S&P Global
Market Intelligence

Lloyds Banking Group plc LSE:LLOY

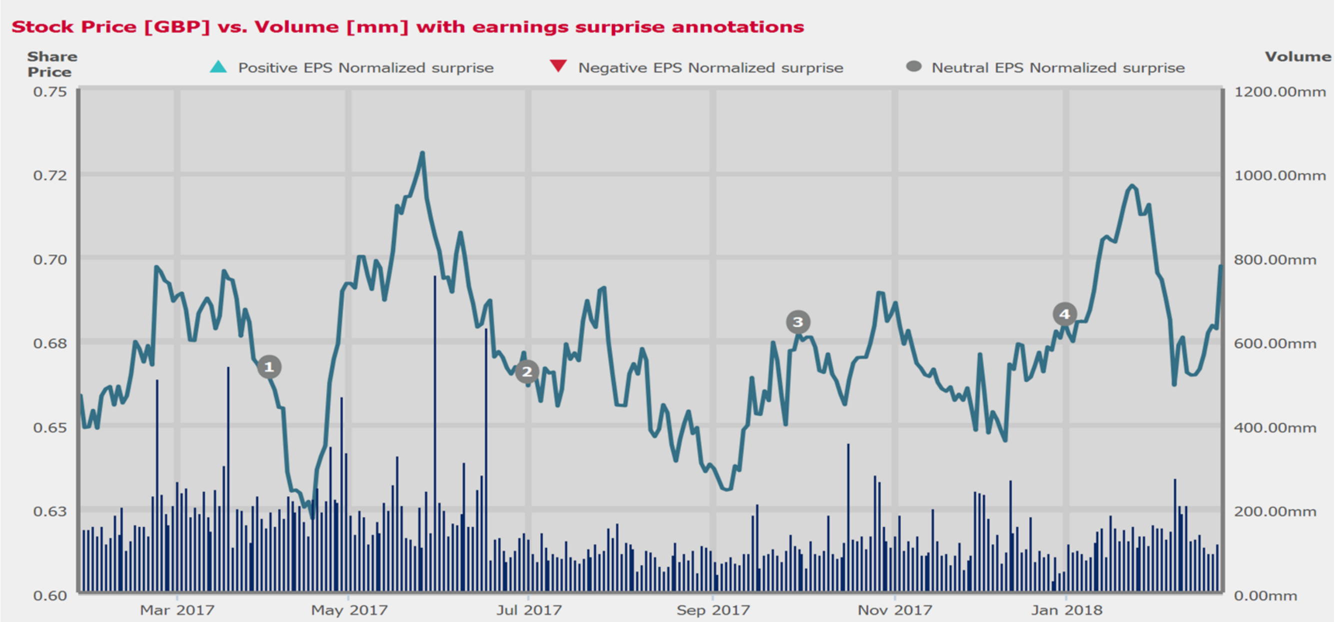
FY 2017 Earnings Call Transcripts

Wednesday, February 21, 2018 9:30 AM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2017-			-FQ1 2018-		-FY 2017-			-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	SURPRISE	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	0.02	0.02	0.00	0.02	0.00	0.08	0.08	0.00	0.07
Revenue (mm)	4425.52	4632.00	▲4.67	-	-	18469.82	18525.00	▲0.30	18325.89

Currency: GBP
Consensus as of Feb-21-2018 9:21 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FY 2017	0.08	0.08	1 0.00 %

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Presentation

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Good morning, everyone. It is great to see you all here. Today, we will update you on our strong strategic and financial progress, and provide details on the strategy that will transform the group for success in a digital world. We will spend the next hour going through the 2017 results, including time for questions, before moving on to the strategic update.

So turning to the results. 2017 was a landmark year for the group, with the return to private ownership in May. This was the culmination of hard work by colleagues from across the group, and it is a source of great pride to all of us that we were able to return to full private ownership, with the government realizing more than its original investment.

We have also made significant strategic progress in the year. We completed the second phase of our strategic journey, making great progress in creating the best customer experience, becoming simpler and more efficient, and delivering sustainable growth.

We have continued to develop our market-leading digital proposition and have the U.K.'s largest and top-rated digital bank, with almost 13.5 million active online customers, of which 9.3 million are active on mobile.

We have achieved lending growth in targeted segments within SME, Mid Markets and Consumer Finance, and increased our corporate pension assets. Our Simplification program has delivered GBP 1.4 billion of run rate savings, ahead of our original target, and further improving our market-leading cost-to-income ratio.

In June, we completed the acquisition of MBNA, which gives us additional scale and the great brands in prime and secured consumer lending. And in December, announced the acquisition of Zurich's U.K. workplace pensions and savings business, which gives the group a platform to develop the next phase of our strategy for financial planning and retirement, which you'll hear more about later this morning from António Lorenzo.

And in July last year, we announced the restructuring of the business and the reorganization of the management team in order to better align the bank's organizational design and capabilities with the changing external environment and to plan in advance the next phase of our strategy. You'll be hearing from a number of the leadership team later.

