Lloyds Banking Group plc – Interim Results 2009

The Plaisterers Hall, London – Wednesday 5 August 2009

Sir Victor Blank – Chairman

Ladies and gentlemen good morning and welcome to the Lloyds Banking Group results presentation for the first half of 2009.

With me on the platform are Eric Daniels, our Group Chief Executive and Tim Tookey, Group Finance Director, and they will both join me in making some prepared remarks, following which we will as usual open the floor to questions.

But first, let me make a few comments.

In examining these results, and in conjunction with the comments from Eric and Tim, you will see that they demonstrate that we have made excellent progress with the integration of the HBOS businesses, clearly one of the largest such integration projects ever undertaken, and we are well ahead of our plans.

And we have achieved this progress whilst at the same time, ensuring that our key businesses have continued to perform well against what remains an extremely challenging economic backdrop.

During the first half, I was also particularly pleased to see the successful completion of a £4 billion fund raising through a placing and open offer, which saw us raise a considerable sum from equity markets, both from the initial open offer and from the subsequent institutional placing. I think I am right in saying that this is the first repayment of Government capital injected into a Bank in Europe. The subsequent preference share redemption, then the block on payment of ordinary dividends was removed. However, it remains the case that the Board does not expect to pay a dividend on ordinary shares in respect of 2009.

In the last six months, we have been able to review fully and to take actions on our more problematic loans, particularly the larger HBOS exposures. We have taken a prudent view of the impairment losses and as a result we expect the impairment charge taken this half to be at the highest level we will see. We anticipate that this charge will decline from here on.

The UK economy where we have the vast bulk of our exposure is stabilising. The risk of a more pronounced downturn is less than it was even a few months ago. Nevertheless we remain cautious about the short-term outcome of the economy and all our plans are based on this cautious view.

Before I hand over to Eric and Tim, as many of you know, this will be my last results presentation as Chairman of this Group before I hand over the reins to Sir Win Bischoff, who succeeds me as Chairman in the middle of September and I wish Sir Win every success. He inherits the Chair of a great financial institution. Lloyds Banking Group has a fantastic customer franchise in the UK with

a wide range of key product lines, current accounts, savings, mortgages, insurance and long-term savings.

We are a leading player in the SME market and the Corporate Banking sectors. We have a very significant insurance presence, incorporating Scottish Widows, Clerical Medical, our general insurance and our bancassurance businesses. The Group has an exceptional footprint with approximately 3,000 branches and is able to support our customers in more UK locations than any other financial institution.

I have immense belief in he exciting prospects for this Group going forward, particularly as the economic backdrop improves and we continue to develop and improve our businesses. And we are very strongly positioned for long-term success, whilst in common with other banks we are addressing short-term challenges, we have plans and actions in place to deal with each of them.

One of the most important ways in which leading businesses differentiate themselves from their peers is through the quality of their people, and the high quality of service they provide for customers. At Lloyds Banking Group we are very fortunate in having many of the best people in our industry working for us. The job that all of our colleagues do for our customers is incredibly valuable and has been highly valued by me during my time at Lloyds. And I would like to take this opportunity to thank them, once again, for their outstanding contribution to our business.

With that let me hand you over to Eric.

Thank you.

Eric Daniels – Group Chief Executive

Thanks very much Victor. Thank you all for coming.

The first half of the year was clearly a difficult period for banks. It is against this backdrop that the new Lloyds Banking Group is reporting a substantial loss for the half year before the benefit of negative goodwill. This loss which was mainly due to the high level of impairments in the large HBOS property book. Although the economic environment remains difficult, we are successfully addressing the near term challenges and believe the Group is strongly positioned for long-term growth.

The messages I would like to leave with you are: Our core relationship business is performing well; the integration is ahead of schedule; our capital and funding plans are in place and showing good progress; we have a realistic view of the economy; and we expect to outperform over the medium-term, delivering value to both customers and shareholders.

I will start by reviewing our performance for the first half of 2009. I will then outline how we are positioning the Group to outperform. Tim will take you through the results and provide texture behind our near term outlook and longer-term goals. I will then come back and summarise, before we move to the questions and answers.

Our statutory results came in with a profit of some £6 billion, but were boosted by the one-off benefit of negative goodwill associated with the acquisition of HBOS. However, the way that Tim and I look a the numbers and what we will be talking about today is the way the business is really performing without the non-recurring items.

Income was up 7 per cent on the year, over the prior year, helped by lower write-downs on treasury assets and profits from debt swaps. These gains more than offset the decline in margins, which suffered from the very low base rates and increased funding costs. While the income line was flattered by the one-offs, I am really pleased that despite the weakness in the economy, the core business performed strongly.

Costs were down 3 per cent as we continued to manage the expenses of the Group and we began to deliver against the integration benefits. As a result, the trading surplus was up 17 per cent. Clearly the most significant number on the slide is impairments which are up significantly at £13.4 billion. This was the primary driver behind the £4 billion pre-tax loss that we reported. And I will get back to impairments in a second.

Looking beneath the headlines, the core business is performing well. In retail, our sales performance was only slightly off the very high levels of last year, despite the economy. We opened 1 million new current accounts and 2.3 million savings accounts. We continue to support our customers looking for mortgages, advancing £18 billion of gross new lending and achieving a market share of 27 per cent of gross lending and 37 per cent of the net.

We are a commercial business, we opened 60 thousand new accounts which includes a 24 per cent share of start-ups. In the first six months of the year, we approved 180 thousand overdraft requests and opened nearly 19 thousand loans worth £1.8 billion for SMEs.

We have an equally strong story in the corporate bank, and as a result of the acquisition, Bank of Scotland is lending again. We continue to work on deepening customer relationships, and across our Wholesale customers we saw a 40 per cent improvement in cross-sales income. We are very cognisant of the importance of supporting households and businesses through the recession, and we are absolutely continuing to lend.

We set up the Wealth & International Division and they have made an encouraging start. And I'm really pleased that bancassurance remains resilient despite the difficult market for investment products and pensions.

In February, we said that we were undertaking a detailed reviews of the acquired portfolios with emphasis on the most stressed parts of the book. We also informed you that we were rolling out the Lloyds risk and sanctioning processes across the enlarged Group. These processes are now in place and all new lending is now being made within the Lloyds risk criteria.

We have completed the detailed credit reviews of the HBOS book and this is reflected in our first half impairment charge. Of the £13 billion in impairments, around 80 per cent of the charge is accounted for by the legacy HBOS portfolio, with the majority of the loss coming from property related assets. Normally, we expect impairments to peak one to two years after the trough of recession. But we anticipate our loss profile will be different this time, given the nature and concentration of property assets within the HBOS portfolios.

In this recession, we have seen an early and sharp fall in asset prices and this has driven the prudent view we have taken on the valuation of these assets. We expect the rest of the portfolio to behave more in line with past recessions. Therefore, while impairments on these portfolios will rise, the very high property related impairments will be lower. So we expect the Group's total impairment charge to decline from here on in.

This is one of the largest banking integrations ever undertaken. It would have been a significant challenge at any time, but even more so in the current environment. I am therefore pleased that the integration is proceeding well and we are in fact ahead of schedule.

The new organisation was up and running very quickly and we have already made major decisions on the IT platforms. We are on track with our cost targets and generated over £100 million of savings during the half. Combined with the programmes that we are putting in place in the second half, we expect to exit the year with a run rate of some £700 million, and we remain confident we will deliver more than the £1.5 billion run rate target by the end of 2011.

Despite the level of write-downs, we ended the half with a robust core tier one capital ratio of 6.3 per cent, in line with the pro-forma opening position.

We took a number of management actions to mitigate the impacts of write-downs and pro-cyclicality. These include the successful placing and open offer and liability management initiatives.

Over the next several years, we expect to run-off around £200 billion of higher risk assets. This will allow us to further strengthen our balance sheet and to re-invest in our relationship businesses. We have strong and diversified sources of funding anchored by our large retail and corporate deposit base.

