Lloyds TSB Group plc – Results 2008

The Plaisterers Hall, London – Friday 27 February 2009

Sir Victor Blank – Chairman

Ladies and gentlemen good morning and welcome to the Lloyds Banking Group results presentation for 2008. With me on the platform this morning are Eric Daniels our Group Chief Executive and Tim Tookey, the Group Finance Director – they will both make some prepared comments and after that we will open the floor to questions.

We are very pleased at last to have the opportunity to talk to you fully about our results and to respond fully to your questions, regarding our Group, including HBOS.

Before we start you will have also seen our announcement this morning with regards to the Government Asset Protection Scheme. We have confirmed that we are in discussions with the Treasury about participating in the scheme and those talks are progressing well and whilst I suppose I have to say there can be no certainty about the outcome, we will provide a market update in due course.

Now at last we can concentrate on our future and look to it with confidence. As you know, the acquisition of HBOS was only completed on 19 January, some six weeks ago. And whilst much of the time since then has been spent working on the detail of the HBOS figures for 2008, it was made more complicated by the fact that the Lloyds Management Team had no involvement in the 2008 activities of HBOS. We are now in a position to present, not just the figures, but also much of our plans.

The arrangements for this morning will start with Tim presenting the Lloyds TSB Results, demonstrating the strengths of our underlying businesses and particularly sharing a well controlled organisation with high quality risk management. Whilst there has clearly been a significant impact on all the numbers from market dislocation and insurance volatility, the Lloyds TSB relationship based businesses have been remarkably resilient, delivering strong momentum. This is the Lloyds you know.

Tim will then go through the HBOS figures for 2008, showing a number of the key issues that we as Lloyds Banking Group, are focusing on.

I will then pass over to Eric who will discuss how we are managing the short-term challenges we face, and how we plan to create substantial value in the newly enlarged Group.

In the presentations we will show you how we continue to fund well. We will highlight some of the higher risk areas in the HBOS portfolio. We will set out our robust capital position. And in particular we will show you our plans as to how we are going to manage and develop the HBOS businesses, including those higher risk elements of the portfolio.

I think it is fair to say historically, everyone saw Lloyds as a very conservative organisation with a strong risk management culture. And these qualities remain in place and we have applied them to HBOS. HBOS was acquired as part of a carefully developed strategic plan for our Group. The opportunity to acquire HBOS came at a time when its own business model was being significantly challenged. And this in truth created the opportunity for us to consider and ultimately execute the transaction.

That opportunity and the price at which we purchased the assets could only have come out of HBOS's adversity. It's the Board's job to look beyond the short-term and to look to the future options for any organisation. And that is what we on the Lloyds Board have been doing for some time now to enhance our medium to long-term position and performance. The HBOS acquisition allows us to extend our earnings platform and to continue to deliver great momentum from our core relationship businesses.

I guess it is an understatement to say that 2008 was a very difficult and challenging year for the banking industry, both in the UK and worldwide. We have been through the most tumultuous times over the last few months and have seen significant acceleration in the speed of deterioration in the UK economic environment. We are in the middle of a global economic downturn, the like of which we have never seen before.

But as we look beyond the present and the near term, we are creating something important and valuable. The Lloyds Banking Group is now the largest financial services franchise in the United Kingdom with a range of leading market positions in important product lines, such as current accounts, savings, mortgages, insurance, long-term savings and so on. We are a leading player in the SME and corporate banking sectors. The Group has a very significant footprint and with about 3,000 branches, it is present in more United Kingdom locations than any other financial institution. Essentially we are number one in an attractive and fundamentally profitable UK market. One that is particularly attractive to our core business areas.

In short we saw the acquisition of HBOS as being strategically important for us. Furthermore our strength and size will offer opportunities for growth for the future which a stand-alone Lloyds TSB would not have been in a position to deliver to the same degree.

Over the last few weeks and months there have been periods of reflection when we considered some of the key questions that many of you have been asking, not least, will it be a success? Let me just say, the view of our Board unanimously and clearly is, absolutely yes. The short-term outlook for all financial service companies in the United Kingdom and around the globe is challenging, but significant acquisitions such as the one we have just completed, need to be examined with regard to determining their success over time and not just a few weeks after the deal has been completed.

Now let me touch briefly on the role of Government within our business. A great deal has been said in recent months about the nature of the Government's involvement with the banking sector. We believe that most of the Government's initiatives have been positive and well considered, and in particular we very much welcomed the Government intervention last year to stabilise the banking system and encourage more lending. The dramatic unfolding of events across the world following the collapse of Lehman's meant that the Government needed to take swift and decisive action. And it did just that. And just as it took decisive action this week again when it launched the Government Asset Protection Scheme, in respect of which, as I said, we are in detailed discussions.

That is why, despite our relative strength, we, together with other UK banks, were required in October by the UK Government to strengthen capital ratios as part of an industrywide initiative to reduce the systemic risk in the UK banking system. As a result of that the Government has become a 43 % shareholder of the Group. Our first real tangible experience of working with our new shareholder came as we selected two new independent directors for Lloyds. I can only say that the shareholder involvement was supportive and constructive and we now have two new directors of great experience and great quality in Tony Watson and Tim Ryan.

But the Board will act, always has acted, and will continue to act in the interest of all shareholders. Whilst in common with Government, we recognise the importance of all of the social aspects of operating within the UK and within the UK banking industry, the Board constantly examines and ensures that everything we do is tested against the broader shareholder interests.

Tim and Eric will cover our results and strategy shortly, but let me just reiterate that our success has been based on building a strong, well thought through business model. We aim to add real, consistent value to our individual and corporate customers with the full range of banking, insurance and life products that they need to manage their personal lives and businesses effectively. The result is that our model is a more conservative, lower risk business model, and one that we have already implemented in HBOS.

Before I hand over to Tim and Eric, let me just point out that they are the two most visible senior executives here today. But they are just two high quality executives in an exceptionally talented management team. As I can look round the floor today I can see all the other executive directors and Group executive committee members that form a great team, and they have already made great strides in bringing our two businesses together, and they are the ones who will be responsible for driving the enlarged Group forward.

Ours is a business that enjoys number one status in the attractive and profitable UK market. It's a business that has clear scale benefits which we believe will lead to superior returns in our new banking environment. And this is a business that has great opportunities ahead to deliver significant cost and revenue synergies. We are all committed to delivering those benefits to shareholders.

With that let me hand you over to Tim.

Thank you.

Tim Tookey – Group Finance Director

Thank you Victor and good morning everybody. This morning I'm pleased to be presenting to you the financial results for both Lloyds TSB and HBOS, along with further detail on the new enlarged Group.

I have quite a number of slides to run through with you today and wherever possible, I have used the format that we've previously used for the Lloyds TSB Group to make them easier to follow quickly. And given the significant content and time limitations I am going to canter through many of the slides and simply focus on the key points.

The core business performance of Lloyds continues to be strong and this will be critical going forward. The Lloyds TSB business model is based on developing through the cycle customer relationships, which means that, in a downturn, our earnings are much more resilient than many of our peers. Clearly the HBOS franchise has been under more pressure but there remain a number of core areas that have performed well and will continue to underpin revenues in the new group going forward.

Victor has commented on the key strategic benefits of the HBOS acquisition. However it is also important to note that it delivers significant tangible net asset value enhancement and significant potential to deliver shareholder value. The new Group enjoys a robust funding and capital position and we continue to fund at market leading rates.

In terms of this presentation, I will initially focus on the Lloyds TSB results, then review the HBOS results and finally take a look at the combined entity and provide you with some key information relating to the new Group.

So let's start with the Lloyds results. As we previously signalled to the market, the Lloyds TSB statutory profit for 2008 was just over £800m.