On the financials. We have again delivered a strong performance, with improved profit and returns on both the statutory and an underlying basis. We have also returned the business to growth, with an increase in loans and advances in the year. This strong financial performance, along with the continued derisking of the balance sheet, enabled the group to boast its credit ratings increase again, and to deliver very strong capital generation of 245 basis points, above guidance.

In terms of capital requirements, we talked at Q3 about the 50 basis points increase in the group's Pillar 2A. We are now pleased to announce that the PRA has also completed its review of the group's PRA Buffer requirement. As a consequence of these and other developments, we are now targeting a revised capital requirement of circa 13%, while also holding a management buffer of around 1%. With our strong capital generation, we are already at this level.

On returns to shareholders, the board has recommended a final ordinary dividend of 2.05p per share, which means that the 2017 total ordinary dividend of 3.05p per share is 20% higher than last year and in line with our progressive and sustainable ordinary dividend policy. The board also intends to implement a share buyback of up to GBP 1 billion over the next 12 months, reflecting the board's desire to return surplus capital to shareholders. This represents a 46% increase on total returns to shareholders versus last year, amounting to up to GBP 3.2 billion.

In 2017, we have again clearly demonstrated the success of our business model, with increasing both underlying and statutory profit. Statutory profit before tax increased 24% year-on-year to GBP 5.3 billion from a negative GBP 600 million in 2012. And as the below-the-line charges reduce in future years, we expect the gap between statutory and underlying profits and returns to continue to close.

We achieved GBP 8.5 billion of underlying profit, still 60% above statutory PBT and increasing 8% over 2016; with the improvement a result of: net income growth, together with an increase in net interest margin; our market-leading efficiency and an improved cost-to-income ratio; strong asset quality with our AQR being kept at low levels; and our Moody's credit rating improving to Aa- and our S&P outlook improving to positive, driving our cost of funds down further.

As a consequence, the group delivered a statutory return on tangible equity of 8.9% in 2017 and an underlying return after tax of 15.6%, which shows both the progress we have made and what we still expect to achieve for our shareholders over the next few years.

Turning to the U.K. economy. We see an economy that is resilient and continues to benefit from the tailwinds of continuous GDP growth and deleveraging in recent years, with unemployment also at a 40-year low. We expect the employment rate to continue growing in 2018, further supporting consumption. On the other hand, pay growth remains below inflation, which causes pressure on household finances.

Despite the U.K. continuing to run a current account deficit, exports are now growing consistently ahead of imports for the first time in 6 years, helped by the recent devaluation of sterling, which has also increased the value of earnings from foreign assets, which is positive.

All these factors considered, the U.K. faces a period of political and economic uncertainty. But given the fact as well that we are an open economy, we will also benefit from global growth, which has accelerated recently. And therefore, all in all, we expect GDP growth in 2018 at similar levels to 2017.

In summary, in 2017, we have made significant strategic progress and our differentiated multi-brand business model continues to deliver, with a significant improvement in financial performance and returns, along with strong capital generation.

In 2018, we expect a net interest margin of around 290 basis points, in line with the second half of 2017, and again, demonstrating the strength of the group's margin given our multi-brand strategy and overall management of pricing and volumes across the whole balance sheet.

We also expect to continue -- or continue to expect the cost-to-income ratio to further improve, the asset quality ratio to remain below 30 basis points and capital generation to be in line with our ongoing guidance of 170 to 200 basis points.

We are well positioned for the future and face the next stage of our strategic development with confidence as we continue to build on our existing competitive advantages and develop new ones. You will hear from various members of the senior management team later this morning, and they will provide you with an overview of the key strategic priorities and the initiatives we'll be implementing under the next phase of the group's strategy.

I will now hand over to George, who'll run through the financials in more detail.

M. Culmer

Thank you, António, and good morning, everyone. As you already heard, the group has delivered a strong financial performance in 2017, with statutory profit before tax up 24% at GBP 5.3 billion, and underlying profit up 8% at GBP 8.5 million. This performance was driven by a strong final quarter in which underlying profit was up 7% on Q4 2016 and net interest income up 14%, with a net interest margin of 290 basis points and in line with Q3.

In terms of the full year, net income is up 5% at GBP 17.5 billion, reflecting both higher NII and other operating income. Operating jaws were a positive 4% and the group's market-leading cost-income ratio has improved further to 46.8%, while asset quality remained strong with a net AQR of 18 basis points and a stable gross AQR of 28. And as you've heard, the group delivered an underlying return on tangible equity of 15.6%, up 1.5 percentage points; and a statutory return of 8.9%, up 2.3 percentage points.

Looking at net income in more detail. Net interest income was GBP 12.3 billion and up 8%, with lower funding and deposit costs, again, more than offsetting asset pricing pressure. MBNA has contributed GBP 430 million of NII for the 7 months of ownership and is performing ahead of our expectations.

The net interest margin for the year was 286, up 15 basis points. And going forward, while we expect asset pricing to remain competitive, particularly on mortgages, for 2018, we still expect NIM to be around 290.