In the half, we took a number of steps to extend the maturities of our wholesale funding and to further improve our liquidity profile. At the end of June, 47 per cent, nearly half, of our wholesale funding had maturities over one year. This ratio compares favourably to many other banks.

We have great access to short-term funding, but have chosen to extend our maturity profile, despite the higher cost. We believe that this is the prudent and appropriate way to manage our balance sheet, especially given the current environment. We raised £4bn of unguaranteed public debt in the half. Our 7 year, unguaranteed 2 billion Eurobond issue was very well received by the market. It was twice over-subscribed and priced well within our expectations.

Let me now turn to the future and start with the economic outlook.

The performance of the economy this year has been worse than most expected, including ourselves. Although we remain highly cautious, our view is that the risk of a severe further downturn in 2010 is significantly lower than a few short months ago.

Our customer data shows that consumers and corporates took early action to cut spending and have been helped by very low interest rates. This has led to increased savings and in some cases early repayment of debt.

Corporates acted early during the downturn, aggressively shrinking stocks and cutting costs. In the first quarter, inventories were down 5 per cent and investment fell by 10 per cent. Our corporate customers' financial positions are showing signs of improving. Our surveys of business customers show they are becoming more confident about an upturn in sales.

Despite this, we remain cautious. We model a number of scenarios for the economy. Our central scenario projects a slow, below-trend recovery. This is in line with the more recent external forecasts which reflect a deeper trough this year and a moderate upturn next year.

We project the recent moderating trends in property prices to continue. We now expect residential property prices to fall by 7 per cent or less this year and rise modestly next year. We had previously been forecasting a 15 per cent drop, but the year to date fall that is of July was only 0.8 per cent, according to the Halifax measure that we released today. On commercial property prices, we are expecting a fall of 15 per cent in 2009 but we expect that they will stay flat in 2010.

We expect company failures to continue to rise, peaking in 2010, but not to reach the heights seen in the last recession due to much lower corporate debt servicing costs. We also expect unemployment to continue to rise, peaking in 2010 at a rate similar to that seen in the last recession.

Against this forecast, let me now turn to how we see the business developing over the next several years.

We expect revenue growth to build to a high single-digit level over the next two years. In the short-term, the primary driver will be the modest economic recovery, combined with an improvement in margins, backed by good volume growth. We expect margins to better reflect the real cost of funding and risk, as the book gradually re-prices. Deposit margins will improve but will remain below the long-term trend, given the outlook for base rates.

In the longer-term, revenue growth will benefit as we re-direct capital from the lower returning businesses and deliver the potential within our franchise.

We remain focused on cost management. We are targeting a 2 per cent per annum reduction in the cost income ratio, although the earlier years it should be better as we deliver against the synergies. As I have mentioned, we believe we are already past the peak of impairments.

Turning to the balance sheet, we will run-off around £200 billion of higher risk assets. But with redeployment, we expect our balance sheet to reduce by around £100 billion.

Reflecting our increased distribution scale, we expect our customer deposits to grow and when combined with the reduction in higher risk assets, we would expect our loan to deposit ratio to return to legacy Lloyds levels.

I would now like to turn to why we believe we can deliver a level of sustained growth that we have set out here.

We are well positioned to grow and outperform. First, this is a large and attractive market. While it has been impacted by the recession, it will grow as the economy recovers and we will benefit from that growth.

Second, our business is focussed on the higher growth areas of the market. Areas such as savings, life and pensions and wealth management, which will grow as consumers look to save more and provide for retirement. In addition, small and mid-cap companies are looking for increasingly sophisticated banking products which enable them to better manage their businesses.

The new Lloyds Banking Group is well positioned for these trends. We have an unparalleled distribution network which serves 30 million retail customers and around 1 million business customers. We have powerful information systems and product capabilities to help us better serve our customers. And finally, scale, which allows us to deliver better value for both customers and shareholders.

We have a strong track record of delivering profitable growth by focusing on acquiring, deepening and broadening the relationships we have with our customers. This will continue to drive our growth.

We begin a customer relationship with the sale of a product. We are good at this, as evidenced by our sales figures for the half, especially in the key relationship products, such as current accounts. We also have an opportunity to further broaden the franchise, with the creation of the Wealth division and the development of new Corporate products.

We have started up the Wealth division, as we think we have substantial opportunity to refer wealth customers from our wholesale and retail franchises into the Private bank. There, we can better serve their needs with a richer product offer and more personalised attention.

While there are opportunities for us to acquire new customers, the real value is the opportunity to build deeper relationships and broaden our reach and offerings. I would like to briefly illustrate the opportunities we see with a couple of examples.

The value of our relationship model is illustrated by this chart which shows the distribution of the Lloyds TSB retail customers by the number of products they buy from us and their relative profitability. Today, even with the success that we have had in relationship building over many years, nearly half of our customers still only have one of our products. A further 20 per cent have just two. Clearly there is still a great deal of potential left within the Lloyds TSB franchise. We see an even bigger opportunity to increase our relationship depth within the legacy HBOS customer franchises, as their cross-sell levels are lower; over 60 per cent holding just one product.

And as we integrate the two banks, our scale will enable us to deliver better value for our customer and win more of their business.

The benefit of deepening relationships is just as evident in our corporate business. We have been very successful in deepening relationships by expanding into capital light and fee-based products. Sales of these products through Lloyds TSB doubled between 2006 and 2008. The left hand chart shows the significant income differentials between single product corporate customers and those

who buy more products and services. Those customers, with whom we have a trusted advisor status, contribute 9 times more income than a customer with just a lending product.

We still have considerable scope to build deeper more valuable relationships with Lloyds customers but as the right hand side chart shows, the upside is even greater in the Bank of Scotland franchise where revenues per corporate customer are roughly half that of Lloyds.

Before handing over to Tim, let me summarise. Our aim remains to become recognised as the UK's best financial services provider and to deliver sustainable value for our customers and shareholders.

The principal elements of our strategy will be very familiar to you. Our customer relationship focus, our cost management skills, our capital management disciplines, and our prudent risk management framework. What is different is the breadth of the revenue opportunity in the enlarged franchise, the size of the cost opportunity from the merger between Lloyds and HBOS, and the opportunity for capital redeployment as we build the quality of our earnings.

Within the next two years, if the economic environment plays out as forecast, we expect to be delivering sustainable high, single-digit income growth. We will deliver an annual 2 percentage point reduction in the cost income ratio with a faster reduction in the earlier years as we realise the cost synergies. Finally, we will run-off £200 billion of assets as we restructure our balance sheet.

We have a successful track record of creating value by executing against this model. This gives me the confidence that we, in fact, can deliver.

Now let me turn over to Tim who will walk you through the results and the financial framework in more detail.

Tim Tookey – Group Finance Director

Thank you Eric and good morning everyone. This morning I'm pleased to be presenting the financial results for Lloyds Banking Group for the first half of this year. And in the following slides, I will take you through some of the key elements of Eric's presentation in greater detail and further reinforce our confidence in the strength of our business, its strategy and its expected performance over the next few years.

In the first half, we have demonstrated that our core business is in good shape, with resilient revenues in a difficult economic environment, notwithstanding significant margin pressure. The integration of the new Group is ahead of schedule with cost synergies well on track.

We have completed detailed credit reviews of the HBOS higher risk portfolios and applied Lloyds' prudent provisioning methodology and taken the pain of very substantial first half impairment provisions required in the current economic environment on the higher risk HBOS books. Following this analysis we can say with a high level of confidence that based on our current economic assumptions, Group impairment charges have peaked.

As you know, we have a track record of deepening customer relationships. It is from this

relationship model that we see opportunities for growth across the enlarged franchise.

For the first half of 2009 we can report a resilient trading performance in very challenging markets with our trading surplus up 17 per cent despite significant margin pressure.

On a proforma basis, total income is up 7 per cent. At the same time, we have continued to maintain excellent cost control with operating expenses down 3 per cent. And I will break out some of the component parts of our revenue and cost performance shortly.