Insurance volatility continues to be significant, as a result of the falls in equity and property markets and movements in bond spreads. And once again policyholder interests was negative, although as we have previously noted, whilst policyholder interests is a debit above the line, there is a corresponding credit in the tax line. The other one-off items have been previously disclosed, except for the £100m goodwill impairment which relates to the Asset Finance business.

Adjusting for these items, our continuing businesses profit was down 35%. This fall was primarily due to market dislocation, which remains low relative to many of our peers.

Despite the market environment our income has remained strong, and increased by 2% for the year, even after market dislocation. Underlying income grew by 8% reflecting a strong performance from our relationship businesses. Expenses have grown by 5% but, adjusting for exchange rate movements and the impact of accelerated depreciation in the AutoLease business, underlying expenses grew by a more modest 3%. So I could say, that underlying JAWs were 5% positive.

Whilst talking about our cost effectiveness, I'd like to draw a line under our efficiency programme, which was completed at the end of last year, having delivered annual net cash savings of over £300 million against a target of £250 million.

Clearly, we have seen a significant increase in impairments in line with our recent statement and I will return to these later in the presentation.

So let's look briefly at divisional performance. All divisions were profitable, even after market dislocation.

UK retail banking posted a strong trading performance. Income growth was 7%, equally balanced between asset and liability performance, and cost control continued to be very strong with only a 2% rise in expenses.

Insurance and Investments had an excellent year in a difficult market. Profit growth was excellent, but in part due to the 2007 flood claims which were, of course, not repeated.

And despite market dislocation, Wholesale & International was profitable as a result of the strength of our customer relationships across our Corporate and SME businesses.

Central items includes additional funding costs but our overall income was achieved at a constant banking margin compared to last year, as additional funding costs have been recovered through a variety of pricing initiatives.

We have continued to see good lending growth but this was also supported by strong deposit growth, with the result that our year end loan to deposit ratio was the same as at the half year and only marginally higher than last year end.

Our underlying charge for impairment losses grew by 57% reflecting the more difficult market conditions.

In the Retail Bank, impairments show the impact of falling house prices which account for approximately £150 million of the impairment rise or charge. Looking forward, it is our view that in 2009 house prices could fall by a further 15%. In the unsecured book, card impairments were flat year on year, but we saw an increase in loan and overdraft impairments reflecting the economic conditions, although our enhanced collections activity continues to make a difference.

Whilst overall asset quality in Wholesale remains satisfactory, corporate impairments continued to rise in the second half as the economy deteriorated further and the charge in corporate markets includes £151 million for losses relating to Lehman and Icelandic bank exposures.

Across the various Lloyds TSB businesses, levels of impairment remain modest reflecting strong asset quality at origination. Where provisions are considered necessary they are made swiftly and at a level consistent with our sound active risk management principles and disciplines.

The point I'd highlight to you on here, is the significant increase in provisioning for retail impairment to reflect the deterioration in retail credit conditions that one would expect at this point in the economic cycle

In summary then, Lloyds TSB relationship businesses have continued to perform well demonstrating strong income growth, good cost disciplines and rigorous risk management.

Turning now to the HBOS results. In line with our recent statement, the HBOS statutory loss for 2008 was £10.8 billion. HBOS incurred a number of one-off items, the main one shown here, being the loss of £845m relating to the sale of BankWest and St Andrews Australia.

The HBOS franchise has been under pressure, and the results in Corporate and Treasury have overshadowed some solid performances in other areas. In Retail, the underlying trading surplus was up 9% reflecting income growth of 5% and marginally lower costs. Retail impairments were dominated by HPI as we will see in a minute.

The insurance and investment division performed well and like Lloyds, benefitted from the fact that the 2007 floods and associated claims were not repeated.

The international results were dominated by the provisions against residential property development in Ireland which took that country's result from a profit to a loss.

During the year, HBOS managed lending very tightly to alleviate funding and capital concerns, with little origination and focused repricing which supported overall income levels and delivered margin stability.

The business saw significant deposit outflows in the second half of September, however these subsided in October and there were net inflows in November and December.

Corporate reported a loss before tax of £6.8 billion. Income was down just over £3.2 billion largely driven by significant investment write-downs.

The impairment charge reflects the sharp deterioration in corporate credit conditions generally and HBOS's exposure to property related sectors which alone accounts for about 60% of the charge.

The Corporate investment portfolio write-downs included, mark-to-market adjustments in respect of interest rate hedges, lower realisations from the JV portfolio, write-downs on equity investments.
And of course, impairment on investment securities. Corporate impairment charges were broadly spread across the principal portfolios but included an increase in the collective provision of £1.3 billion.

In Treasury, the pre-dislocation contribution of £300 million was more than offset by market dislocation charges.

Losses in respect of AFS impairments totalled £1.4 billion comprising £600 million relating to exposures to Lehman, Washington Mutual and the Icelandic banks, £700 million relating to US RMBS, primarily Alt-A, and other charges relating to ABS CDOs. Losses in respect of negative fair value adjustments totalled £2.5 billion.

As expected in the current economic environment, impairment losses increased, the main items being the losses in Corporate which I have already discussed.

Retail impairment charges increased primarily as a result of the house price index fall. The mainstream HBOS mortgage portfolio continued to perform well and in line with the Lloyds TSB portfolio. However there was a further deterioration in the specialist loans portfolio including subprime and self cert mortgages.

As I mentioned earlier, the provisions against residential property development in Ireland were the major items contributing to the impairment charge in International.

HBOS impairment losses totalled £10 billion last year. And this is some £1.6 billion ahead of our estimate in the Autumn when the deal was announced. At that time, we took a very conservative view and anticipated losses for the second half of 2008 of £8.0 billion, a figure more than 3 times the HBOS internal estimate at the time. When this assessment was prepared, the consensus view was that GDP would fall by 0.2% in the fourth quarter of 2008. As we now know, the significant deterioration in the economy during the fourth quarter led to a fourth quarter GDP reduction of 1.5%.

I think it is fair to say that the extent and pace of economic deterioration has taken all market participants by surprise. As a result of that deterioration and a more prudent provisioning methodology we have increased our impairment provisions and this resulted in impairment losses coming in slightly ahead of expectations.

I'd like to draw your attention to two points on this chart. Firstly, you can see that as part of our conservative provisioning methodology we have increased our provisions, notably in corporate, in response to the deteriorating economic environment.

And secondly, you will also see that in International, provisions as a percentage of impaired assets actually fell, but this is largely due to the sale of BankWest and St Andrews Australia.

In summary, these HBOS results reflect a major deterioration in the credit performance in Corporate; the associated reduction in the value of the investment portfolio; and an increase in the impact from market dislocation to the treasury portfolio.

The core business in the HBOS franchise performed well in the difficult market environment, with good performances particularly in Retail and in Insurance and Investments.

Having gone thorough the key results issues for both businesses for 2008, I'd like to spend the remainder of the presentation focussed on the combined Group.

Before going into detail, I think it is worth saying at the outset that we have made significant progress with our initial integration plans and Eric will talk to you more about this shortly. One of the very first things we did on day one was to ensure that the whole range of Lloyds TSB's risk management policies and practices were applied across the HBOS businesses. This has included a significant tightening of the risk controls and procedures, particularly with regard to credit sanctioning.

The new Group launched with a robust opening capital position and a core tier 1 ratio of 6.4%.

In focussing on the new enlarged business there are a number of key messages: The core businesses throughout the group are continuing to perform well, particularly the core franchises in retail, insurance and the corporate relationship businesses. Costs have been, and will continue to be tightly controlled. We expect retail impairments to rise significantly from 2008 levels, to a large extent driven by further house price falls and the expected increases in unemployment levels in the UK. Corporate impairments are also likely to remain at 2008 levels. We do expect to see significantly lower charges for market dislocation and investment provisions. And we are currently expecting risk weighted assets to grow by low-teens percent in 2009, largely as a result of pro-cyclicality impacts.