Other operating income was GBP 6.2 billion and up 2%, with a good contribution from Lex Autolease and Retail, a robust performance in Commercial, offset by reduced Insurance income due mainly to lower bulk annuities. Other income also benefited from the gain on sale of VocaLink. And as previously stated, we continue to be a seller of gilts and have realized gains of around GBP 270 million in the year.

Turning to costs. Cost management continues to be a competitive advantage for the group. And excluding the impact of MBNA, operating costs fell 1% year-on-year to GBP 8 billion. Total operating costs, including MBNA, were GBP 8.2 billion.

Our Simplification program has delivered GBP 1.4 billion of run rate savings, in line with the enhanced target we set for the end of 2017. And these savings have helped deliver the 19% reduction in operating costs since 2010, with reductions every year and enabling increased investment in the business.

In terms of asset quality, our gross AQR of 28 basis points is in line with the last 2 years. This is after a large single corporate impairment in the third and fourth quarters, and the consolidation of MBNA in the second half of the year, which adds around 2 basis points to the ratio. Our net AQR of 18 basis points reflects the lower expected level of releases and write-backs.

Impaired loans for the group now stand at GBP 7.8 billion, 1.6% of gross lending and down 0.2 percentage points on prior year. The coverage ratio of 45% is up 4 percentage points, with a prudent increase in coverage across all business lines despite the fall in impaired loan ratios.

Within Retail, the mortgage portfolio continues to benefit from strong affordability and falling LTVs. And the average LTV across our book is now 43.6%, and nearly 90% of our portfolio has an LTV less than or equal to 80%.

In Motor Finance, we continue to take a prudent approach to residual value provisioning. Our prime credit card book uses conservative pricing and reserving assumptions, and is performing well.

In Commercial, the book has continued to benefit from effective risk management in the benign economic environment, including the continued low interest rates. For 2018, as you've heard, we expect an AQR of less than 30 basis points, although IFRS 9 will, of course, introduce additional short-term volatility.

In terms of divisional performance, Retail has put in a strong performance and benefited in the second half from the consolidation of MBNA. Underlying profit of GBP 4.4 billion increased 9%, with the net interest margin improving by 14 basis points, while other income was up 3%, largely driven by Lex Autolease. Lending is also up 3%, including year-on-year growth of around GBP 1 billion in the open mortgage book.

Commercial has seen a 5% improvement in underlying profit at GBP 2.5 billion and a market-leading return on risk-weighted assets of just over 2.8%, and well ahead of our target of 2.4%. The net interest margin has improved by 18 basis points, driven by 5% improvement in net interest income, while other income has remained broadly stable.

Underlying profit in Insurance and Wealth is down 3% on 2016 due primarily to lower new business income from bulk annuities and a lower contribution from Wealth. The business, though, continues to generate strong returns and capital generation, with an underlying ROTE of just over 16% and a full year dividend of almost GBP 700 million.

Finally, in the Center, we've seen increased income on profits due to the GBP 146 million gain on the sale of VocaLink and the GBP 274 million of gains on the sale of liquid treasury assets, primarily the gilts that I mentioned earlier.

Looking then at statutory profit. Statutory profit after tax is up 41% at GBP 3.5 billion, reflecting the higher underlying profit, lower below-the-line charges and a lower effective tax rate. Market volatility at GBP 82 million is significantly lower than 2016, primarily due to the GBP 790 million charge for the ECNs in prior year.

Restructuring costs of GBP 621 million were in line with 2016 and include the final costs of the Simplification program, as well as our investment in our nonbranch property rationalization, the group's ring-fencing program and the integration of MBNA.

PPI costs of GBP 1.7 billion include GBP 600 million in the fourth quarter, reflecting an increase in expected weekly claims through to the time bar from 9,000 to around 11,000, which is the average received over the last 9 months.

Other conduct and remediation charges were GBP 865 million and included GBP 325 million in the fourth quarter for package bank accounts, arrears handling and other legacy issues. Going forward, we expect remediation costs to reduce significantly.

Finally, the effective tax rate of 33% is lower than prior year due to the impact in 2016 of writing down deferred tax assets, but is still adversely impacted by the nondeductibility of conduct charges and is above our long-term expected rate.

Turning then to the balance sheet. Loans and advances stand at GBP 456 billion, up GBP 6 billion in the year and up GBP 11 billion since the low point in Q1. As guided, the open mortgage book finished the year slightly ahead of 2016. And as we heard, the SME portfolio continues to grow ahead of the market, while Motor Finance continues to grow strongly and within the group's conservative risk appetite.

The acquisition of MBNA, obviously completed in June, contributed around GBP 8 billion of credit card balances and GBP 7 billion of risk-weighted assets. Even after allowing for MBNA, however, RWAs are down GBP 5 billion in the year at GBP 211 billion, reflecting the portfolio optimization, model approvals and ongoing RWA reduction, predominantly in Commercial.

Finally then, in terms of capital. The group has generated 245 basis points of CET1 in the year. Underlying banking operations and Insurance dividend delivered 250 basis points; RWAs, a further 80; and the 40 basis points came from market movements; all offset by around 120 basis points for conduct.