In line with previous guidance, we have experienced a significant increase in impairment levels in the Group's lending portfolios. This largely reflects the impact of the further economic deterioration, including falls in the value of commercial real estate, the effects of rising unemployment, reduced corporate cash flows, and the continuing impact thus far of lower house prices. However, we believe that overall impairments have now peaked and I am going to go through this more specifically later.

With the positive effect of the fair value unwind, we have reported a loss before tax of some £4 billion for the half.

Our statutory result in the first half was a substantial profit, reflecting the impact of the credit to the income statement from the negative goodwill arising on the HBOS acquisition.

Now let's look briefly at divisional performance. Retail has delivered a good underlying performance against the background of slowing economic activity. Income however fell 14 per cent, driven by the erosion in the net interest margin, reflecting higher wholesale funding costs and lower deposit margins in the falling base rate environment.

However, the quality of Retail lending remains good, reflecting continued strong credit criteria. An example of this is the average LTV on new mortgage lending, which in the half was 58 per cent, compared to 63 per cent last year, and this demonstrates our focus on avoiding higher LTV lending.

Wholesale banking reported a loss of £3.2 billion, primarily due to the expected increased levels of impairment. But Wholesale trading surplus grew strongly driven by income being up by 37 per cent, principally as a result of lower impact of investment write-downs and reflecting continued strength in cross-sales into wholesale markets and continued good trading.

The Insurance reduction in profit reflects the extremely challenging market conditions. Income was affected by the market-wide slowdown in life, pension and investment sales across both the UK and Europe. But operating expenses were very well managed and reduced by 14 per cent.

In Wealth and International, a sound underlying performance has been turned into a significant loss before tax due to increased impairment losses driven by the economic downturns in both Ireland and Australia.

Group Operations and central items is a loss for the period reflecting the impact of fair value adjustments which more than offset the benefit of the liability management gains made during the half.

Now I want to walk through some of this in more detail. Firstly revenue. As I said, first half revenue was supported by a good performance in Wholesale, as a result of the absence of last year's market dislocation impact, and good underlying growth from traditional corporate customers.

I also want to draw out here the overall resilience of revenues against both the backdrop of the significant margin pressures we experienced which I will talk about shortly, and the impact of moving to a monthly premium PPI product in January which was also a drag on revenues this time around.

In addition, you will see that we have executed a number of liability management transactions in the first half. These have generated strong gains over and above the fair value unwind that crystallises as a result of these transactions.

Turning now to margins. The net interest margin from our banking business was 28 basis points lower at 1.72 per cent, as higher asset pricing was more than offset by the impact of lower deposit margins, reflecting the impact of falling base rates, and higher funding costs as the Group consciously extended its wholesale funding maturity profile.

Before I expand on our expectations for margins going forward, I would like to discuss the key forces that are currently influencing our margins.

Starting top left. New lending is generally being done at prices that reflect the appropriate cost of funds and of course proper pricing for risk. However, in many sectors, notably within Wholesale, we are seeing considerable reductions in demand as companies refocus their own businesses and look carefully at their financial requirements.

Within existing lending, we are seeing quite different trends from those that have prevailed in recent periods. This is perhaps most noticeable in our mortgage portfolios, where redemptions and remortgaging have dropped significantly. In fact, this is underpinned by totally logical customer behaviour as whether you are coming off a fixed rate period or your tracker product is coming to an end, reverting to the current contractual SVR is probably getting you the best rate around.

Of course for us, customers moving to SVR from trackers is helping interest income whereas customers moving from fixed rate products to SVR is reducing our income. Corporate lending products however are naturally repricing much more quickly which is helping us avoid further net interest income reductions.

To understand the overall impact of these forces on our margins, we must look at funding costs. As far as wholesale funding is concerned, costs generally have increased and of course, as I have said, we have consciously extended our maturity profile. On customer deposits, the rates we pay have not borne the full impact of base rate reductions as we seek to secure and grow such balances.

So what does all this mean going forward? We do not expect these trends in our net interest margin to continue throughout the rest of the year and, during the second half we expect a

significant slowdown in the rate of margin decline as the impact of lower base rates and higher funding costs eases.

You will also see from our News Release issued this morning that we have given some future guidance. We expect the margin to start to increase next year, although not to the 2008 levels of 2 per cent. Thereafter, we expect the impact of rising base rates, further portfolio repricing, and greater stability in wholesale funding markets to lead to further margin increases.

Now let's look at costs. The Group has an excellent track record in managing its cost base, and has continued to deliver a strong cost performance. During the first half of 2009, operating expenses decreased by 3 per cent. Over the last six months, staff numbers have reduced by over 2,500 to 118,000, as the Group has started to achieve integration savings from bringing together the combined businesses.

We anticipate further significant cost savings from the integration over the next 3 years, more in just a second, and as a result of this we expect to exceed our recent cost:income ratio improvement of approx 200 basis points per annum. After 3 years of integration delivery, we will still be targeting further improvements in the cost:income ratio of that same 200 basis points per annum.

So now let's look at progress on integration. Less than six months after the date of acquisition, and with the planning of many of the key integration activities largely complete, the execution of a broad range of programmes is well underway. We are very pleased with the progress made so far and this reaffirms our confidence that we will meet our commitment to deliver cost synergies of greater than £1.5 billion per annum by the end of 2011.

In the first half of this year we have already captured savings of over £100 million. Early synergies have come mainly from non-IT dependent programmes such as procurement benefits, streamlining our non-branch property portfolio and the obvious de-layering and de-duplication of roles. We are aiming for over £400 million of savings this year which would equate to a run rate equivalent of some £700 million. All in all, I see this as excellent progress.

This being one of the largest bank integrations ever, we have over 70 integration programmes planned. The initial planning phase is done and we have the programme management team and structure in place to support and drive the integration process and a considerable amount of time is being dedicated to achieving a smooth integration.

This is one of the most important issues currently on the management agenda and, as you would expect, the Group Executive Committee reviews status and progress on a weekly basis, dealing with any potential issues before they can become problems.

As I have said, programme delivery is gaining momentum, and a number are already delivering benefits. But of course some projects are more complex, including product migration and full systems integration. Whilst initial scoping work and the main platform choices have already been made, many of these programmes will take until 2011 to see full delivery.

I would now like to spend some time on impairment and the outlook for the second half of 2009 and beyond.

Firstly, Retail. In the first half of 2009, we have started to see a change in the mix of retail impairments between secured and unsecured towards a more normal pattern. What we have seen is the combined impact of a number of factors; a stabilising outlook for house prices; increasing levels of unemployment primarily affecting the unsecured portfolio, and lower than previously expected repossessions as customers benefit from the low interest rate environment.

Compared to the first half of 2009, we expect to see a moderate increase in the retail impairment charge in the second half of the year, which we believe will represent the peak in Retail impairments, with an improving trend expected in 2010.

Looking specifically at our secured portfolio for a moment. We are reasonably pleased with the performance of the different mortgage books. Over the past 6 months our secured portfolio has performed better than our expectations. As I said in February, we were swift in identifying those parts of the mortgage books which are our areas of focus as a relationship lender and we immediately put certain books into run-off. We have stopped writing specialist self-certified and sub-prime mortgages and have continued to write only a modest amount of new lending in Buy to Let, and this is being written to Lloyds TSB lending criteria.

The values of our book that are both more than 100 per cent loan to value and in arrears are very modest indeed, in fact, they total 1.1 per cent of the total mortgage portfolio. It is worth noting that all of the assets with an LTV greater than 100 per cent and more than 3 months in arrears within the specialist and HBOS buy to let portfolios are intended to be covered by GAPS.

Forgive me if I dive into detail here, but I think it is just worth drawing out another good nugget of mortgage book performance, repossessions. Our repossessions actually peaked in Q3 2008 and since then the trend has been marginally downward, against the clear industry trend, reflecting the benefits of quickly identifying and working closely with customers who get into financial difficulty. And there is a lot more data on the mortgage portfolio in the back of your packs this morning.

And now to Wholesale. As expected, the charge for Wholesale impairment losses increased significantly from the first half of 2008, although it is only moderately higher than the second half of last year. The increase principally reflects continuing declines in commercial property prices and reducing levels of corporate cash flows. In addition, what we saw in the half was that, in particular, the real estate related exposures in the legacy HBOS portfolios, were more sensitive to a downturn in the economic environment.