The net result is that, notwithstanding the good underlying trading performances of our core relationship businesses, we do expect the Group to report a loss in 2009, before accounting for the goodwill aspect of the acquisition.

I would now like to spend some time on the Group balance sheet, as I know this has been an area of significant interest. As we can see the Group lending base is diverse and around a half is made up of personal mortgages. The book is approximately split 51% retail secured, 7% unsecured and 42% corporate.

Looking at some of the key portfolios in more detail and turning first to mortgages. As you can see, 79% of our portfolio is prime mortgages where as I will show you, the performance is strong across both heritages. The Lloyds TSB buy to let book is also performing very well. So, overall, we have low levels of concern indeed, over more than 82% of the portfolio.

Let's look at overall mortgages arrears trends. We see here that the HBOS prime portfolio is performing slightly better over time than the Lloyds equivalent. And the Q4 kick-ups in arrears trends are mainly arising in the HBOS buy to let and Specialist portfolios.

In 2008, Lloyds TSB saw arrears increase by 47%, while HBOS saw a 40% increase. With the combined Group being 28% of the market, it is reassuring to see our overall portfolios performing so much better than the market, given that the CML increase in arrears last year was 72%. Lending continues to be tightly controlled with new prime business being written around 65% LTV and we have exited the Specialist sector.

Looking further down the slide to the proportion of loans with a loan to value in excess of 100%, I would highlight that although these may seem higher than we have seen in recent years, it is important to put this into context. I have therefore set out the absolute value of mortgages with over 100% loan to value and as you can see, a relatively small proportion of these are in the specialist book.

Let's look at it another way. The values of our book that are both more than 100% loan to value and in arrears are very modest indeed, in fact, they total around £2 billion, just 0.6% of the total mortgage portfolio.

Having conducted a significant review of our newly enlarged mortgage book, we have identified areas of focus and have taken the appropriate actions. We have stopped writing specialist self-certified and sub-prime mortgages and are focusing on the prime sector and some aspects of Buy to Let.

Looking at properties in possession, Lloyds TSB has tended to operate at about half of the industry average. It is true to say that HBOS also operates at about the same level. The new repossessions rate, as a percentage of total mortgages in 2008, was significantly below the industry average on both the Lloyds TSB and HBOS books.

The card portfolios of Lloyds TSB and HBOS are very similar and performing almost identically in terms of impairment rates and is a similar story for the remaining unsecured lending portfolio.

We have historically used dynamic delinquency charts to demonstrate the quality of our new business. And the shaded area, or "fan", shown here, depicts the boundary of Lloyds TSB arrears performance for vintages dating back to December 2004. If I overlay corresponding data for HBOS, you can see that, overall, the HBOS trends are within the Lloyds TSB fan though generally towards the top. Recent vintages are showing some early signs of stress as I would expect at this point in the cycle.

Turning now to our Corporate book. Our Corporate loans book which stands at just over £300 billion is again a reasonably well spread portfolio but you can see a predominance of loans and advances to Financial institutions and Property exposure. And I am now going to talk in more detail about our property related exposure in commercial real estate and housebuilding.

Looking at this exposure, I have included exposure to property investment, development, housebuilders, hotels, housing associations and related joint ventures in the HBOS portfolio. To put this into context, property exposures represent 17% of Lloyds' customer lending and 36% of HBOS lending at year end. Of the Group's total exposure of nearly £100 billion, three quarters comes from the heritage HBOS business and one third is from HBOS Overseas.

Let's look at this in more detail. You are familiar with the Lloyds TSB property profile. This is based on a relationship focused lending philosophy but with little development exposure and then only with significant covenants and lending protection. The Lloyds TSB housebuilder lending is about £1.3 billion. Because the focus is mainly towards larger names, we have seen only limited evidence of stress. Residential is holding up well, largely reflecting that the majority of lending is to housing associations, equivalent to a local authority covenant.

The HBOS acquisition brings £45 billion of UK property and construction lending to the Group. This is after significant write-offs and impairments in 2008, which included virtually the full write-off of all housebuilders' equity exposures. The residual exposures to housebuilders has significant security including land banks, although this portfolio is suffering acutely in the current economic environment and will require considerable work out effort.

About half of the overall exposure is to property investment and this has an average maturity of nearly 5 years, strong levels of interest cover, typical lease lengths in excess of maturity timings and a well diversified tenant portfolio which even includes the Government as a tenant. Whilst the tail of this portfolio is expected to cause further write-offs in 2009, the core is sound.

Within commercial exposures here I have included civil engineering and construction, building contractors and property management. The latter is the largest sub-segment exposure at £5 billion and is performing satisfactorily at the moment.

The residential portfolio is over one third housing association lending with the balance being a large number of small value exposures. The housebuilder exposure is largely focused on private housebuilders with lending predominantly secured against land banks and work in progress. We have written down our equity exposure to housebuilders to effectively nil.

Overseas property lending within HBOS is £29 billion across Ireland, Australia, Europe and North America. As you can see the largest individual country exposure is in Ireland which is split 55% investment and 45% development. Clearly this is a troubled portfolio and you will see from the HBOS news release today that we have increased our provisions to cover higher impaired assets. Only 7% of the investment book is currently stressed or impaired however the development book is under considerably more pressure and 38% is currently regarded as stressed or impaired. And we have established a 28% provision coverage against such development exposures.

Turning now to the leveraged finance portfolio which amounts to almost £15 billion. On the Lloyds side, the Acquisition Finance Unit has a well spread portfolio where the underwriting criteria has always been the same as for transactions that we plan to hold on our balance sheet. The "hung" balances are currently only about £900m. The HBOS leveraged finance portfolio is well spread by sector and we consider just over £2 billion of the combined HBOS portfolios to be high risk or impaired.

The equity holdings within the Group total nearly £6 billion and these are well spread across the HBOS Integrated Finance, Funds Investments and Joint Venture portfolios together with Lloyds Development Capital. The HBOS Integrated Finance portfolio comprises over 60 assets that were largely originated pre-2007 whilst, similarly almost two thirds of the Joint Ventures portfolio exposures go back to pre-2007.

The Lloyds Development Capital portfolio is a conservative one, well spread around the UK with low average ticket values, and has generally been less affected by the current downturn than other portfolios. The Funds Investment tranche here reflects over a hundred investments in private equity funds written since 1995.

Looking at our treasury debt securities portfolio which totals nearly £140 billion, the majority comprises Bank notes, certificates of deposit, treasury bills, covered bonds and other government and supra-national paper. And the balance is made up of approximately £56 billion of asset backed securities.

So let's look at that tranche in more detail. You will note that of the total asset backed net exposure, 13% of this is made up from US Residential Mortgage Backed Securities and these are priced at a book value of 64. Within the US RMBS category of £7.4 billion, £5.4 billion relates to Alt-A exposure largely originated by HBOS. And you will have seen from the detailed additional disclosures at the back of the news release that our Alt-A exposure has been written down to a book price of 59.

The other large holdings are non-US RMBS which reflects that originated in the UK, Australia and mainland Europe. These bonds are well protected senior tranches and overall we believe that there is limited risk of losses materialising in this sector.

The other major exposure within the asset backed securities portfolio is US student loans and many of you will have heard me talk about these before. As we all know, the vast majority of these student loans benefit from US Government guarantees and the average mark of 88 really reflects a liquidity adjustment rather than a credit problem.

I have talked in some detail about the exposures we have of the asset classes of concern to market commentators. Over the last few weeks we have undertaken a significant review process of all material exposures in our Corporate and Treasury portfolios to assess the impairment expectations. In Corporate this has focused on commercial real estate, leveraged finance, equity exposures and joint ventures, and within Treasury we have focused on the difficult asset classes, including CDOs and Alt-A.

