer: George Culmer
And you have got to remember scale as well. I mean we talk about impaired loans of about 0.1 and provisions of about 0.1 so I mean they are good questions and you have to remember proportionality here.

Further question
I appreciate small at the moment, I was just wondering if things do deteriorate?

Answer: Juan Colombás
I could answer this more broadly, in unsecured we have not seen any changes at all. So all the time there is continued improvement in all the portfolios in unsecured lending.

Question 8: Andrew Coombs, CITI
Andrew Coombs from Citi, three questions from me please. The first is slightly pedantic so I apologise, but given you have changed your capital generation guidance from 200 to 160, 30 basis points of that we have seen this quarter and on the FX translation impact that could arguably be one-off in nature depending what you assume is the drift in FX rates from here. What is the extra 10 basis points? Is that a lower profit outlook for the second half or another assumption?

The second question would be on July mortgage application rates. I know you don't like talking about the next quarter, but given the extraordinary events we have had, could you comment on what you have seen in terms of applications in July?

And then finally, I noticed you have put through quite an aggressive cut on your first time buyer mortgage rates in June, it's moved you back into the pack. So just what the rationale for doing that was and I know it is a space you have been very active in beforehand.

Answer: George Culmer
Shall I go first, you are right, it is pedantic. Look yeah guidance is 200 basis points. I think we said some years it is going to be tougher than others. This was a pretty tough year to achieve that. We came in, we had the ECNs in Q1 which we had to work around, we then had changes in the utilisation of brought forward tax losses that we had to work around as well, we had the new imposition of PVAs that came as well that we had to work around. So despite all those headwinds as we move through the year we will be able to hold to that guidance and that is based upon sort of what we saw as underlying profit generation and what we are doing in terms of RWA optimisation. So in terms of this, this is quite an active management of the 200 basis points because there some things we had to work to overcome. There are some things we have had to work to to overcome. In terms of what has happened, in terms of basis points, most of those yes, RWAs as discussed, there is a bit in terms of PVA volatility as well, you have to drop the numbers into the machine and it works against you as well. When I look at the numbers, no, underlying profit will remain strong, I am not trying to signal any deterioration. When I look at the first half numbers I am pleased with income, I am pleased with costs, I am pleased with credit. Other conduct was a disappointment so that works against me. I don't expect that level in the second half of the year, but certainly was a disappointment in the first half of the year again and made it slightly harder. So those things are just things we sort of strive to overcome and 10 basis points in the size of the capital base, well we thought we were close enough.

Answer: António Horta-Osório
You could see it the other way around. We generated 50 so far, we are giving 160 for the year, which is more than 50 for each of the following two quarters, so it depends how you look at it. For your second and third questions. We have seen a slight deceleration of mortgage applications in recent months, but I don't think that is related to the vote as I said before, we think it is related to the tax changes in April which led people to anticipate mortgage applications and therefore you move forward to pre-empt it, so it is too soon to call any material change on the retail space.

Further question
Just on the first time buy mortgage rate cuts in June?

Answer: António Horta-Osório
You should take that in the context of what George said, it depends on what the market does, we act in the market, but as I said before our strategy has always been to privilege margin and low risk versus volume and given the volatile as I said before, even more so going forward which I think is absolutely the right thing to do in a low growth market and which now will have a higher risk premium.

Question 9: Tom Rayner, EXANE BNP PARIBAS
Thanks very much, Tom Rayner from Exane BNP Paribas. Can I have two questions please? The first really on your core franchise because obviously you describe yourself as the leading UK retail and commercial bank. And the first half of the year your mortgage book shrunk, your commercial loan book did not grow and the only real growth we saw was coming through your UK motor and to a lesser extent your European consumer business. I wondered if you could comment how you are feeling about the franchise in terms of that performance in the first half?

And I have a second question if I can just to come back on the structural hedge please.

Answer: António Horta-Osório
So on the first question, I would disagree with that comment to be fair.

Tom Rayner
It was a question not a comment!