We have spent considerable time analysing and addressing the issues in these portfolios, with the greatest attention paid to the over concentration in real estate and those portfolios that fell outside the Lloyds risk appetite. As a result of our portfolio review, and with the further deterioration in the economy in the first half, translating into lower commercial real estate valuations, we took a prudent but significant impairment charge during the first half of this year. It is worth drawing out at this stage, that approximately 80 per cent of the first half impairment charge relates to assets intended to be covered by our participation in GAPS.

As we have said, we believe that Wholesale impairments have now peaked and we expect a significant overall reduction in the Wholesale impairment charge in the second half, and a further reduction in 2010. As with Retail, we expect the mix of the Wholesale impairment charge will

change. Against our base economic assumptions, we expect to see lower charges from commercial real estate related portfolios. This will be partially offset by higher charges from corporate and commercial businesses, as a result of what you might call more normal impairment levels against a backdrop of deteriorating economic conditions and higher corporate failures.

Turning now to International. In our International businesses the impairment charge rose to £1.5 billion reflecting significant deterioration in real estate related exposures and we have booked significant provisions against these portfolios. Again, these portfolios are predominantly expected to be included in GAPS with some 85 per cent of the first half impairment charge related to assets intended to be included.

Looking forward, we expect a reduction in the charge in the second half of 2009 with further reductions next year, although we do continue to have ongoing concerns with regard to the outlook for the Irish economy.

I have given you a lot of impairment guidance here so let me just recap for a second. We believe the overall Group impairment charge peaked in the first half. We believe Wholesale and International impairments have peaked and we expect Retail impairments to peak in the second half of 2009. Though we would normally expect impairments to peak one to two years after the low point of a recession, given the prudent approach we have taken resulting in the very substantial Wholesale charge in the first half of the year, and based on our current economic outlook we believe that the Group's overall impairment charge in the second half of 2009 will be significantly lower than in the first half. Thereafter we expect the 2010 charge to be significantly lower again.

We expect to put into the Asset Protection Scheme virtually all of those assets that we deem to be higher risk or overly concentrated following the acquisition of HBOS. And the portfolio will of course evolve as we complete the GAPS documentation. Looking at the initially announced GAPS portfolio, approximately three quarters of the Group impairment charge in the first half of the year relates to assets intended for GAPS. The residual charge relates to non-GAPS assets such as our credit card and prime mortgage portfolios, where impairment trends are pretty much as expected given the economic environment. Approximately £1 billion of this residual charge relates to impairments on legacy HBOS asset backed securities where there is a largely offsetting credit in the income statement fair value unwind. So that leaves just over £2 billion of the remaining charge as what you might consider our 'non-GAPS' lending portfolio impairment.

Now turning to fair value adjustments. We spent some time on this topic back in February so I don't intend to go over the full technical details again now. However, as a reminder, there was a reduction in the net assets acquired from HBOS following the fair value exercise. We reduced the value of assets acquired, principally the loans acquired to their fair value, and this was partly offset by a reduction in the value of own debt on the HBOS balance sheet. The former reduced net assets acquired and results in an increase in profits going forward as it unwinds, whilst the latter increased net assets acquired and will reduce profits as it unwinds. We also had to take adjustments for HBOS's available-for-sale and cashflow hedging reserves.

These adjustments have now started to unwind. The credit of some £3.7 billion in the first half is principally the unwind relating to the expected credit losses coming through on the HBOS loan portfolios which were a component of the fair value acquisition and adjustment and have now been

incurred. Quite simply, with the level and speed of impairments increasing as it did in the first half, so the unwind gets accelerated.

The patterns of unwind of course are tied to the underlying assets and liabilities, so for predictable maturities on HBOS debt for example, the unwind is straight line to maturity but on loans and advances the faster the impairments come through, the faster the unwind of credit adjustments comes through to mitigate.

I have also shown the unwind I currently expect in the second half and beyond. I should stress however that these numbers are likely to change somewhat, especially on the credit side, as I have just set out, as part of the unwind is determined by the profile of expected losses being incurred, and I will update you on an ongoing basis with regard to the evolution of this profile.

Between 2010 and 2013, the unwinds are modestly favourable overall as further credit adjustments are greater than the unwind on the own debt revaluations also taken on acquisition. The tail after 2013 is not expected to be significant.

Let's move on to net tangible assets. During the first half of the year the key changes to our net tangible assets were of course the £4 billion increase from the Placing and Open Offer and the impact of our earnings. As a result of these, the overall impact was to increase net tangible assets to £25 billion.

In per share terms, and allowing for these adjustments, net tangible assets per share have reduced from 140 pence to 92 pence. Adjusting further for our intended participation in GAPS, we expect the initial net tangible assets per share, fully diluted by the issue and subsequent of conversion of B shares, to increase to £1.

At the end of June 2009, the Group's capital ratios, prior to the implementation of GAPS, remained robust with a total capital ratio of 10.6 per cent, a tier 1 ratio of 8.6 per cent and, perhaps most importantly these days, a core tier 1 ratio of 6.3 per cent.

In addition, the Group's intended participation in GAPS is expected to substantially de-risk the Group's balance sheet, reduce risk-weighted assets and very significantly further strengthen our capital position.

When we look at the evolution of our core tier 1 ratio in the first half, we can see the impact of the Placing and Open Offer, the balance sheet management initiatives, and lower risk-weighted assets have more than mitigated the impact of the losses incurred in the last six months, bringing our core Tier 1 capital ratio for the half year back up to 6.3 per cent.

In an economy which we believe will continue to be difficult, but one which is showing some early signs of stabilisation, the capital management actions we have taken continue to give us a robust capital position and one which leaves the Group well positioned.

And while we maintain and strengthen our capital base, it is crucial to consider the size of our balance sheet going forward. As part of our review of the business, we have identified over £300 billion of assets associated principally with non-relationship lending and investments, and of business which is outside our current risk appetite. This equates to just under 30 per cent of the

Group's total balance sheet assets. It is our intention to manage these assets for value and, given the current economic climate, our primary focus will be on running these assets down over time. Over the next five years, we expect to achieve a reduction in such assets of approximately £200 billion, split about £140 billion of customer lending and £60 billion of treasury assets and with the profile of the run off weighted towards the latter years. The rest are likely to take more time to run off.

The expected RWA reduction of some £100 billion is of course heavily overlapped with the RWA reduction that would arise on completion of GAPS, but the rightsizing and funding benefits from the asset reduction over time will give the Group greater optionality, and I want to set out our current thinking on this now.

With most of the assets targeted to run off currently generating lower returns, our optionality is many-fold. We can look at this as the opportunity to increase returns by reinvesting in our core relationship businesses or to reduce our overall wholesale funding requirements, further supporting our desire to reduce the loan to deposit ratio and maintain a prudent wholesale funding profile. Whilst we will clearly have a range of options and outcomes, it is our current view that up to half of the released funding and capital would be redeployed in our core relationship businesses, principally in the UK. The remaining funding and capital benefit will be absorbed within the Group's overall plans.

As far as these portfolios are concerned then, in summary we are seeking an asset reduction of about £200 billion, of which up to half would be reinvested in the businesses. As a result, our balance sheet size is currently expected to reduce by some £100 billion over the next five years but the impact of this on income and therefore earnings will be minimal, reflecting the higher returns on reinvested assets.

Let's now look at funding. Our high customer deposit base is a key part of our funding model, and we currently have some £370 billion of retail and corporate customer deposits, the majority of which are 'sticky' relationship deposits. As you can see, however, we do have a significant wholesale funding requirement but that is satisfied from a wide variety of sources. We have a very well spread funding profile and the enlarged group now has a longer term maturity profile than Lloyds had previously. Our broad aim is to ensure that we maintain our more-than-one-year funding balances above 40 per cent of the Group's wholesale funding requirement.