Clear credit risk appetite statements have been put in place across HBOS aligning all new business flows to Lloyds heritage risk appetite. In addition, a new credit committee structure was put in place from day 1 of the acquisition. This has already led to the cancellation of a number of limits and a significantly scaled back participation in a number of business areas.

I'd now like to move on to acquisition fair value accounting. As you are aware, this only arises on an acquisition and can have a distorting impact on the way in which a bank's results, and particularly capital position, are reported. Under acquisition fair value accounting, all of the assets and liabilities of the target company, whether on or off balance sheet, are fair valued. We have therefore reviewed at portfolio level £1 trillion of balances of HBOS, predominantly loans and advances to customers and general liability balances. In addition, we have to offset the HBOS AFS and cash flow hedging reserves against capital on acquisition. The result is that we have made a number of adjustments to value. These adjustments will unwind through the income statement over time as I have illustrated here, and I currently expect about £2 billion net to unwind on a pre-tax basis in 2009.

Of course the economics of these assets and liabilities are totally unaffected by such fair value adjustments but this aspect of the accounting regime introduces complexity which makes our balance sheet, and as I said our capital position, difficult to directly compare against some other banks.

On this slide I have broken out the estimated fair value adjustments to both sides of the balance sheet. You can see that the net impact from fair value from the loans and deposits is negative £10.7 billion after tax, but this is slightly more than offset by a credit for the fair valuing of HBOS' own debt. The net impact of fair value adjustments that affect core tier 1 capital is therefore a small credit, which also flows through to net tangible assets.

Now this slide breaks out the net negative capital adjustments. In addition to the fair value adjustments which I have just taken you through shown on the first line here, we have had to adjust for the impact of the AFS and cash flow hedging reserves that have been previously taken to reserves within the HBOS accounts but had not been deducted from the capital position. Thus the net impact of the negative capital adjustment is £3.7 billion, a number that we will deduct from our capital position. These last two deductions are made only because of our acquisition of HBOS and thus, had we grown our business organically, we would not have had to reflect them in our figures.

We can see here the distortionary impact of this net negative capital adjustment on our capital ratios which on a reported basis show a 6.4% core tier 1 and a 9.8% tier 1. I have commented that only LBG has to offset AFS and CFH reserves against capital, adjusting back for these items to reflect a more representative economic basis, which I have labelled here as "comparable", the ratios are actually 7.7% and 11.1% respectively.

In looking at this impact, some of you will comment on the appropriateness or otherwise of the ratios appearing to benefit from the fair valuing of HBOS's external debt. Whatever the merits of this, I would caution you please to note also that only Lloyds has to include the AFS and CFH reserves as a capital deduction, or indeed has to fair value normal loans and advances. I regard our ratios as perfectly robust and we have given you both sets to help you do proper comparisons.

We have previously said that the HBOS acquisition will increase net tangible assets per share for Lloyds TSB shareholders. The increase arises because the acquisition price paid is considerably less than HBOS's December position, even after their second half losses. Also affecting the answer are fair value adjustments, although the net impact on net tangible assets is only £0.2bn as shown here. Overall therefore, the chart shows that there is a £10bn uplift to the Lloyds net tangible assets from the HBOS acquisition.

In per share terms and adjusting for the January capital raising, net tangible assets per Lloyds Banking Group share rise from 118 pence at year end to a proforma basis 179 pence. Within all the proforma disclosures in the back of the news release you will see a proforma consolidated balance sheet highlighting this number and showing a proforma net tangible asset value for the enlarged group of £29.5 billion.

I'd now like to touch on the liquidity position of the Group. Throughout the crisis we've continued to fund well and at market leading rates. And this is due to a number of reasons but one of the key factors is our diverse funding portfolio. Following the merger our credit ratings have all been reviewed by the respective ratings agencies and in each case our short term ratings are at the highest possible level and all of our long term ratings remain in the double A range. We have made measured use of the various government schemes and maintain a very significant pool of eligible collateral for further use, as appropriate.

Finally, not only have we maintained a consistent market presence, leveraging our long term relationships, but we have always ensured we maintain significant funding headroom.

Our high, and growing, customer funding base is a key part of our funding model. We currently have over £350 billion of customer deposits, the majority of which are 'sticky' relationship deposits. As you can see, we do have a significant wholesale funding requirement but this is satisfied from a variety of sources.

We have a very well spread funding profile and the enlarged group has a longer term maturity profile than that of Lloyds TSB Group previously. Our broad aim is to ensure that we maintain our less-than-one-year funding balances at below 75% of the Group's wholesale funding requirement. At the year end, you can see that only 65% of our wholesale funding requirement was of less than one year maturity.

In conclusion, as I mentioned earlier, we have made significant progress with our initial integration plans. We have ensured that the whole range of Lloyds TSB risk management policies and practices have been applied across the HBOS businesses. The Group has a robust opening capital position, and we have spent the last 6 weeks getting our arms around the HBOS business.

Clearly 2009 is going to be another difficult year but, whilst we are preparing the business to take advantage of the longer term opportunities ahead, we understand the challenges we face in the short term and we are managing them appropriately.

And with that, I will hand over to Eric who will take you through a further overview of our progress.

Eric Daniels – Group Chief Executive

Good morning all, thank you very much for coming. You have heard from Victor about the strategic underpinnings for the acquisition and why it remains a good deal. And Tim has taken you through the numbers in some detail.

This morning, I will cover three areas. First, I'll give my brief take on the 2008 results for Lloyds and HBOS. This is the last time I'll talk about the two companies separately. The results from hereon in will be Lloyds Banking Group.

The Results for Lloyds and HBOS reflect the very different business models that each company had adopted. It is important to understand the difference, for as we apply the Lloyds model to the HBOS side of the business, its performance will look very different going forward.

I will then speak to you about the near-term economic outlook and issues we face as a result. I appreciate there has been huge concern about the short-term issues, particularly the lending book and how it will fare in the downturn. Pretty clearly, the HBOS portfolio is a higher risk book and it will feel the effects of the difficult economy more severely than the Lloyds book. But we understand the challenges we are facing and that we are addressing them.

Third, I'd like to give you a view on how the Lloyds Banking Group will create value. With all the attention that is being paid to the credit issues, we should not lose sight of the fact that this is a franchise with great potential. We have a strong core earnings momentum and that is being masked by a bad set of losses from non core businesses. As we work through the credit issues, the strength of the core business will start to emerge. In addition, we will realise more than £1.5 billion of cost synergies. The programmes are underway and they are starting to deliver.

I will also talk to you about revenue synergies. We have not included them in our forecasts but we believe they are significant and real.

Let me start with the results which reflect how the very different business models performed in the year. The Lloyds performance, whilst down 35% on a continuing business basis, is reasonable in a very difficult environment. The performance reflects the through the cycle conservative positioning that we have taken over the past 6 years.

In addition, we delivered great franchise growth with a 16% growth in customer lending, whilst maintaining our high credit standards. We opened one million new current accounts. We grew our retail savings by 12% and we saw double digit increase in cross-sales to corporate customers. So, all the hallmarks of the performance you would expect from Lloyds

Turning now to HBOS. Their performance reflects their higher-risk business model, which has proved more vulnerable during the downturn. They had good performances in the insurance and retail businesses as Tim mentioned, and they opened over a million current accounts. However, their results were overshadowed by the increase in impairment charges, the mark to market losses, the drop in retail savings and their inability to access the funding markets during the second half of the year.

With that recent performance as a backdrop, let me now move on to the challenges facing the Group in managing the HBOS portfolios. I will start with the economic outlook, then I'll talk about asset quality and then briefly touch on capital and funding.