António Horta-Osório
It was a comment, you said we did not grow in our Commercial portfolio and we did. I mean we have a commitment of growing around £2 billion every year until the end of 2017 on both SMEs and Mid Markets and as I said in my speech, we actually grew £2.2 billion, so we met that target. We don't have loan growth targets for large corporates because large corporates can tap the capital market, can do whatever they want, so there is no logic in targeting as we said many times loan growth in large corporates. So we met our targets, slightly exceeded it in Mid-Markets plus SMEs, we continue to gain market share in both segments, we have as you said continued to grow very well in Consumer Finance where our target was also £2 billion per year and we did £2.6 billion in the last 12 months, significantly ahead of the target. So we feel very well about the growth in our key segments and the only additional segment where we have not grown is mortgages, where we have not grown for the reasons that we have been discussing over the past 18 months. The only segment growing in mortgages is buy to let, we felt it was prudent not to grow as the market in that segment, second we thought as the largest lender we should set the right standards and the regulator was worried about the segment and as you know buy to let is growing 12 per cent year-on-year and we are only growing 2 per cent in that segment, which again with hindsight of the vote, it is more appropriate in our opinion to do and will continue to balance risk and margin in mortgages versus volumes because of those reasons. So our core loan book was growing around 1-2 per cent, is it going to grow slightly less going forward? Probably yes as I said previously because I expect a slight deceleration of loan demand following an expected deceleration in growth. But our risk policies are not changing as I have told you because we were already managing it in a very prudent way and we continue to be completely open for business, but I have to remind you, it is very easy to grow in credit, you just have to give money to people. That is not the point. The point is to get it back in a profitable way and we are always very mindful about that.

Further question
Fair enough. Just going back to the structural hedge. Maybe one of the surprising things was the size of the hedge at £120 billion. If I look at your equity and add on your interest free balances, you don't get to a figure as big as that so I was just wondering if you could explain the sort of size of the hedge and also given that that is now in place, does that not represent a fairly severe headwind to margin in the next two to three years or does that depend on the term structure and how it unfolds?

Answer: António Horta-Osório
Do you think the hedge is too big or too small?

Further question
Well bigger than if it was purely hedging your equity and fee balances, that is the point I guess

Answer: George Culmer
Well you have got current accounts, you have the rate insensitive elements, the variable account balances that sit in there as well so you have an amalgam of things and in terms of headwinds, I don't know. We think what we have done has served us well in terms of income generation. As Antonio says, we have not been investing in the first six months, there is a predictability value trade off in terms of deployment, in terms of downside protection. We will see where rates go. We remain very flexible, we

remain able to respond. It goes back to part of the questions around you know, give me a number for rate cuts and what happens. Well actually you know it depends what happens through to swap rates and my ability to respond as and when they move.

Answer: António Horta-Osório
By the way I think RBS also gives similar information on hedge and we have seen ours versus theirs and we think very much in line. If anything ours is a bit smaller now because as I was saying previously, we have not reinvested any of the hedge in the first six months of the year because we felt that the risk trade off was not appropriate at the current level of rates, but if you look at the RBS, as of the end of the year we were very much equivalent because you have to add the rate insensitive deposits to the equation.

Question 10: David Lock, DEUTSCHE
Hi David Lock from Deutsche, two quick questions please. Firstly on PPI. I think it was about a year ago George that you gave the guidance that every six months delay would be about a billion. I just wondered if you still stood by that guidance given where claim volumes have gone?

And secondly, one of the things that was highlighted from the stress test last year was that you had a higher than average mortgage loss impairment driven by your self-certified book and I noticed in the specialist book that half the arrears have actually picked up a little bit in terms of balances and volumes. So I wonder if you could give a little colour on what is going on in that book in particular and if you see any concerns there.