Over the last six months, as many of you will be aware, we have been consistently and consciously been working to reduce our reliance on short-term funding, and it is pleasing to report that the percentage of our funding with a maturity of more than one year has increased from 44 to 47 per cent. This compares very favourably with many of our competitors.

As I mentioned earlier, this has not come without cost but, at a time when wholesale funding markets have not been easy, I believe the additional cost is a price worth paying for an extended maturity profile. And this extension achieved has, of course, further de-risked what was already a prudent maturity profile.

During the first six months of the year, our retail customer deposits grew by 1 per cent despite subdued retail deposit markets in general. Our corporate deposits however reduced during the

half, as we chose not to renew a number of historic high interest paying Bank of Scotland corporate deposits.

Whilst looking at a funding slide, I should briefly comment on our loan to deposit ratio which, excluding repo activity, improved slightly to 1.76. As you know, for those of you who know me, the Group does not set a target for this ratio, which does not reflect either the quality of lending or the term of deposits held, but I would expect to see a slow and steady reduction in the ratio and thus for it to return to legacy Lloyds TSB levels of around 140 per cent over the next few years.

So, in concluding, our business is in good shape, with resilient revenues in a difficult economic environment, notwithstanding margin pressures. I have outlined as well, how we expect to see improved margins over the next few years. The integration of the new Group is well under way, in fact it is operating ahead of schedule in many areas, with cost synergies firmly on track.

We believe that overall Group impairment levels have peaked. We have a robust capital and funding position and expect this to improve significantly as a result of our intended participation in GAPS.

Overall therefore, we expect the second half of the year to be tough but manageable, with strong medium term upside.

And with that, I would like to hand you back to Eric.

Eric Daniels – Group Chief Executive

Thanks very much Tim.

Before concluding the formal remarks today, I wanted to take a moment to say a few words of thanks to Victor, as this is his last Results meeting.

He has been our Chairman since 2006, and during that time he has made a significant contribution to the Group and its development. On behalf of the Group, I would like to offer him our sincere thanks for the important role he has played and to wish him every success in the future. Victor.

This last year has been particularly difficult for our industry. We have all been reminded of the over-riding importance of strong risk-disciplines and a prudent through the cycle approach.

It now seems that the UK economy is stabilising. But the growth will be below trend as the credit excesses of the boom years are unwound. For many years, Lloyds Bank has aimed to deliver sustained growth and value for its customers and shareholders.

We have focused our business model on customer value and deep relationships, within a highly disciplined risk framework. We stuck to what we're good at and have not expanded into the higher-risk, product led businesses which drove much of the unsustainable growth in banking profits in recent years.

You've heard today that we will continue to pursue our business model across the enlarged franchise. Although the economic environment remains difficult, we are successfully addressing the near-term challenges.

We believe that our new Group can consistently outperform and create value for its customers and shareholders as we deliver against the significant opportunities within our business franchise.

Thanks very much for listening. Now let me hand you back to Victor for the Q&A.

Sir Victor Blank – Chairman

Thanks Eric and Tim. Let's go straight into questions and answers.

Q&As

Question 1 : John-Paul Crutchley - UBS

Can I ask you a question Eric about longer-term? You have not really said anything about longer-term returns and earnings. Clearly the environment is still highly uncertain and the regulatory environment is still very uncertain. But if you put together what you have been saying in terms of revenues looking to be stable to upper in the longer-term, but clearly taking costs out...I think about a more normalised impairment, it is hard not to get to the conclusion that this is a mid-to-high teens ROE business the other side of the cycle. I just wondered if you could make some comments on whether that analysis is sound or whether there is anything missing in that in terms of the equity part of the equation?

Answer : Eric Daniels

I think that you read all the trends exactly right. That is as we see it. It is of course dependent on how the economy eventually pans out. But if you take that forecast, that would say that our guidance would look an awful lot like the old Lloyds Bank. And you know what the returns were in the old Lloyds. So I think that that would be about how we would view the future.

Question 2 : Peter Toeman – HSBC

I wondered what your attitude is towards the Asset Protection Scheme because it seems to me the benefit of the scheme was the elimination of uncertainty…back in March/April where no one had any idea how impairments could be. Now you are sufficiently confident to tell us that the peak of impairments have passed, so do you really need to spend £15 billion on an insurance policy to remove a risk that might now be less likely to materialise? I suspect you will answer me by saying you need recapitalisation from reduction in Risk Weighted Assets (RWA) that the Government Asset Protection Scheme will give you. But I wondered if you considered asking shareholders directly to recapitalise the bank rather than relying on the GAPS scheme?

Answer : Eric Daniels

The way we think about the GAPS is that it is insurance. And as with any insurance, you would hope like hell that your house does not burn down, but if it does you are protected. And that is sort of the way we think about it. Very clearly, we do believe that the peak of impairments has passed, but we also believe that it remains an uncertain environment.

Question 3 : Ian Smillie – RBS

Two questions please. The first one is thanks very much for the forward looking guidance. Just to make sure we all take it away correctly, are you suggesting that there will be a profit or loss in the second half of this year on a proforma basis?

Answer : Tim Tookey

We are not changing our guidance that we gave previously on the overall result for the year.

Further question

You have clearly seen the first half numbers and I am trying to work out what you are pointing us to for the second half of the year?

Answer: Tim Tookey

We have given guidance on the full year results and we have given in the statement today, indicators on some of the trends that we see, but I am not changing my guidance for the overall year.

Further question

The second question is on book value progress. Could you give us the updated fair value adjustments on both sides of the balance sheet as they stand at the period end because I am just trying to work out why you are guiding us to a net positive contribution from that net unwind over the coming years, given that the starting point was slightly bigger benefit to liability reduction than asset reduction. Now I know it is distorted by the debt buyback that you did in the first half of the year. So it would be very helpful if we could see what the end of period numbers are so we can work through that amortisation process for ourselves and therefore take a view on where book value will be in a couple of years time?

Answer : Tim Tookey

Yes, the guidance we have set out here shows what is happening. All of these things will unwind through the income statement. So there is nothing else you will see that is not in the profile that I have set out on the slide there. In terms of why you are seeing that overall positive trend. You are looking to say, well where is the negative? Remember that those numbers are actually net of the fair value on HBOS own debt that unwinds with the liability management actions that we have taken in the first half, we have of course captured, is the word I use Ian, some of that unwind that now cannot unwind and hurt, because the gain that we show on the liability transactions, about three-quarters of a billion, already reflects the capturing of that unwind. So that is dealt with and can't come back and therefore reduce profits and capital going forward. It is a very smart tool for managing capital and managing profits going forward. The overall profile going forward you have seen we have guided on what we will see in the second half and in the years to come. Of course the, what you are seeing there is what is going to happen in the income statement. There are two sources of that. You get the pure fair value that affects net assets, but you also get the available for sale reserves unwind that comes through. And that is why you don't see an overall negative coming through in any of the years going forward.

Question 4 : Sandy Chen - Panmure Gordon

I am trying to put the guidance that you have given in terms of balance sheet shrinkage together with goal of maintaining top line growth of increasing cross selling the customer base. Because the

way to think about it, if you are looking at a net £100 billion reduction in your balance sheet assets, or £200 million reduction on let's say a £650 billion customer loan book, would you be in effect giving maybe 10-20 per cent of your customers behind those loans the heave ho? Or am I thinking about that the wrong way in terms of cross selling? And related to that, the participation in the Government Asset Protection Scheme, obviously it has been widely reported that the EU may require both non core or core disposals related to that. Do you see that having an impact on that top line growth?

Answer : Eric Daniels

In terms of answering your second question first. You are asking a state aid question and whether that is going to be a meaningful consideration? I think that it would be safe to say, that we are in conversations with Europe and we would expect to have a satisfactory conclusion. In terms of how we are managing the business going forward…very clearly we have a large percentage of our portfolio some £300 billion as Tim pointed out, of assets that are reasonably high risk. And if you look at a real risk adjusted return, we talked about these during the February Presentation where they occupy a very large part of our risk weighted assets, but don't really contribute an awful lot to our returns. And so what we will do is run those down over time. We will use part of that run down to help support our relationship businesses and as you know, we have been very successful in growing in our risk efficient fashion if you will. So there is a disproportionate impact by switching it over to the relationship business. And we would expect to use part of it to shrink the balance sheet.