When undertaking our analysis for the HBOS acquisition, our outlook was somewhat more pessimistic than the consensus at the time and we forecasted impairments based on that more conservative view. Our central case, was a drop of 1.6% in GDP, and that was at the bottom end of consensus expectations, which was for a relatively mild reduction of 0.2%. At the time, our downside case was well below other forecasters. However, despite our caution, we weren't quite gloomy enough and our latest central projection now is for a fall of 2.5%. While there is a wide range of uncertainty around that number, we also factor the downside into our risk assessments and stress scenarios. The consensus is now in line with our central case and our downside.

The deteriorating outlook has clearly had an impact on the asset portfolios and the impairments. Our expectation is that we will not see economic growth returning until well into 2010, and the recovery thereafter will be slow. We have also revised down the expected fall in house prices this year from 10 to 15% and, we expect rising unemployment throughout the year and consumer spending will reduce by more than 2%.

I will now turn to the loan portfolios. The total Group customer lending amounts to some £717 billion. The Lloyds TSB customer lending portfolios of £243 billion are well known to you and are behaving within with our expectations, given the economic environment.

So I will focus on the HBOS portfolios. Across the three key lending Divisions, we have about £432 billion of customer lending. In reviewing the portfolios, we applied the Lloyds credit criteria to gauge how much of the portfolio would fall within and outside the Lloyds risk appetite. As you can see, we believe about £165 billion of the HBOS portfolio falls outside of the Lloyds risk appetite, leaving about 60% or £265 billion that falls within. We expect this £265 billion to behave like the Lloyds book. I'm not by any means suggesting that it's bullet proof but it will behave more like the conservative Lloyds portfolio.

Then, taking the assets that didn't meet the Lloyds risk appetite we have identified the higher risk assets, shown here on the bottom row. The higher risk loans constitute £80bn or 18% of the total portfolio, which we arrived at through the rigorous application of portfolio specific criteria. I would remind you that a substantial part of the higher risk book is secured, so the losses in the book will be somewhat mitigated.

Let me go through each of the divisional portfolios, starting first with retail. In retail, we believe the unsecured and prime mortgage books will behave just about the same as Lloyds. Of the non-prime mortgage book, we have identified £31 billion of higher risk assets, where we classified all non-prime loans with a greater than 90% indexed loan to value ratio, or anything three months or more in arrears as higher risk. As a result of this conservative review, we are treating as higher risk 46 % of the buy to let portfolio , 39% of self certified portfolio, 100% of sub-prime portfolio and all of the so called 'mortgage plus' product.

These are high percentages. This indicates that the portfolio quality was not good at origination and that we have used very conservative criteria in assessing them. We have a detailed set of actions that we are taking to address these areas. We have revised the new business criteria to stop the higher risk new business from coming in. We are running the HBOS portfolios through our own models and that highlight the immediate problem areas. We have 1,900 staff assisting customers who are in arrears, and are increasing that number by 20% in 2009. We have assigned specialist collection teams to manage these portfolios.

Corporate is the portfolio where you probably have the most concerns. We took a similar approach here. We identified all the lending that is outside our risk appetite, for example, the entire JV and Integrated Finance portfolios. We then took a second cut and identified £40 billion of higher risk loans in Corporate, where we have lending that would be on the Lloyds watch list, for example, those at risk of breaching covenants. This highlighted 31 % of real estate portfolio. 57 % of joint ventures, 35 % of commercial lending and so on. These are high percentages as we are being deliberately cautious.

Again, we have a set of specific actions lined up against each of these assets. In first six weeks we completed a detailed review of the larger and more doubtful exposures. The whole book is subject to ongoing reviews. We are isolating the bad books in each business to provide the necessary focus, with separate management and reporting. We are using the work out skills that we have successfully developed in Lloyds over the years. We have 240 dedicated staff within Lloyds with 4,000 years of experience, and many have worked through two recessions. We will treble that number to 800 people in 2009 to manage the bad book.

We have undertaken a similar approach in International. These portfolios are smaller and while we have concerns, we have initially prioritised our resources against the major portfolios. But we have taken the same set of corrective actions in International.

To sum up. Within the divisions, we have stopped the flows of higher risk business coming in. We have completed the first pass review of portfolios to prioritise our actions and we are now going back for more detailed reviews and we are significantly gearing up our work-out teams.

Concurrently in the Group centre we are putting in place the Lloyds risk appetite and sanctioning processes. The centre provides an independent view of the state of the portfolio, which gives us the appropriate checks and balances. Carol Sergeant, whom you know well, is the Chief Risk Director for the combined Group and she is ensuring that we have full alignment of governance processes and strict adherence to risk limits. She reports to the Risk Oversight Committee of the Board as well as me.

The HBOS central functions were apparently not strong enough to govern their federated model. That will not be the case with the new Group. Over the next few years, we will work our way through the problem portfolio. We are permitting only new lending within our risk appetite and this will result in the lower risk, less volatile growth that you have come to expect from us.

I don’t want to repeat what Tim has already talked about in terms of capital and funding, but I did want to briefly touch on each as they are critical. As Tim showed you, we have a robust capital position. Our core tier one ratio is 6.4 per cent, well within our stated target range and we have a comparable ratio, Tim claims 7.6 % and he is probably right. I think I had 7.6 % on the slide, which is the comparable figure to other banks.

As you would expect, we will look to maintain our ratios above the regulatory standards. We also expect our capital strength to improve as we realise the potential of the new Group. We also have a good funding position, and enjoy a broad funding base. We have a leading share of current accounts and retail deposits which give us strong stability and we do see the opportunity to increase business sector deposits. We have a pricing advantage in the capital markets. Since Day 1, we have enjoyed a 35 basis point advantage relative to peers, at the long-end of the market. We have recently taken the opportunity to extend our maturity profile. We expect to maintain our credit ratings in the double A range. So, we can pace our lending to match our funding, risk and capital parameters as we move HBOS to the Lloyds TSB model.

Let me now turn to how we will drive the combined business to create value. The new Group will drive value in four ways. First, we have leadership positions in the most attractive parts of the UK market, where it is possible to build strong customer relations and generate sustained low-risk earnings growth.

Second, we are combining two efficient organisations and generating significant cost synergies. This will make us a clear leader on costs, and enable us to compete extremely effectively.

Third, across the Group we can combine some very strong capabilities in relationship building and in driving sales. We believe this will generate material revenue uplifts, as we exploit those capabilities across the much enlarged franchise.

Finally, the Group will generate substantial amounts of capital in the medium term as we redeploy resources away from non-core riskier activities. We calculate that over 40 % of our capital is currently tied up in the non-core, high risk businesses. As that is released, it can be used to generate much better returns for our shareholders.

Although I am speaking about where the Group will be in the next several years, we are already making substantial progress. The executive team and managing directors were in place ahead of time, so that on day 1, they were accountable for, and managing, the combined businesses. Since then, we have selected the next layer of management, and we now have the top 500 senior managers in place. When we launched on January 19, we had all the appropriate governance processes in place, including credit sanctioning and we set out the Group values and missions to all staff that day.

We have taken the opportunity to put in place a more effective organisation. There will only be 8 layers and we will have an average span of 8 direct reports per manager. We are assigning goals on a balanced scorecard basis, including economic profit, for all businesses

As we learn more about the HBOS business, we have been able to improve our synergy targets and we expect more than £1.5 billion, or 14 % of the combined cost base to be realised in synergies. We have 61 programmes underway and the top 5 initiatives account for 75 % of 2009 benefits and 55 % of 2011 run rate. As an example, procurement offers a major opportunity to drive savings across the enlarged Group. In Lloyds, we achieved £205 million cost savings, a 10 % reduction on the eligible universe of about £2 billion.

The new Group has effectively doubled our addressable expenditure, And we expect to deliver £300m of cost savings. We have a strong pipeline of savings and have delivered significant results in our first 6 weeks of the newly formed Group.