As you've heard, the strong capital generation has enabled the board to recommend a total ordinary dividend of 3.05p per share, up 20% on 2016. And our CET1 ratio, after the ordinary dividend, was a strong 14.4%. We also intend to implement a share buyback of up to GBP 1 billion over the next 12 months, which gives us a pro forma CET1 ratio after the buyback of 13.9%.

In terms of capital requirements, as António mentioned, group's PRA Buffer has now been agreed. And after included in the coming systemic risk and countercyclical buffers, the board will now target a CET1 requirement of around 13% and a management buffer of around 1%.

On pensions, we've taken significant steps in recent years to derisk the pension fund. We've now agreed the latest actuarial valuation and the new deficit contribution plan. On IFRS 9, the day 1 impact before transitional relief was a reduction of 30 basis points, which will be phased in over the next 5 years. And the impact of both pensions and IFRS 9 is fully reflected into our ongoing guidance of annual capital generation of 170 to 200 basis points.

And finally, on net assets. After adjusting for MBNA, TNAV increased 3.1p per share before dividends, driven by the strong statutory financial performance, offset obviously by a deduction of 3.2p for the dividend payments.

So in summary, our low-risk business, cost discipline and targeted growth continue to provide competitive advantage. We've delivered on our October 2014 strategy. And in 2017, we've achieved further significant improvements in profit and returns on both statutory and underlying basis.

As you've heard, we've set strong targets for 2018, with a net interest margin around 290, further improvement to the cost-income ratio, an AQR of less than 30 basis points and we continue to expect ongoing capital generation of between 170 and 200 basis points. The trajectory of the statutory ROE is clear, and we're on track to deliver our targeted 14% to 15% return on tangible equity in 2019.

Over the last 3 years, we've made significant strategic progress, and we're well positioned for future growth and face the next stage of our journey with confidence.
That concludes today's results presentation. I think we now have 30 minutes for questions on the results. There'll be plenty of time and plenty of opportunity later to discuss the group's new strategy. I should also say that António and I will be around during the coming breakouts for any of those we don't get to during the shortened Q&A session. Thank you.

Question and Answer

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Right. Shall we start here? Chris.

Christopher Robert Manners
Barclays Bank PLC, Research Division

It's Chris Manners from Barclays here.

M. Culmer

Welcome back.

Christopher Robert Manners
Barclays Bank PLC, Research Division

So yes, just 2 questions, if I may. The first one was looking at your strategic update. And yes, I suppose if we look at your cost target, your cost-income ratio target and what you're saying about a resilient margin, it does actually look like we need a quite punchy other income and loan growth expectation to deliver that. Could you maybe tell us a little bit about how you see the growth outlook for the loan book? And I've got one more as well.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Okay, so I'll tell you, as I usually do, segment-by-segment, to give you an idea of what our targets and intentions are. So in terms of the open mortgage book, our intention is to do exactly the same that we did last year. We expect the open mortgage book to be slightly above the position which it reached at the end of the year. And in the mortgage market, given the low growth of the market, historically high house prices, uncertainty in general, we think the right thing to do for our shareholders is to continue to privilege margin and capital and lower risk, so we'll continue to focus on margin. But we will grow the open book in mortgages slightly this year. But over the plan, to your question, we think there will be growth in the open mortgage book. In terms of Consumer Finance in general, so including UPLs, Credit Cards and car finance, our intention is to grow reasonably in line with the market over the next 2 or 3 years. It is an area where we are still underrepresented, excluding Credit Cards, where we are where we want it to be. And therefore, my best idea is to grow in line with the market. SMEs, where we have consistently grown above the markets in the last 6 years and which is a critical area, we think, given the huge importance for employment and exports in the country, we have always focused a lot on SMEs as you know, our expectation is to continue to gain market share in SMEs. That's why in our Helping Britain Prosper Plan, we put out a target of growing net balances in SMEs and Mid Markets by GBP 6 billion by 2020. So that is an area we expect to grow and gain market share. And finally, on large corporates, we don't target as we always did. It depends on how companies want to access the market, through capital markets, securitizations, you name it. We don't target Global Corporates. We expect the Commercial Bank as a whole to increase its lending and its RWAs. And finally, the closed book, which is getting smaller and smaller, will continue to run off. That gives you the coverage of all the segments, I think. You had a second question?

Christopher Robert Manners
Barclays Bank PLC, Research Division

Yes. I just had, I suppose, one more question, which is on competition in the mortgage market. If we are seeing TFS coming to an end, if we're seeing -- maybe that puts a bit of pressure on the challenger banks. Just trying to think about how you see mortgage market competition at the moment.