Answer : Tim Tookey

I agree with all of that. I would just add that of course we have got a market leading business support unit, which is really a turnaround unit. It is not a unit that says, "let's go in and get as much as we can out and create significant pain for customers". This is a unit that specialises in supporting customers through their difficulties which at the end of the day will minimise the losses or any losses that we will take on that portfolio. So to the very first part of your question, no we have no intention of leaving customers in the lurch as we look to manage down over time and for value assets that we would regard as outside of our risk appetite or non relationship based.

Question 5 : Aaron Ibbotson, Goldman Sachs

Just a quick question on Wholesale funding. You seem to be reasonably happy with the profile at the moment. I was just hoping that you could clarify. Do you expect to push the funding profile out further, i.e. increase the term-funding part of it? Or, are you all-in-all reasonably happy with the current structure?

Answer : Tim Tookey

Thanks very much for the question. I have said here what we would like to do over time is maintain it at more than 40 per cent. I said that from the podium. At the moment it is 47 per cent. I am comfortable with that 47 per cent. I think that is a prudent place to be and we have deliberately and consciously pushed it out this year from 44 to 47 per cent, notwithstanding the margin pressure that has put us under. That reflects a prudent profile, given the state of the funding markets generally. But over time I want to keep it above 40 per cent.

Question 6 - Michael Helsby – Morgan Stanley

Firstly I was just wondering if you could tell us what the deposit spread is at the half year and what is the marginal cost of your deposits at the moment? Then within your margin guidance what is the

average mortgage duration that you are assuming? There has been a very sharp change clearly in duration, so that is key. In the move in the wholesale funding greater than one year, I was just wondering if you could clarify how much of that is being Government led? Because clearly all the Government funding is sort of greater than one year. And also if you can tell us to what extent the total reliance on Government funding is at the balance sheet, at the period end? And then just lastly on funding. I am very, very surprised that you are making the comment that you can move back towards a 40 per cent greater than one year wholesale funding duration. If we just take the proforma as you did at 44 per cent, that is even lower than where HBOS were at the end of December. And we were all here, we all watched the concerns about the funding position of HBOS. So the fact that you in the new world, think that you can move to a level that is substantially below that, I just find very, very surprising. So if you could explain why you feel so comfortable in making that statement.

Answer : Eric Daniels

Michael I fully appreciate your concern and I will ask Tim to talk to you about the margins, but let me address the wider issue of wholesale funding and what does 40 per cent guidance mean? I think the first thing you have to look at, is what is the quality of your lending and what is the quality of your deposits on the overall book. And what is going to happen with those. What we have basically said is that we are going to grow our deposit base. There is a couple of different ways you can grow it. If you offer very high rates, you will attract in hot money. That is clearly what HBOS did and then you are on a drug. You have to keep on paying very, very high rates. If you build them an account at a time, and when we opened from the first half for example, the million current accounts, and the 2.3 million savings accounts, that is building it a brick at a time. And so over time what we will do is increase our rich consumer deposit base in our wholesale deposit base and have less reliance on wholesale funding. When you are a smaller player in the marketplace, which we already are, we have as much different wholesale funding requirement than many other banks. But if you are a smaller player in the marketplace then your maturity is less of a concern because you have the big part of the nut already solved. So that is the context. This is not an HBOS strategy, this is a prudent Lloyds strategy.

Answer : Tim Tookey

Michael I am not going to get into individual deposit spreads or marginal costs. What you do know because we set it out right from the very first presentation we gave around the new Group back in September, is that one of the key strengths of having multiple brands and multiple distribution channels is that we can use different pricing techniques to manage our liability gathering particularly in the retail space and that is something that we continue to do very successfully.

You asked about mortgage duration. I have already commented that we have seen a significant reduction in redemption activity, but we are seeing an encouraging proportion of those customers who are on tracker mortgages, actually using some of the benefit that they are seeing in their own pockets from the rates coming down to actually make some capital repayments. But mortgage durations are going out, they are extending because of the lack of redemption activity. As I said from the podium, the Standard Variable Rate (SVR), that people are migrating onto is probably the best rate around that people will get. How that pattern will change going forward, I don't know. I think that is one we will have to sort of wait and see.

On the next part of your question you asked about more than one year Government funding etc. Clearly an element of our extension has been using Government guaranteed debt. We make no

bones about that. We have also done some very successful unguaranteed issuance and we are particularly pleased with the way our recent seven year Eurobond issue was received, it priced inside competitors and inside our own expectations and was a significant over demand and we are very pleased with how that got away.

In terms of where the overall profile goes forward, I think you can sense from the table here today and from the numbers that we have given you that we will maintain a prudent funding position for the bank. Notwithstanding how we would see that happening over time, the decision to move that out during the first half of this year was taken very carefully and in a very considered way. I think a 47 per cent funding in more than one year stands us in exceptionally good stead against peer banks. You then have to look at the diversity of funding sources. And what we will be looking to do over the next few years is diversify the kind of writers of some of that term funding that is coming into place and as one diversifies away, then we can consider the overall risk profile of the balance sheet. But at the moment I would look to maintain that above 40 per cent. But don't think that I am going to come back to 47 to 40 per cent by Christmas because that won't be happening either.

Further question
Part of that question was just the total amount of Government sponsored funding, if you could show that number that would be useful

Answer : Tim Tookey
We don't disclose that I am afraid.

Further question
On the bad debts, I think if we look to the US banking system as a guide to how they approach the credit cycle and clearly they have been building provisions very aggressively for the last couple of years, so on page 67 of your press release, I am very surprised to see that actually you have just reduced your cover from your provisioning, but you have also released about £1.3 billion or you have shrunk the actual provision by £1.3 billion. I can see that you have done some write offs with the unsecured, but it still looks more than I would expect so that is an explanation for that? And also what recovery rate you are assuming on your unsecured bad debt?

Answer : Tim Tookey
You are right to observe we have done some writing off. What we have done is simply netted off principle against provisions where we have got close to or exactly 100 per cent provision against it. What that gives you is actually a greater line of sight in the impairment provision coverage that we have across the three different books. And I might get the numbers wrong, but you have got 40, 46 and 40 per cent across the three different banking divisions that we have, which gives us a very, very substantial level of provision coverage against impaired loans. I think at that type of coverage, where it is not being in any way distorted by what might be there for things that are 100 per cent provided, you are really getting line of sight for a very comfortable level of provisions. And we are certainly very happy at that level. You have got here good old fashioned Lloyds TSB proven methodology now sitting in our 30 June balance sheet and I am very comfortable with he levels of provision.

<u>Question 7 : Mike Trippett – Oriel Securities</u>
I want to come back to Peter Toeman's question actually. What I don't understand is the relationship between the £200 billion run off of assets and the £260 billion that goes into GAPS. To

what extent is there an overlap? And if there is an overlap then I begin to understand less the merits of GAPS because you are still going to get the capital release by the £200 billion run off and I guess you will also move towards your funding targets as well. And I guess at the same time you will also reduce the concentration risk that the EU is worried about. So I think just to understand the relationship between the £200 billion and GAPS portfolio is crucial.

Answer : Tim Tookey
There are a number of numbers in play here. £260 billion is the intended asset portfolio that we announced back on 7 March. That included about £30 billion of undrawn commitments. So in terms of items on balance sheet, you had about £230 billion. We have identified it now, it is probably just over £300 billion of total assets and investments that we will consider either outside risk appetite or of an investment nature. That we would look to run off over time. In terms of the capital benefit, there will be significant overlap between the run off of £200 billion out of the £300 billion and what will go into GAPS, very significant run off. But what you get by running these assets off is you get a funding benefit. And we want to use that funding benefit as we set out to further derisk what is going on in the balance sheet. Further derisk the profile of funding and also create the capacity for reinvestment because what this business is, the bank is open for business. The bank is not in run off. And we are here to work with our core relationship strategies in our main divisions, banking and insurance, to build the business going forward. And we want to create the capacity to do that. Now GAPS does not give you any kind of a funding benefit. So by being careful and measured in how we manage this portfolio of assets over time, we can create capacity to both invest in the business going forward and further derisk the balance sheet and that is what we are going to achieve.