We haven’t talked to you about revenue synergies previously, as they didn’t make up part of the financial case for the deal. Additionally, I fully appreciate that revenue synergies are not valued until they are delivered. But I did want to share with you the approach that we are using, and the potential size of the prize of some of the projects.

We have identified a series of major programmes and I have listed several examples on this slide. The first opportunity is to drive the Lloyds relationship focus into the HBOS network. As we have shown you over the last few reporting periods, Lloyds has been very successful in deepening relationships and increasing cross-sell. The proportion of Lloyds customers holding three or more banking products is nearly twice that of HBOS, and we estimate that raising the HBOS penetration to Lloyds levels is worth £80 to £120 million of additional annual profit.

A second opportunity is to achieve the same level of SME referrals from retail customers. In recent years, Lloyds has consistently been the market leader in new business start-ups, based on our approach of generating referrals from the branches, and we believe we can achieve similar results in HBOS. Estimates suggest this could be worth around £100 million.   I will talk to you about these opportunities at future meetings. The opportunities are real and, potentially, they are very significant.

The new Group has a powerful opportunity to create value. We have taken a ‘core’, ‘non-core’ split of the Group The ‘core’ businesses are those that fit our relationship bank model and conform to our risk appetite. We will nurture and grow these businesses going forward. ‘Non-core’ businesses are those which do not fit our relationship model or risk appetite and have unsustainable revenue streams or use a disproportionate amount of capital. The chart uses actual 2008 results to demonstrate what the Lloyds Banking Group would look like if you stripped out the non-core businesses. On a continuing basis, excluding the market dislocation, the pro-forma Group revenues in 2008 were £21.6 billion. Stripping out the revenues of the non core businesses leaves us with core revenues of approximately £19 billion. The non-core businesses contributed just 10 % to the 2008 Group income but used 45.7 % of the Group’s capital. If you then deduct the operating expenses and impairments associated with the core business this leaves a core business profit of some £6.5 billion.

We have the opportunity to substantially grow that profit in the core businesses over time. As the core markets recover, as we deliver on the cost synergies and we capture the revenue synergies. As we redeploy the 45 % of capital supporting the non-core businesses and we benefit from more normalised level of impairments as we run down the higher risk portfolios. The Group has very significant earnings potential of as we drive the strategy forward.

In closing, I would remind you of my key messages. I fully appreciate the huge concern of what we actually bought. I hope that Tim’s slides helped you understand the numbers in some detail. With my presentation, I hope that you share our belief that we have a thorough understanding of the issues and are addressing them sharply.

We have an experienced management team that has been built over the years. They have a strong and proven track record and know how to work together to build a business. We believe we will create significant value from the franchise. We will realise the significant cost opportunity

We believe we can generate substantial additional revenue. And, as we work down the bad portfolio, the strength and growth in the core earnings will create terrific shareholder value.

Thank you

Sir Victor Blank – Chairman

I hope you all feel that it was valuable to take a little bit more time today with so much to talk about. And so much detail we wanted to share with you. We are now happy to take questions.

Question & Answer Session

Question 1 : John-Paul Crutchley - UBS

Good morning, it's John-Paul Crutchley from UBS. I want to ask a question maybe for Tim or Helen about margins. And I guess clearly it is difficult in a competitive environment for margins, given what is happening in terms of deposit spreads right now. But relative to other UK Banks, you are slightly unusual in that you have a much greater mortgage portfolio relative to your deposits, than the competition and that is I guess one area that is re-pricing with some time lags coming through. I just wondered if you could comment on how you see that playing out, particularly if you see any differences with the legacy HBOS portfolio, relative to the legacy Lloyds portfolio?

Answer : Tim Tookey

Morning John-Paul. The cocktail is quite difficult to predict in how margins are going to perform going forward. We haven't put out today any forward looking statements on margin. Let me walk through some of the ingredients if I may. Clearly base rates are at their current levels causing some pressure on margins. Also putting pressure on margins, are funding costs. I would however flag that both the heritage Lloyds and HBOS businesses have to a degree had those pressures, certainly the funding cost pressure during 2008 and each business, through a variety of pricing activities, as well as pricing any new business, appropriately for the full cost of funds, have been able to achieve margin stability during 2008. During 2009 it will be more of a challenge as we have more of the year operating at the very low base rates that came into effect during the last quarter. So it is a difficult one to predict, but I would just say that the businesses have worked very hard on repricing and taking advantage of new business opportunities to make sure they are appropriately priced for the cost of funding and appropriate pricing for risk.

Answer : Eric Daniels

One of the encouraging things is that for a good long time we have been talking about risk not being priced appropriately whether it is liquidity risk, funding risk or credit risk and I think with this correction in the markets we are seeing now appropriate pricing for risk, it is something we have not seen for quite a while so that is an encouraging sign.

Question 2 : Peter Toeman – HSBC

The fair value adjustment on assets, particularly lending, enables you to be able to write down the value of some £10 billion of corporate and retail loans. I mean to what extent does that write down make you feel more confident about future impairments going forward?

Answer : Tim Tookey

Well the accounting fair value exercise has a number of elements to it. One of which as you rightly say, does regard credit. But it is not so much taking write downs, it is more about applying portfolio level at a portfolio level market based credit default spread across the different books that make up the HBOS balance sheet. And that is the approach that has been done on both the corporate and the retail books. Another key element of the fair valuing is of course that you update your carrying values to reflect the current interest rates. And clearly that has more effect or much more effect on a fixed rate book than anything that is baring a variable price. To that extent the fair value work is somewhat separate from the impairment exercise which is clearly at a transaction by transaction level, where you look at the expected realisable net present value using current interest rates of any situation where you have had an impairment event.

<u>Question 3 : Ian Smillie – RBS</u>

Good morning, two questions please. The first one follows up on Peter's. Of the £15 billion fair value asset reduction you have taken, could you quantify how much of that relates explicitly to credit and how much of it relates to the other issues that you just mentioned?

Answer : Tim Tookey

That is not separated out in the book. But what we have seen since the initial exercise was undertaken in the Autumn is that clearly there has been a larger adjustment for the credit aspect of it. But also where interest rates have moved, that has given also a larger adjustment. So the two are roughly offset in how it has moved since the Autumn, but I have not split them out in the book. I will have a chat with you afterwards if you like.

Further question

The second question, thank you for the pre impairment proforma number that you gave us for the Group, I think £11 billion. Could you give us some sense of how that is split first half, second half of last year, because it is important to understand the current trends that the Group is delivering? My guess is that it would be very much weighted to the first half of 2008 and therefore I am interested to understand how it would have performed if you did that just on the second half? I would guess maybe £4-5 billion out of the £11 billion would have been generated in the second half of the year and perhaps that is a better number to carry forward?

Answer: Tim Tookey

Are you talking about '08 or '09 Ian?

Ian Smillie

I am talking about the £11 billion number that you gave to try and split it into first half and second half so that we can understand better the trends?

Answer : Tim Tookey

Certainly when I was giving a comparison of the impairments in corporates,

Ian Smillie

Pre-impairment profit?

Answer : Tim Tookey

Pre-impairment profit. I have not got that with me. I have not got that information with me.

<u>Question 4 : Sandy Chan - Panmure Gordon</u>

Thanks very much for the disclosure on the core, non core view as well. That was much appreciated. What I would like to do is kind of put that together with probably the announcement you would have liked to make about the Government Asset Protection Scheme as well. Putting the non core bits together, maybe the £165 billion of non Lloyds qualifying HBOS exposures, the £56 billion of asset backed securities, you kind of get to £200-250 billion that has been reported in the press for assets you might want to put into the asset protection scheme. If that is the case and I realise that you can't really comment on any of this, is it a good way to think about the potential risk weighted asset uplift reduction you might get in the capital uplift? And also, wouldn't that imply, given that you have clearly signalled, there is a lot of incentive to ditch the non core assets, that you might be willing to pay more for your asset protection scheme in order to eliminate the risk?