António Mota de Sousa Horta-Osório

Group Chief Executive & Executive Director

Right. I continue to see over the next, let's say, 6, 12 months on the foreseeable future, and I'm a bit -- going to be a bit boring on this, but I continue to see a very similar behavior to the past 3 years. I continue to expect -- on one hand, as you said, I continue to expect TFS ending to have an effect on funding for players in the market in general, especially the ones that took the most of TFS, the smaller players. And therefore, that is going to pressure their cost of funds. That would be a reason for prices to be go slightly up. On the other hand, some other players have said that they want to increase their presence in the mortgage market. So you have 2 contradictory factors there. I continue to expect the leverage ratio to be announced on the second half of '18 by the PRA on the ring-fenced bank to have a significant impact on the equity that will have to be allocated to mortgages given it becomes a restricting factor. So it almost doubles and, therefore, to be another pressure for prices to go slightly up. But all in all, as I have been saying now for 3 years, I expect the trends to be the same over the next 12 months, so some pressure in mortgage prices, which we will continue to offset given we have higher costs on our multi-brands approaching certain brands. And also, given our improved and continuing improving credit ratings, our lower wholesale cost of funds, and that's why we are targeting a NIM of 290 basis points for the year, which is in line exactly with what happened in the second half of last year. More questions? Please.

Raul Sinha
JP Morgan Chase & Co, Research Division

It's Raul Sinha here from JP Morgan. Can I have 2, please, as well? Maybe first, to start off on NIM and the debate. Can I ask what you're assuming in terms of rate sensitivity, please, and the trajectory of rate hikes? Because obviously, I think what's quite important today as you've talked about resilience in the NIM beyond just the 2018 guidance as well, so trying to understand a little bit as to what is the driver of the resiliency in the NIM beyond, let's say, just the 12 months? That's the first one. And then I've got a second one on M&A, if you want it now or I can wait.

M. Culmer

These questions are straying off the results, aren't they? Look, in terms of sensitivity, yes, I've looked at the Annual Report, buried in there, I think we talk about the now 25 basis points is GBP 80 million or something like that. And previously, I think it was about 175 or whatever the numbers were, which is a number we have to calculate. But it's a bit of misleading because it depends the extent to which you're invested and liquid. And the easy way to short-circuit that and show the sensitivity of the business is to look at things like the structural hedge, which we talk about and my GBP 165 billion of invested assets, and say 1% on that, which will come over time, is an easy bit of math to do, and the GBP 1.5 billion, the GBP 1.6 billion. So without dissing some of the numbers that are in my Annual Report and Accounts, that one's not the most meaningful number and it's more important to look at that. Our outlook is -- and what we've assumed for the plan, is I think rates go to about 1.25% or something by 2020. And our original planning assumption was 1 rate hike this year. So we've assumed sort of a steady rise in rates over that period. In terms of what gives us confidence against that backdrop, if I start by looking back, you know the story of how we manage the business, you know the story of how we manage the NIM. You've seen that in the results. You've seen that -- what we've done over the years. We will continue with that operating model in terms of how we manage the spread and in terms of how we manage the detail of this. There is still more that we can do in terms of some of the Retail liabilities. We've probably got most of the biggest gains out of the wholesale funding, those have come through, although we will still be very keen and rating upgrades are fantastic and help in those respect. The structural hedge is big in size. And whilst somewhat might limit at the moment, in terms of GBP 165 billion, let's see where balances grow. And we're very good at growing current account balances, as we have in 2017. If those continue to grow, those will add to the volumes. But also, whilst on about that GBP 165 billion in terms of maximum, I'm short, as we've said before, and some are about 3 years versus 4 and a bit, so that gives me ability to extend and play into rate rises as well, so I can deploy that to generate. So it's a mix of how I manage the book, the structural advantage in terms of things like that, that structural hedge, and our confidence that those will continue as we go forward.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Just to add one point, you were very thorough. As we have been repeating -- repeating-ly saying, a multi-brand strategy that gives what customers want in terms of segmentation, coupled together with total integration of all back-office systems and everything the client doesn't see has been, for a long time, my strongest belief that provides the best cost-to-income advantage if properly done. First point. Second point, as George says, these estimates are being given with what, I think, is quite a prudent estimate of interest rates because of the huge uncertainty that faces the U.K. economy on a 3-year view. And therefore, we are only forecasting interest rates to increase to 1.25%, with one base rate this year increase, while inflation is at 3%. So rates would normally be significantly higher. Why am I saying this? Because with this very low and gradual increase of interest rates is what joins the guidance. Should interest rates be higher, as George very clearly explained, we are very positively exposed to rising interest rates if they rise beyond the plan. Second question?

Raul Sinha
JP Morgan Chase & Co, Research Division

Yes, that was very comprehensive. On the second one, I mean, what's very clear is there is going to be a significant step-up in cash flows. Statutory profit was up 40% and, going forward, it looks very likely that you're going to have a lot more cash generation, underpinned by 200 basis points capital generation target. In the past, obviously, you have been very clear about returning capital back to shareholders, while, clearly, if there is an exceptional opportunity, like there was in MBNA, you would look at that. Could you address this -- the question of what you would do with the capital generation? Because now you're already at 14%. If you generate 200 basis points of capital per year even after paying what dividends you have, there is substantial room, I would argue, to return capital back to shareholders. And what is your framework to decide whether you should be returning that capital or reinvesting into growth?