Further question
I would have though by definition, the GAPS assets are in run off anyway? They are clearly not core. So I am still not clear, is the £200 billion, is that part of the £260 billion GAPS.

Answer : Tim Tookey
There is a very significant overlap between the two.

<u>Question 8 : Leigh Goodwin, Fox-Pitt Kelton</u>
Just another question on the GAPS. I wonder if you could just confirm for us where we are in relation to the first loss piece now? I mean clearly we can see £13.4 billion of impairments, 75 per cent of those are on GAPS assets, so that gives us about £10 billion. The complicated bit is, of the £25 billion, there was then an adjustment, part of the capital adjustment on acquisition could effectively come from that £25 billion as I understood it. Now the capital adjustment you guided us back in February has changed. It looks a bit more severe, hence the move positive unwind shall we say of the next few years. So how should we think about where we are in relation to moving through that first loss piece?

Answer : Tim Tookey
The capital adjustment you get with GAPS has a number of legs. You have the increase in capital from the B shares, you have the reduction in the RWAs and then you have an adjustment as you right say, around first loss, which has an overlap with fair value accounting. The impairment charge that we have taken in the current year, about three-quarters of that relate to assets that are intended to go into GAPS. There is not a direct correlation between that and the first loss consumption, because you need to understand what is happening around first losses and other

pieces. We are not going to go into any more detail on that at the moment. We are in the middle of a process working to complete the GAPS and we are confident we are going to complete that process.

Further Question
Okay well let me just put it a different way then. When we do our models looking forward for you, shall we assume that there is another £15 billion left so to speak in the first loss piece or is it less than that?

Answer : Tim Tookey
I think I am going to just go back to my previous answer. We are in the middle of a process. The detailed terms and conditions on GAPS and how it is going to work is still being discussed and documented. It is an incredibly complex beast.

Further Question
Just on the margins. I appreciate we can all see the trends that are going on, those things that have been negative this year and which hopefully provide positive momentum through next year. I suppose my question is more thinking through the longer term and where you think margins are going to go to? You say next year you don't expect them to go back to 2008 levels. I wonder whether you think that by 2011/2012 we will have done? And in that context, one has to think that this is going to be a fairly visible change in pricing that will be taking place perhaps as interest rates rise. And whether you think that there might not be some external scrutiny of any marginal widening?

Answer : Tim Tookey
What I have done is set out today quite a lot of detail on what I see is the forces that are influencing our margins. And I have given near term guidance on how that is going to play out. My intention is to provide the analyst community with enough guidance on what the inputs will be, that they can watch and observe those inputs and come out with their view and then interpret that into how the margin will perform going forward. So we are not actually giving specific guidance beyond 2010 except around those inputs. So I think we have given a significant amount of guidance on the inputs for how that will happen going forward.

The second part of your question was around pricing. Let's be careful how we look at this here. You are suggesting that the only way we achieve it is by putting up prices. I am suggesting that actually by focusing on relationship businesses and relationship customers, there are other ways of earning income. And if you look particularly at some of our activities around corporate businesses, we are looking to achieve far more non interest based income from customers. We are looking to have a greater share of transaction business providing interest rate and currency management activities. That has been a keen driver of some growth in the Wholesale business in the first half of this year and we look to continue that momentum going forward.

Further Question
On impairments on the unsecured book. You don't split it up by credit cards and unsecured loans and I think credit cards are outside the Asset Protection Scheme. But in any case, we have had quite a rise in the unsecured charge in the first half of the year, over 9 per cent of the book and quite a big increase. We know unemployment is going up to next year as you pointed out. So I

wonder why you feel so confident that the retail impairment charge will improve a lot next year considering those trends?

Answer : Tim Tookey
Okay, what I tried to do and I apologise if I didn't do it clearly enough was talk about the change in mix that we see in the retail impairment charge. And you have got here the different dynamics of rising unemployment, which as you quite rightly flag is a driver of unsecured impairments. But also the improving outlook for house prices. Our current view for this year is to be 7 per cent fall or better in terms of house price performances and then to see it marginally increase going forward. We are looking here at the balance of overall retail impairments and that is what has underpinned our guidance on how charges will peak and then improve.

Answer : Eric Daniels
I just wanted to follow up on one question which was Government pressure and what would happen with pricing. I think there are two things that I would point out. The first is that risk has not been appropriately priced for a good long time and if you recall we talked about this in the first half of 2007, where Lloyds had basically withdrawn from the mortgage market because we thought pricing was nuts. It was about 10 basis points. You can't cover your liquidity risk with 10 basis points never mind credit risk. So what we believe is that the market will in fact have reasonable risk adjusted pricing for both credit as well as liquidity risk and that means that prices will in fact go up on lending. But I think the other thing we have to look at is where we are in the cycle, that if you have traditionally very high interest rates, what happens is that you have very good liability spreads and asset spreads tend to compress. And likewise if you have very low interest rate environment, asset spreads tend to go up, liability spreads go to hell. So what I think we are going to see is as base rates adjust, we are going to see some adjustment in that asset liability mix and hopefully what we will see is that the market has at least learnt something from the more recent troubles and price risk appropriately.

<u>Question 9 : Robert Law - Nomura</u>
I have three questions please. Firstly just on the Asset Protection Scheme. I am a little surprised that you aren't prepared to update us on some of the financials. Can I check that the initial broad financial guidelines that you gave when announcing the scheme are still appropriate, i.e. the £25 billion first loss piece and the £260 billion of assets that you are putting into the scheme and essentially the make up of those assets has not materially altered since you announced them?

Answer : Tim Tookey
Yes broadly speaking that is absolutely right. Those are the numbers that were there with the intended portfolio to go into GAPS. As I have said in my prepared words, there may be some minor adjustments to the construct of the portfolio, as due diligence and everything goes through. We are in the middle of that process and when we have something formal to update then we will update.

Further question
Secondly, also related to that. In terms of page 67 of your release where you look at impaired assets. Could you comment on the split of impaired asset between GAPS and non GAPS assets?

Answer : Tim Tookey
No we haven't given that information.

Further question
And the final one, was in the revenue line, there has been, I think there is likely to have been some negative revenue affects on the private equity portfolio or principle finance portfolio of HBOS, can you quantify that and any other negative revenue items that I may have missed?

Answer : Tim Tookey
The total value of all write downs on investments is less than £200 million

Further question
In revenue?

Answer : Tim Tookey
That is where those write downs are taken yes.

Question 10 : Simon Pilkington - Cazenove
Just a couple of questions on the margin. A point of clarification on Slide 8 where you refer to base rate movements. Are you assuming that base rates go up next year and really if base rates stay flat does that have any impact on your guidance for the net interest margin?

Answer : Tim Tookey
We would expect there to be a probably one small increase in base rates next year, nothing particularly material. The benefit of that to us would be marginal, but would be positive, hence you get a small arrow on there. In terms of, if the economic scenario was different and therefore you had different base rates, then that little favourable arrow on my margin chart would disappear.

Further question
And then what has been the benefit in the first half from hedging?

Answer : Tim Tookey
Not significant.

Simon Pilkington
Because you have given it up or what?

Answer : Tim Tookey
There were some hedges that were in place in the second half of last year, principally on the HBOS side. Many of those were closed out and the benefit was spread over the second half of last year. Small benefit into the first half of this year.

Question 11 : Ian Gordon – Exane BNP Paribas
Can I have three quick ones please. Firstly on GAPS. Can you remind me, when you first announced your proposed participation, you explained that there would be a non linear amortisation of the premium. For 2009 should I assume a albeit non linear, full year's worth, not withstanding the fact that the scheme won't formally be signed off until maybe Q4?

Answer : Tim Tookey
If you want to model it in that way, that would be perfectly acceptable, yes.