Answer : Eric Daniels

It was a wonderful question and wonderfully framed and one that I can't answer. So thank you for the question, but as we said this morning, we are well engaged in and talks are progressing with the Government, but that is about as far as I can go.

Question 5 : Jonathan Pierce - Credit Suisse

Coming back to fair value adjustments, there was no axis obviously put on the spread, but I think we can roughly back out that we must be talking 2-3 years for the debit and 3-4 on the credit, would that be about right?

Answer : Tim Tookey

Jonathan good morning. The chart was clearly illustrative. I would encourage you not to read anything into it. What I do expect is I expect a net unwind in 2009 of about £2 billion on a pre-tax basis as a credit to income. So I wouldn't read anything into the axes.

Further question

Then your comment about Group profits in 2009 or actually being losses, is that after the credit as well?

Answer : Tim Tookey

Yes it is.

Further question

Thanks, the second question is about the longer term plans with regard your loan to deposit ratio. Because at the Group level, with HBOS it has gone up to about 175 percent which is pretty similar to where HBOS itself was at the Interims stage of last year. RBS yesterday was indicating they would be looking to take theirs back down towards 100 percent over maybe a 3-5 year period. So I am interested in your longer term thoughts on that ratio and whether you think it will hold back loan growth aspirations in the medium term?

Answer : Eric Daniels

We have not published any kinds of targets on returns or key ratios. What I would tell you is that very clearly what we are seeing in the combined Group, a relatively conservative Lloyds portfolio which is the smaller portfolio and then the larger HBOS portfolio which I spent some time talking about as did Tim. We clearly think that the current ratio is unacceptable, that it is the result of a very vulnerable high risk portfolio reacting to a very bad economy. So we expect a couple of things. One is we stop the new flow coming in, that is clear. We have work out specialists who have identified and are now working down the bad portfolio, It will decline over time. And we would expect more normal economic environment to return. So I think that in terms of guidance, what I tell you is if you look at the old Lloyds TSB and the kind of asset quality that we generated year in, year out, that would be where I would expect to guide the Group.

Question 6 - Derek Chambers - S&P Equity Research

Can I ask questions in two areas? One is presumably if you do get some settlement on the asset protection scheme, you might have to agree some incremental aspirations for lending. And you have set out the areas where you are going to contract. I wonder if you could perhaps indicate what would be the benchmark levels of growth in the continuing business against any incremental promises that will be given, particularly in the mortgage and SME areas. And as a supplement to that, could you say whether the agreement you struck last year to take on extra business from Northern Rock is still of any relevance to you? And then as a second area, the business you are creating, the franchise there is clearly dependent on customer service and customer satisfaction and metrics and monitoring that will be very important. I just wondered if you could say anything about how you see the business you have taken over in HBOS and also how that is performing against Lloyds Banking Group and will do in the future?

Answer : Eric Daniels

In terms of the first part, I am afraid I can't really give you much guidance in terms of lending commitments and how they would fit into a potential commitment under the asset protection scheme. Again I think I have said just about all that I can say there.

Your question on Northern Rock, was is the referral scheme still viable? What I think we would have found and I want to be a little bit careful with my words here is that while this was potentially a valuable source of or could have been a valuable source, we did in fact have differences in credit quality and credit criteria so it probably was not as robust as we would have hoped for. That said, I think that we were very successful in capturing a very large share of the market last year. Lloyds alone without HBOS had something like about 30 percent of the net mortgage lending in the market. As you know, this was lending that adhered to all of our very high credit standards. It is a prime book. I think our average new loan to value ratio was in the low 60's on that book last year. So origination is not a problem for us.

You also asked about customer satisfaction and the role that it plays in the enlarged Group. Very clearly we have implemented the balanced scorecard across the new Group. If you recall the balanced scorecard has five sections, I won't rehearse them here, but it is critical that we measure each business unit, each business manager and I get measured by the Board by those same criteria which leads to well balanced healthy growth based on an economic profit discipline. Our customer service and customer satisfaction are a very key part of how we build a long term high quality stream of earnings. So it is one of those things where a manager who produces brilliant financial results, but has poor customer results, will not in fact be rewarded. This is something where obviously the manager is doing something in the short term but not building long term value for the franchise. And so that is how we will continue to measure and manage.

<u>Question 7 : Leigh Goodwin - Fox-Pitt Kelton</u>

I have just got a couple of questions on the balance sheet and a couple on risk. Just on the balance sheet, I wonder if you could confirm, I know this may be a sensitive issue, can you confirm what the combined Group's UK tax credits are as at the end of 2008?

Answer : Tim Tookey

I haven't got that information with me on the table. You will find that disclosed in our report and accounts, with an analysis with any tax balances carried forward when the Report and Accounts is published in a few weeks time.

Further question

I was just thinking, just looking at 2008, and the HBOS tax credits, around about £3 ½ billion. Would I be a long way out if I was to assume that might be the sort of figure?

Answer : Tim Tookey

The numbers will be in the Report and Accounts, but you can see the news release, the tax adjustment taken in each of the heritage Lloyds and heritage HBOS numbers. Just be careful because you don't know what is in the balance sheet before you apply that credit though.

Further question

That's why I asked the question. Just one on the balance sheet. Just on the pension deficit. It seems that the Lloyds pension deficit increased, HBOS came down. I just wondered whether that is because of different methodologies or whether it is the same methodology and therefore this is absolutely fine? I suppose the more important question is, how should we think about the pension deficits and the way you are going to close that deficit over the years?

Answer : Tim Tookey

The movements in the deficits in the accounts are following fairly similar IS19 assumptions. So there is nothing untoward in the slightly opposite movements that are seen in there. That is partly down to the different asset mix that is in the two schemes and how the different asset mixes are performed. In terms of how we close that over time, I mean we are currently both schemes are in discussions with trustees about revaluations that are going on. You are probably aware that the Lloyds scheme valuation three years ago actually resulted in a what I call a deficit ratification programme of agreed payments with the trustees and that has continued and still continues. I am not expecting the valuation work to be completed for some months yet.

Further question

Okay thanks and just on the mortgage side, house price inflation. You have given us your estimate today of 15 percent decline this year, or at least that is what your planning assumption is. What proportion of your book will effectively be in negative equity were we to see 15 percent? In the past HBOS has given us a break down by LTV band which has enabled us to do the calculation. You are at 16-17 percent already so I would be interested to know where that will go to? And secondly, also in the past Tim you have helpfully guided us as to how impairments might change as a consequence of HPI movements and I wonder if you could just guide us for 2009?

Answer : Tim Tookey

Sure. I was trying to give the loan to value split on page 27 of my pack. There was a lot of data on there because what I really wanted to do was draw out the relatively modest amounts. So there is tranche there in the 80-90 and 90-100 to help you in that. I guess the follow up question which I won't answer, that we are guiding to a house price move that is half way between the bands, so I will save you asking the question. In terms of what that turns into in terms of impairments, we are not giving guidance on the impairment impact of that at the moment. But I think the main driver of what happens in 2009 is actually what happens on unemployment, because what happens in unemployment will be what feeds into whether people are seeing arrears on their mortgages. And clearly if you don't have an arrears on a mortgage you don't need an impairment provision whatever with house prices. So I think it is too difficult to pull 2009 at the moment. We have previously guided at a half in advance on 2008 and I am not giving any guidance on 2009 impairment values today, I am sorry.

<u>Question 8 : Tom Rayner - Citigroup</u>

Could I just ask you Tim on your guidance on low teens, RWA growth in 2009? I am assuming that ignores any potential asset protection scheme impact, but could I ask you whether that does include the switch from point in time to through the cycle approach by the FSA?