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Well, I think you are completely right, and we have been very clear, as you said, about that. We have presented what I think is an ambitious plan. But it is exactly on the -- as in the previous plan, a plan based on organic growth. If there is an opportunity like MBNA was a unique opportunity in credit cards that came up at contained risks with a 17% expected ROE, it is in our shareholders' interest that we take it. And by the way, it's going better than plan. The same thing happens with the smaller-scale Zurich's pension and savings business. It gives us a good platform, helped a lot the corporate pensions. The plans that António has in Insurance, we could build it or buy it. It's a small amount of capital, but it shows how we consider the framework. So we don't have any -- as I said in the previous plan, this will be the same. We don't have any special acquisition in sight. Our framework is exactly the same. Our plans are to grow organically. We want to grow where we are underrepresented. Should specific opportunities present themselves in areas where we are underrepresented, we'll look at it with the same eyes that we have on the second strategic plan, main target to grow organically. And therefore, the board will consider, as it is very clear on our dividend policy at the end of the year, with all available information what to do with the excess capital that we'll have at that time. And now we have very clear capital requirements post clarification from the PRA in terms of the buffer and in terms of the stress test, which is 13%, plus around 1% management buffer. So exactly clear as you describe it. Please.

Andrew Philip Coombs
Citigroup Inc, Research Division

It's Andrew Coombs from Citi. Perhaps one follow-up on capital and one on your loan-loss guidance. On the capital, I think you were clear, but just to clarify, the 13% plus 1% is assuming stable Pillar 2A, stable Pillar 2B and embedded in the DSIB and the countercyclical that's coming in. Is that correct?

M. Culmer

You ask a lot. Look, it's -- that is our guidance. We are confident in that guidance. And that reflects the countercyclical of about 1%, that reflects the systemic risk buffer coming in, that reflects the capital conservation coming in. And we've got a, currently, Pillar 2A of about sort of 3%. You will find out what that is as that moves. As we go forward, we think as we continue to derisk the business, then actually, there could be some more opportunity there in that, we'll come to that. The Pillar 2B, as António said, we had our review of this in January. We're pleased with that review. We're not allowed to tell you the consequence of that review, but it certainly is reflected in the numbers that we're talking to you today.

Andrew Philip Coombs
Citigroup Inc, Research Division

So you're not relying upon reduction in the 2A or 2b to absorb the DSIB; it's all factored in there?

M. Culmer

We are very confident in our numbers.

Andrew Philip Coombs
Citigroup Inc, Research Division

Okay. And just following on from that, buyback versus special dividend, the rationale there? And then my final question is on loan losses after that.

M. Culmer

Yes, you squeezed that one in. The -- look, previously, we weren't 100% privately owned, the numbers were smaller, et cetera, the ordinary dividend was smaller. So I think special as a supplement suited at that time. Now we're fully privately-owned, the ordinary dividend is of a more significant, normalized level, doesn't need the buttress of a special dividend alongside it. So we think a buyback is more appropriate to where we are now and just brings a bit more flexibility as well.

Andrew Philip Coombs
Citigroup Inc, Research Division

And then on the loan-loss point, if you look at your second half loan losses Q3, Q4, 23, 24 basis points. You're guiding to sub-30 for 2018. You're also guiding for sub-30 between '19 and 2020. So you're not looking for much of an incremental uptick in loan losses at all despite what you're saying about a higher rate trajectory. Admittedly small increases, but nonetheless. So what gives you the confidence given that at the point we're at today, unemployment's very, very low, rates are at record lows or close to record lows, what gives you the confidence that you're not going to see any form of real uptick in loan losses?

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Well, I think you have to look at our guidance holistically. There is a small uptick in interest rates, but as I just answered in the previous question, very small. With a 3% inflation, you would expect the loan bonds to yield 4% in normal conditions. So we are expecting the base rates to increase from 50 basis points to 125 in 3 years. As I said, that's quite mild. As you know, with low interest rates, normally, you have an association of low impairments. And on the other hand, we are at 18 basis points net this year, so we expect some increase. We think that the bank is continuing to derisk. So the 40 basis points through the cycle that had been 60 basis points in our first strategic review, fourth in the second, will now be lower, 35 basis points, so continue to derisk of the bank. But given the outlook that we have for the U.K. economy, so holistically speaking, what we see is you have these tailwinds that I mentioned to you. We see pressure on consumption given disposable income is growing less than inflation. But employment is going up, so you have more people consuming. You have exports being positively impacted by the devaluation of the pound given we continue to have complete free trade with Europe. Earnings from foreign assets are increasing in pounds. The world growth has increased. We are a big open economy that helps the U.K. economy. So for me, it looks quite clear, subject to any major political problem in the world, that the next 12 months will be very much like the past 12 months. When you ask -- and beyond that, obviously, that's more difficult to predict. The holistic guidance we give is coherent with the following view. The government agree the transition with Europe in December, which we welcome like all businesses. That should be in writing in March. By the end of the year, it will be clear what the agreement with Europe will be. And we will have, as businesses, 2 years to plan for that transition, which I think for most businesses is critical. For us, as you know, it does not impact anything given that we are completely positioned in the British economy. But for the economy itself, it's very important. So people, from year-end, they will have 2 years to prepare for whatever the agreement will be. And therefore, for the next 3 years, our holistic guidance, I think it's very coherent with that assumption. And given the tailwinds in the U.K. economy and the world economy, we see a continued resilient economy going forward. Let's go to this side now, please.