Answer: George Culmer
I will do the PPI, yes you are right, 12 months ago, 15 months ago whatever it was, that was pre time barring. At that point that was sort of a conversion factor because pre time barring what happened is you always have the extrapolation, I get adverse experience now I have got to extrapolate forward. So actually if you have a time bar in place that sort of run rate drops away and you don't have six months equals a billion because you don't have the forward extrapolation as you have a cut-off point. Now what we have assumed in terms of our provision at the back end of last year when the consultation paper was out, we assumed a two year period through to time barring. So with effect time barring was coming into play mid 2018. We are obviously past the start point of that because we await the FCAs response. We know no more than yourselves probably in terms of what they might say and when they might say it. In terms of what it means for, let's just assume it is delayed or start point delayed and extended on that, we will make that decision at that point. And whilst that may sound a bit rubbish, that will depend on what I am seeing in terms of run rates at the time. So as I said in the Presentation, we talked about where reactives are coming from. We went into this year with time barring in place, also the CMC regulations coming in place etc. There were many scenarios we talked about including big spikes etc. So claims have stayed pretty stable, but as I said over the last six weeks or so, let's wait and see, but we have actually been seeing a decline. So answering to your question, if I get to the end of the year and whatever the FCA has been delayed, let's wait and see at that point. The reference points are not just what the FCA has said or hasn't said at that point, but also what my trends of reactives look like at that point and that is quite important. And as I said, what we have been seeing of late is quite encouraging for those reactives.

Further question
As a follow-up to that, is it fair to assume then that the 160 basis points core tier 1 capital this year, given that you don't know what the FCA will or when it will say that there isn't any further PPI number in that you pencil in for the second half of the year?

Answer: George Culmer
That is correct.

Answer: Juan Colombás
With respect to the mortgage portfolio, it is true that we have had an increase in the numbers on this portfolio in the last six months. You will recall we mentioned the judgement in Northern Ireland, and a consequence of that we have done some changes in operations in the litigation of mortgages and what you have seen is that we are taking longer in the litigation process of mortgages. These operations have been implemented so we think these will be absorbed or normalised in the coming quarters. If you look at the new to arrears and early arrears of any portfolio in the mortgage book it is improving as we were expecting.

Question 11: Edward Firth, MACQUARIE

Thanks it is Ed Firth here from Macquarie, again just two very quick questions. The first one, I hear what you say about not passing on base rate cuts to customers, but I just wondered.

António Horta-Osório

We have not said that, I am sorry. We have said that the automatic pass would be half and the rest would be decided into the context of what decision the BoE takes and what competitors do.

Further question

Okay, I guess there is a question about the whole sort of, I guess the logic of a base rate cut, if banks don't pass it on then the economic benefit is obviously not there so I guess there is some imperative on you to pass those on?

Answer: António Horta-Osório

Well we will see what happens.

Further question

And my second question was just on, going back to your NPL cover, I note it is down quite a lot from the full year, it was over 46 per cent at the full year and it is now down to 43.5. Is there some sort of disposals that are driving that and how would we expect to see that as we go through the year?

Answer: George Culmer

The answer is yes there have been some disposals of heavily impaired assets so that is what has caused the move in the period. In terms of futures coverage trends, I mean.

Answer: António Horta-Osório

I think you should look at the Retail coverage as quite steady and the Commercial coverage has the lumpiness given which assets we disposed and normally when you dispose of high risk assets they have higher coverage. So when you sell them the remaining coverage comes down because with Commercial you do asset by asset, when in Retail it is statistical. If you look two years back it was 43 as well. It will be a bit lumpy because of Commercial, but we do provision asset by asset. On the Commercial side as Juan showed you it is prudent because we normally have write-backs in the future. As you see we always have write-backs and you should expect some steadiness on Retail but lumpiness on Commercial. We don't see any trends at the moment as Juan said of any iteration in any of our portfolios.

Further question

So we should not be expecting any increase in cover in the second half?

Answer: António Horta-Osório

No you should just expect coverage name by name in Commercial and steady in Retail

Further answer: Juan Colombás

Regarding Commercial, you should expect a BAU flow of write-backs in the future, because the more prudent and the sooner you make provisions and if it changes we will have the write-backs. So if the write-backs continue in and out there is a BAU flow of write-backs in the future.

Question 12: Robert Noble, RBC

Hi, it's Robert Noble at RBC. Just on your capital generation guidance going forward, not for this year, you say there is a risk it might be lower, I just wonder what you see as the biggest risk, is it higher RWAs because of lower house prices, lower growth, lower margin, higher cost of risk. What is the pecking order of the risks there?