Answer : Tim Tookey

Certainly as we haven't concluded discussions or negotiations with the Government on the APS, clearly my guidance can't take account of something that has not happened. So yes, it is before that, before any benefit from that.

Tom Rayner

On the slide it said it was mainly pro-cyclicality the switch through the cycle has been accounted for or not in that guidance?

Answer : Tim Tookey

Already the majority of the book is already accounted for. The mortgage book is already accounted for on a through the cycle basis, using the scale as approach, that the FSA set out in October 2007.

<u>Question 9 : Michael Helsby - Morgan Stanley</u>

I have got three unrelated questions. Firstly on balance sheet risk. I think you highlight you have got £58 billion of mortgages with LTV greater than 100 percent. There is a £100 billion of commercial real estate assets and £20 billion of equity exposure and leverage finance. I was just wondering if you could tell me how much of the combined pool has actually already got a cover from the fair value adjustment you have made and also the combined balance sheet provision? Second question is relating to the impact of fall in interest rates on your margin. I appreciate there is a lot of moving parts in terms of asset spreads, repricing and things like that, but I was just wondering if you could isolate the impact of fall in interest rates on your net interest income because clearly I would be amazed if that is not something you have planned out in terms of planning? And also just point three is on life assurance capital. There has been a hell of a lot of focus on the market on other life assurers. You have got two very big life assurance companies so I was just wondering if you could give me a comment on your perception of the strength of those two given the fall in the market?

Answer : Tim Tookey

In terms of the overlap or the coverage allowed for in the fair value exercise on the portfolios that you have referenced. Obviously there is a degree of coverage, but I would caution you to look at the two exercises as somewhat separate. When one takes a fair value adjustment against any particular asset on the balance sheet, then you are creating an adjustment that by accounting rules will unwind over time. And it will unwind over the contractural or behavioural if shorter, useful life of the underlying asset or liability. Clearly it will be replaced by whatever impairments will come from that asset over time. So the impairments that will come, will come through the impairment line. The unwind of the fair value adjustment will actually go through income. So it will create a slightly odd texture to the shape of the income statement going forward. But in terms of quantum, then it is built to the £15 billion pre tax adjustment that was shown on the earlier one of my slides. But I appreciate that is net of the interest rate benefit. Clearly you do only get an interest rate benefit where you are dealing with a fixed price book. So any of those that have a variable pricing, you are looking at a one sided value adjustment, which means that one gets a disproportionate portion of contribution into that 15 from the credit default aspect of looking in fair value.

In terms of net interest margins going forward, as I gave in the answer to JP's first question, we only have seen the last quarter or the last couple of months of 2008 being a period in which we have been operating with very low base rates. So we are expecting there to be some margin squeeze during 2009 arising from the current base rate environment. Notwithstanding that of course, we have been pricing business to reflect the true cost of funds in order to protect income and protect margins in both of the heritage Groups and each Group was able to achieve margin stability on the Lloyds side and margin stability on the HBOS side. That will clearly be much more challenging during 2009, but I am not going to sit here today I am sorry and give you any guidance on what I expect the impact of that to be. I think that is just too difficult to call from a public platform at this time.

Your third point, Mike was on life capital and I appreciate the tremendous amount of detail be published in the two news releases that have gone out today, but we are very happy with the level of capital that is held in each of the two life pensions groups that are a part of Lloyds Banking Group. Each of them is very strongly capitalised, has a good working capital ratios and don't at this moment cause me any cause for concern.

Further question

Can I just follow up. If you are not prepared to talk about the breakdown on the fair value adjustment, can you at least give me some colour on the balance sheet provision against those higher risk buckets?

Answer : Tim Tookey

I gave some provision coverages as I went through, but if you catch me afterwards, I will see if I have got some more information for you.

Question 10 : Robert Law - Nomura

During your Presentation, you highlighted quite a lot of work out on problem assets in the HBOS businesses. Could you comment on your comfort level of the reserving o provisioning balances held against those assets please?

Answer : Tim Tookey

We are comfortable that in the December 2008 balance sheet in HBOS we have got the right level of coverage that is required to cover assets in there, whether they are in what we would call the category needing work out, whether they are in high risk, whether they are in impaired or on a watch list. The work that has been gone on by the HBOS team and then working jointing with the Lloyds TSB team since 16 January when completion took place, has left us with a high degree of comfort that the balance sheet at the end of December has got the right amount of provisions in it.

Question 11 : Asheefa Sarangi - Societe Generale

Following on from Tom's question on risk weighted asset growth in 2009, just putting it in a different way, how much of the low teens growth do you expect to come from the £139 billion Treasuries portfolios, how much is from migrations versus how much is from the underlying loans?

Answer : Tim Tookey

We haven't provided any further breakdown and guidance where the growth is going to come from. I would just remind you, I think I mentioned in my voiceover that there is a fair degree of pro-cyclicality still to come through in 2009 and that is incorporated within that low teens guidance on risk weighted assets, but I haven't broken it down by portfolio.

Further question

Any of that was Triple-A at the end of 2008 in your forecast would you still be assuming to be Triple-A rated asset at the end of 2009?

Answer : Tim Tookey

No that is not what I said. I said I am not giving any particular guidance on any particular asset class or credit rating. We have proven ourselves to be very effective at managing our risk-weighted asset growth in both

Lloyds side during 2009 and actually within the HBOS franchise as well, although the drivers behind risk-weighted asset management were clearly different in the two organisations.

Question 12 : Simon Willis - NCB

You have very helpfully I think given us some planning estimates from back in the Autumn on GDP growth and you have also helpfully given us your outlook for the housing market for this year, whilst not giving us the guidance that you gave us previously on the impact on impairments. But could I ask what your current planning assumption is for unemployment in the UK given the relevance to, not just the mortgage book but also the cards and unsecured personal book?

Answer : Eric Daniels

We are expecting unemployment to rise throughout 2009 and finally peak out in 2010. We haven't given specific guidance on it.

Question 13 : Jeremy Hoskin - Marathon

What is the near term 2009 outlook for issuing new shares and can you give us some feeling of how the Board is currently thinking about equity issuance at the current time? Thank you.

Answer : Eric Daniels

We have no current plans.

Question 14: Steve Haines – Morgan Stanley

Sorry, just touching again on the mortgage book. You are the UK's largest mortgage lender and looking at the statistics on as you say slide 27, it is quite shocking, I know we keep talking about the amounts over 100 percent, but if we take the amounts over 80 percent loan to value, I mean more than 40 percent of your prime book, more than 50 percent of the buy to let, more than 60 percent of the specialist book is over 80 percent LTV's. On your own assumptions of house prices falling 17 percent and a lot of futures indicating down maybe 20 percent. Being the UK's largest mortgage lender, with that book, with cover that is 13 percent in Lloyds and 18 percent in HBOS and I admire the fact that you have increased that but I am wondering whether that changes your thinking about default and loss given default as we move through '09?

Answer : Tim Tookey

In looking at the mortgage portfolio I think it is very important to remember the types of criteria that would have been taken into account when original loan was advanced. And clearly an LTV ratio is something that we talk about and most banks talk about and report and analyse publically. But remember also that the Lloyds book in particular across the prime and the buy to let book is actually built up of some very prudent lending criteria. But don't just look at LTV, but also look at income multiples and affordability. And we have got a track record of being exceedingly responsible lender and therefore there is a degree therefore of comfort irrespective of where a loan to value goes, about the Englishman's home is his castle, he won't want to give it up unless he absolutely has to. And that is why in response to the earlier question, I actually said one of the key things here is unemployment rather than particularly just focusing on loan to values and therefore surmising that there is a bigger issue than there might actually be.

Sir Victor Blank – Chairman

Thank you all very much indeed for the time and the questions, thank you.

End of Presentation