Edward Hugo Anson Firth
Keefe, Bruyette & Woods Limited, Research Division

It's Ed Firth here from KBW. I just had a couple quick detail points, actually, and one slightly broader one. Could you just update us on the back book of mortgages again? You normally give us a sort of quick rundown as to where it's been, how it's progressing during the year.

M. Culmer

Oh, the SVR book?

Edward Hugo Anson Firth
Keefe, Bruyette & Woods Limited, Research Division

Yes, the SVR book, and I guess the HVR book and all the other names. And then the second one was you mentioned you had a -- you've revised your actuarial pension deficit. It might have been in the numbers, I apologize. Could you just tell us what that actuarial deficit is now?

M. Culmer

Yes -- well, I'll start with the pension. Yes, I mean, it is in the numbers. But it was -- previously, it was 5.4, and I think it's gone about 7.2, which it doesn't sound like a good result, but that is a good result, in terms of what's happened to interest rates, et cetera, inflation expectations. And it reflects the significant derisking that we've done over the last few years in terms of hedging ourselves, rates and inflation, so in terms of capping and managing that. We also talk about -- it's in the RNS in terms of the deficit contributions, which we've agreed with the trustees. And as I said in my presentation, all that is factored into our ongoing capital guidance. On the first bit in terms of the mortgage back book, with the pickup and rates, we've seen a slight pickup in the attrition level. So I think at Q3, we were talking about 11%. It's now around about a 13% attrition rate. And I think it'll probably stay around that level, might touch up 14%. And it's just the other side in terms of the pickup in rates, which is going to cause some greater attrition there, but it's obviously going to help me in terms of things like reinvestment rates on structural hedge. So it's ticked up to about -- as I say, about 13% in terms of the attrition rate.

Edward Hugo Anson Firth
Keefe, Bruyette & Woods Limited, Research Division

That's an annualized 13%?

M. Culmer

That's Q -- I think that's Q4-on-Q4. So, yes.

Edward Hugo Anson Firth
Keefe, Bruyette & Woods Limited, Research Division

Right. Okay. And then I guess my final question, was just on tangible book. Your TNAV per share continues to be, well, sort of, I guess, down/flattish, which I guess is the reverse of the rising rate environment and the repricing of your hedging, broadly speaking. Is that -- first, I guess, is that a fair analysis? And secondly, can you give us -- have you got some sort of idea of what you expect TNAV per share to do as you look going forward? Because you're obviously factoring in these rate rises into your margin. Should we expect the TNAV, therefore, to be somewhat disappointing as you reprice the hedge?

M. Culmer

The reprice of the hedge is going to be an adverse impact upon it. And you will see that -- rates rising is a good thing. What's the immediate impact of rates rising in terms of my balance sheet? Well, 2 things happen actually. In terms of the group balance sheet, it is a -- it hits TNAV as I reprice the hedge, actually, it helps me in Insurance and helps the capital position of Insurance, which you don't get visibility of, but that's a big plus from a capital perspective that outweighs that. So that will -- as rates rise up, that will be a headwind. But going the other way, I've talked about, and we will talk about more again today and later, the strong statutory profit growth that have come forth, that'll obviously feed in. And obviously, the big counter to that will then, obviously, be what the distribution policy is. But I should expect to see in terms of TNAV going forward with that strong stack profit, restatement of the [bleeding] obvious, that will drive the TNAV, offset by what we determine in distribution. But you're right, in terms of rate rises, you will get a headwind as I reprice that hedge.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

And just to comment on this. I mean, last year, we had an impact from MBNA. Given the high profitability of MBNA, there was some goodwill. So If you do a pro forma, as George showed in a slide, for MBNA, we -- the TNAV increased by 3.1p. And we basically are distributing 3.2p. So basically, what we commit to be distributed, with ROTE of 8.9%. Our target ROTE starting in '19 is 14% to 15%.

M. Culmer

You will get in terms of IFRS tick-over. Whilst we've talked about the capital, that it's more limited because you get EEL offset and then you've got transitional rules, it'll hit your sort of TNAV from an accounting basis as you step up provisions, as you move into an IFRS 9 world as well.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Please. Can we have the microphone there?

Claire Kane
Crédit Suisse AG, Research Division

It's Claire Kane from Crédit Suisse. A couple of questions from me. Firstly, on the CET1 capital calibration. You've moved back to kind of plus 1% buffer. And just to ask, if we're sitting here at the interim and we have another 0.5% countercyclical capital buffer and your PRA or your Pillar 2A buffer doesn't go down, will we be then looking at 14.5% CET1? Or should we consider that your management buffer would adjust to accommodate a higher capital stack? That's the first question. My second one is just on the buyback. Historically, you've assessed surplus capital at year-end. Do we think now this could be more of an interim assessment given your pretty steady capital generation? And then, finally...