And do you see any risk on your pension surplus for the lower rate environment as well? Thanks.

Answer: George Culmer

Look the comment regards to the uncertainty going forward, it is not a higher RWA it is more going back to what we talked bits about in terms of a general deceleration and the expectations that there will be a rate cut out there and to Tom's point in terms of impacts through on structural hedge earnings and reinvestments. So it is predominantly a deceleration in terms of lower growth, lower activity that hangs off the back of that and allied with some rate cut which will then feature through into structural hedge earnings, cash earnings as I move further out. So that is the sort of context we think about as opposed to specifically any

big RWA hike be it through to HPI or imposition of Basel or whatever, it is more deceleration and interest rate, that is how we view that.

On pensions, as you have seen in our waterfall, pensions are absent, going back to hedging and all those sorts of things. We have taken some action over the last few years to hedge the pension out completely which has really come in to its own this year. We have about £43 billion in terms of pension liabilities, but our hedging strategy has benefited us by about £10 billion, it is no less than about £6 billion in 2016 as a whole. So we are still in surplus as a scheme. You are dead right in terms of discount rates and all those sorts of things and our sensitivity is around about £600 million or so, for every 10 basis points, but we still think we would work to offset some of that. So it is a risk that is out there, but I think we have managed the pensions; I shouldn't really say this, but pretty well so far and will continue to do so.

Answer: António Horta-Osório
We have completely revamped the way we will manage the pension funds to three years ago, going into much more fixed income to match the discount rate, that is why George will tell you, quite good results. Two or three final questions.

Question 13: Vivek Raja, MEDIOBANCA
It's Vivek Raja from Mediobanca. A couple of questions please. The first one was I think you previously said guided £6.1 billion for OOI for this year. I just wondered how you felt about that? Obviously that was more productive in Q2 and just as you think about the outlook, I guess the lumpy items within that. If you could give us any colour on how that could pan out as you see it for the rest of the year?

And the second question was on the margin. And I just want to understand what the impact of deposit savings has been on the margin in the first half and how that has worked, so how much of that was Commercial and how much of that was change within the Retail mix. If you could give some words on that please?

Answer: George Culmer
So on the OOI, you are right, we said last year's OOI was about 6.1 and we would hope this year to try and get ahead of that at 3.1 or whatever we are for the half year. This is why we said we think we are on line for that. There are risks out there so there are things like the obvious ones in terms of bulk annuity timing. They are quite volatile. But at the moment that remains our guidance and we look to try and beat the 6.1, but in answer to your question, we appreciate there are some risks out there. Some depends around bulk annuities and some depends what levels of activity we do actually see in terms of the second half. We have seen a slowing over summer, let's see how that comes back. So there are risks to deliver, I would say that.

Then in terms of margin, we do the various walks etc. There are two things going on. As I said earlier, in terms of the retail blended savings, we talked about it dropping from what I said 106 to 100 to 94 or 96. So that is year end, Q1, Q2. So we have managed that down but what we have also done at the same time, we managed the blend across the book as well. So while retail savings have been on a downward track, actually we have been growing Commercial. So Commercial cash is up I think about 10 per cent in the six months and we on that pay on an average 40-50 basis points so there are complications you have got to manage in terms of LCRs and all those sort of things, but as long as you are managing that correctly which we think we are then in terms of being to manage the totality of the balance sheet and be able to use the reputation we are building up within the Commercial business and our rating and as Lloyds as a bank to do business with, we are able to play into that and build up a cheaper source of funding and we are able to utilise that as well. So I manage each book onto itself, but then I can manage the totality and flex between the two and that is how I seek to optimise. And that is how the business is run. So we will sit down with a single balance sheet and sit down in terms of what's the best, what is the most marginal cost effectiveness source of funding from everything, from everything from wholesale going through my retail brands, my relationship, my tactical, through my commercial options and what liquidity costs and what is the marginal cost of that. That is how we look at managing the funding part of the bank.