Further question
Second point, the main positive as far as I can see it in the results was the non interest income component in wholesale. I hope it is not disingenuous to suggest that elements of that outperformance seem to be products with a level of complexity and sophistication which was outside the Lloyds appetite prior to Truett Tate's arrival at the Group. So I wondered if you could provide a little more colour on your future aspirations for developing those particular product lines, i.e. they appear to go beyond improving cross sales for existing corporate relationships? And on a similar vein, the old favourite of Payment Protection Insurance (PPI) was an element that fell into the opposite category, a non sophisticated product, force fed to customers. I think you have explained that the main driver for the reduction in the recognised income from this source in 2009 is not lower penetration, but it is a change in accounting recognition, i.e. you lose the up front recognition. Can you give us any feeling for the current pace of deterioration in the cross sales PPI albeit off a lower base of gross personal loan sales?

Answer : Eric Daniels
In terms of the non interest income, I am going to ask Truett to comment as well. But the quick answer is no we are not becoming an investment bank. No, we never will. We are a relationship bank to the extent that we develop product. It is to help to serve our customer needs. We are not a product shop that basically goes out and tries to, 'invent the better mouse trap', and goes out to find customers that will buy it. We have a group of customers, they have a set of needs. We develop against those needs. That is the way we operate. So we are also gratified to see the non interest income. We think that is an important revenue stream but this is not something where we are going to change colours.

As far as PPI, again, then I will turn it over to Truett to give you a little more colour. Our penetration rates are very good on PPI. No we did not force feed customers. This is a very valuable product and I think that an awful lot of customers, especially with higher unemployment, are very happy that they in fact took the product. In terms of our product change, you know that we now have a monthly charging product as opposed to a single premium product and yes, we do have a difference in accounting recognition and that is accounting for the difference in income. The penetration rates are very, very good.

Answer : Truett Tate
There is not much to add because the core response is 100 per cent correct. I will give you a little colour in the sense that debt capital markets in particular in terms of our hedging derivatives. Clare Francis' area, which you know we brought in about three years ago and invested a lot in terms of people and infrastructure and platform, has proven really very profitable for the last two years. And if you go back to both Tim and Eric's slides, we could give you a fist full of live examples of names that we had an exposure in Lloyds TSB. We had a Lloyds and HBOS exposure. We did nothing more than combine the two exposures. We went from having a third and fourth position that had then been the leading position in terms of balance sheet. And we have doubled and tripled our profitability with no change in the balance sheet. How did that happen? One of the two had not leveraged to balance sheet position to cross sell into what we have in debt capital markets and what we have in terms of Clare Francis' area derivatives, hedging, Tamlyn Knowles area in terms of other creative things. But it is with the product set that we define for you a couple of years ago,

we continue to invest people and platforms and then the key is leveraging the cross sell and we are doing it already this year in a matter of months across a broad number of names.

Question 12 : Steve Hayne – Morgan Stanley

I just want to make sure I understood the guidance clearly in relation to the next few years. You have made it clear that it has peaked in the first half of this year and we are getting better from here. For the non GAPS portfolios, if I add up your guidance, and just make sure I understand it correctly. So house prices going nowhere, sort of 2 per cent in 2010, company [?] peaking in 2010, unemployment peaking in 2010, the vast majority of your bad debt comes in the wholesale, not in the retail area. So if I put all those pieces together, am I clear in saying that the non GAPS book impairment is peaking in 2010 not in the first half of this year?

Answer : Tim Tookey

We have given pretty comprehensive guidance and tried to break it out as far as we can for you how the different books are going to perform. I think we have also been very clear that the majority of the impairments we have seen in the first half of this year on assets that are going into GAPs is about three-quarters. What we have also tried to convey is the fact that you would expect the normal pattern in traditional lending books to see a peak as a bank goes through the economy. We are not calling a profile of that pattern going forward. But the kind of analysis that you are doing is the kind of analysis that I am also looking at.

Further question

Could you just give me a bit more flavour on the £9.7 billion or so in the Wholesale bad debt? As you say the vast majority of that is GAPS, but leaves about £4 billion or so that has come through non GAPS. Can you give me a flavour of where that is coming through? Which bits in the Wholesale are we seeing lots of bad debt coming through?

Answer : Tim Tookey

What I said, I hope I read the words out right, was actually on the Wholesale side about 80 per cent of the impairment actually related to assets going into GAPS. So you have got about 20 per cent of £10 billion or £9.8 billion. Where that is coming through is in the more traditional areas where the Wholesale bank operates around traditional corporate and commercial customers and some of the lending moves in the asset finance business for example.

Question 13 : Jonathan Pierce – Credit Suisse

Can I come back on the GAPS fee? Obviously the GAPS covers assets in terms of deterioration from the start of 2009. On day one when this gets introduced, why won't there be quite a big retrospective accrual in the same way that the fair value unwind has accelerated, because the deterioration has been more rapid? I would have thought the accrual of the GAPS fee would be more rapid as well and clearly there is no accrual yet because it has not been introduced?

Answer : Tim Tookey

What we said about this in March and I still have the same position to at the moment is that you would typically amortise an insurance premium over the profile of the time which you expect to receive benefits. So at the moment while you are burning through a first loss piece, for example, then you have one type of benefit from the fee which is the B share elements, you have a benefit in your capital side, but you are not getting any benefit in earnings. As you go through and that

changes, so the level of amortisation would increase. And that is why we have always said that amortisation in the early years would be lower than it would then become.

Further question
So that should be in line with the payout?

Answer :Tim Tookey
It will be in line with our expectations of the benefits of the GAPS scheme. Quite clearly if you take out an insurance policy on your house, you still have to expense it even if you don't claim. So there comes a point when that changes.

Further question
On margins, specifically the wholesale funding cost elements of the margin guidance. If you hold your term funding of one year plus funding at 47 per cent of total, I would have still thought there would have been increase in wholesale funding costs next year as some of the term funding, the old stuff gets refinanced at libor plus 150-300 basis points as is happening at the moment?

Answer :Tim Tookey
I think we are looking at the overall profile of it and how that is going to come through looking at the diverse sources where we get it from because not all of it is coming from purely money market stuff. All that has been into our guidance on how we expect to see that going forward and I am comfortable with the profile

Further question
I was slightly surprised to hear you say that the repricing of some of the fixed rate mortgages onto SVR was hitting you because ordinarily I would have expected you to have swapped out the fixed rate element of those mortgages on day one of origination and hence when you go from 10-20 basis points as Eric was saying onto an SVR of 200, I would have thought that would benefit your margin. Were you not hedged against a chunk of this book?

Answer :Tim Tookey
What I was describing was the impact on our income. Quite clearly the customer is moving from a fixed rate product to an SVR. The amount of income that we are receiving from the customer is reduced and that is the element that I am feeding into. Where we have fixed rate products, that are put in place, we do absolutely hedge the interest rate exposure on that for the period of the fixed rate. So the hedging in place on the fixed rate mortgage covers the period of the fixed rate. When you come off that, you are then into a situation where you are funding that mortgage, assuming the mortgage stays with you from whatever your various funding supplies and different costs there, is providing you with the input which is the big box across the bottom of my margin forces chart. But the actual level of income that the bank will get from the customer will reduce when they come onto an SVR. That is what I was trying to describe. I was talking about the impact on income rather than netting.

Question 14: Michael Helsby – Morgan Stanley
Just on the income, I was wondering if you could tell us, looking at the £49 billion of impaired loans at the end of June, what the level of income is in the P&L account for the first half of the year.

Answer : Tim Tookey
I don't have that figure to hand. What you have to consider though is of course you don't earn income when you impair a loan, you bring the value of that loan on your balance sheet down to the original affective interest rate that you have, but on the lower balance. And we are currently carrying, I have not got the number in my head, but as I said between 40, 42 and 46 across the three divisions of provision coverage against that £49 billion. You would have to take that into account in determining it. So I haven't broken it out sorry.

<u>Sir Victor Blank – Chairman</u>
Thank you all very much indeed for coming.

End of Presentation