Further question
If I could put that question a bit more simply then, so in the deposit funding, the benefits you have taken recently, how much of that has been about the mixture towards Commercial and how much of that has been about lowering Retail?

Answer: George Culmer
I don't have a pounds, shillings and pence to tell you, but both factors contribute to the basis points improvements that you see. So it is a simpler question, but I am afraid it is an empty answer for you, but I haven't got the pounds, but that is what we do. That is how we manage them.

Further answer: António Horta-Osório

And as I was mentioning in the beginning, we have some additional leeway because following the vote as I told you, we have had abnormally high influx of deposits. Our loan to deposit ratio it was close to 109, it is close to 107 and we in terms of managing the loan to deposit ratio we think in this low interest rate environment, we should be closer to 110 so we have some leeway in terms of managing the mix and the prices to go back to where we were 109 and that we will have an additional lever if you want in terms of our margin management. Because the way we do, we first decide which asset growth we want to do in all segments, that determines the asset growth rate, that determines to the loan to income ratio, how many deposits we need and therefore the price and the mix. And we do this centrally as a whole. So the fact we are at 107 which was a bit unexpected, it is gives us a bit more room to go back to the 109 and have an additional lever for the margin.

Question 14: James Invine, SOCIETE GENERALE

Good morning, it's James Invine from Soc Gen. I have got two questions please. First of all George, you talked about Retail deposit pricing coming down to the 94/96. I was just wondering, could you split out the fixed rate book like you usually do within that please and the ISAs as well?

And then the second question I guess for Juan, this is about the motor finance book, it obviously has been growing pretty well. But if I look at your website I can see that I can see that I can borrow up to £250,000 and I don't need a deposit. So I was just wondering how many people don't put down any deposit and what is the average size of deposit when you lend somebody money in motor finance? Thanks.

Answer: George Culmer

Fixed ISA is about 186 and that is compared to 201 at Q1, 207 at year end and in terms of the fixed book itself, it is about 208 and that was 210 at Q1 and about 213 at the end of last year. So that is the progression in those books and about £29 billion in the ISA and about £23 billion fixed book.

Further answer: Juan Colombás

On the second question, I don't think we fund any loan for £250,000 so I don't know which is the website?

Further question

The Black Horse website.

Answer: Juan Colombás

I will have to look at it, I don't think it is a normal loan.

Further question

That would be a pretty nice car! On the second part of it, what is the average deposit and people put down as a percentage of the car value?

Answer: Juan Colombás

I don't know the answer to that. So I can look it up for you.

Question 15: Raul Sinha, JP MORGAN

Sorry to take this risk of asking another question. But this is an insurance question. On page 22 George, I wonder if you could talk a little bit about the performance of the Life and Pensions experience and obviously if there is a net benefit of £124 million as a result of experience. I am just trying to understand it is not something we usually focus on, but within that you talk about £184 million benefit of the additional new death benefit to legacy pension schemes scheme. And previously when we look at this line, obviously it is a little bit volatile with the numbers, what can we think about the run rate? Are you flagging that this is specific development in this half which we should not really expect to repeat going forward or the numbers here generally reflect the level of business?

Answer: George Culmer

One of the issues obviously as you know with insurance accounting, assumption changes of some degree will always be a feature. And in the current period for example, we have suffered on revisions to assumption changes around corporate pensions, we have benefited here in terms of the extension of death benefit within some of our legacy pension business which essentially turns these things into Life insurance business so you change the accounting of these. So assumption changes will remain a constant, the precise impact will be volatile. Bulk annuities will be volatile. So there are two elements that remain volatile. Other parts though, the general insurance business where we have an absolute jewel in the crown in terms of our home business will and does continue to generate strong, stable profitability. I think the corporate pensions and new business coming

from that, the underlying, should be stable. My in force book, most of that should be stable. So I think the level of profitability you are seeing despite all the moving parts is not a bad guide. Insurance had a much better Q2 than Q1. But in terms of run rate it is not a bad guide in terms of moving forward.

António Horta-Osório
Thank you very much everyone for joining us today.

End of Q&A