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

How many questions do you have?

Claire Kane
Crédit Suisse AG, Research Division

Sorry just the last one. On the Insurance, you paid up a much larger Insurance dividend this year, I think [675]. Just what's the outlook there, please?

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Okay, George will take 1 and 3. On the second one, the answer is no. I mean, the board will continue to assess the capital at the end of the year with all the available information. We decided a buyback with the 12-month horizon, so we will continue with the cycle of addressing capital surpluses at the end of the year with all available information then.

M. Culmer

And on the Insurance, without being sort of too vague about it, it's a balance between opportunities we see in terms of writing new business, market rates, et cetera. 7 is probably at the sort of top end of what you'd expect, benefits from both, it's the sort of counter to some of the things you see in OOI. And I've talked about the lower bulk annuities. If I'm not putting the capital to work there, then that feeds into the surplus position, we've distributed it. We also benefited from market movements at year-end. We've also benefited from market movements subsequent to year-end in terms of what you've seen. And something like the 15-year swap rate is probably the key thing to look at. And as that grows up, that will help my capital position. But 700 is at the sort of top end, I would have said, in terms of run rate-type expectations. And then asking me for the future in terms of what the board might do, I always find those questions a bit tricky. I'm not going to commit on what we might or might not do. And we currently assume around 1% in terms of the countercyclical within our 13%. If it goes up to 50 basis points, we'll have to assess it in the circumstance at the time. So I know it's not a definitive answer to your question, Claire, but I can't answer in terms of what we might do in a future circumstance. The 13% assumes the 1%.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Right. Any more questions?

M. Culmer

Douglas.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Please, Douglas?

Douglas Radcliffe
Group Investor Relations Director

Just one more question.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Yes, one more question. I have not gone to that side of the room. So, please.

John Cronin
Goodbody Stockbrokers, Research Division

John Cronin from Goodbody. Two questions from me, one in relation to the Pillar 2A again and where -- I suppose going in the opposite direction to the last question, to the extent that -- you mentioned derisking from a P2A perspective, with potential reduction from the current circa 3% level in the future, to the extent that everything else were to remain equal, would you dare -- would you bump up the management buffer? Or would you reduce your minimum target CET1 capital ratio were that sequence of events to unfold? Secondly, on the PPI. You mentioned that the lock-in average over the last 9 months now was 11,000. So if you could give us any more information in relation to how that's evolved since the third quarter, that would be very super helpful.

M. Culmer

Okay. So I'll deal with PPI before we come to the hypothetical one. The -- yes, so PPI, we've gone up to 11,000. I think as we disclosed, the extent to which, if it has to go up again, or 12,000 or whatever, it's about -- for every 1,000 now, it's about GBP 200 million. And obviously, the closer we get to the time bar, the penalty, if you like, for being wrong or the benefit from being wrong diminishes. So 11,000, it's moved around a lot. As you might expect, this is a -- what we assume is a completely static -- every week of the year, 52 weeks of the year, I'm going to get 11,000 now. And the most previous experience, that includes December and early January, which are fallow periods because not much happens, so you've got lows there. The most recent we've seen is slightly above that. The most recent week was about 12,500. That's what we saw last week, so that's the most recent. We will remain susceptible to what comes through the door. If you look at the go-forward, the FCA had those -- with the Arnold Schwarzenegger ads or whatever, unfortunately, something's going to follow that. And so we've got 1 large campaign and 2 small campaigns to come, so there'll be increased publicity. At the same time, we've got the PPI CMC fee cap that comes into play in 2018, so it'll be interesting to see what impact that has. So there are still a number of variables out there, and there's the behavioral consequence as you get near sort of closing time. So those are still out there. We've budgeted for what we've seen or provided for what we've seen, but there are still uncertainties around that. And then, unfortunately, a bit like Claire's question, I can't give you hypotheticals. I mean, the Pillar 2A, which, again, I'm restricting what I can say to you, but it reflects those risks that aren't captured. Look at the things that we're doing. We've talked about the earlier question to pensions. As I put money into my pension scheme and make those deficit contributions, then, theoretically, your charge in terms of Pillar 2A should go down because you're actually mitigating that risk through contributions. I've been a seller of things like gilts, et cetera, you get charged for things like asset swap risk. If I've got less gilts, there should be less than that. So I can give you the reasons why, as I derisk, you should see a smaller amount, I can't guarantee that. And I'm afraid what I can't do is tell you that if that happens, what the response of the business would be because it will depend upon the circumstance at that time. But it's certainly an area of opportunity.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Okay. Look, thank you very much. We have to stop now for the breakout sessions. But any remaining questions, we'll take at the end of the breakout session and the strategy review. So you have time to address the remaining questions. Do you want to give any indications?

Douglas Radcliffe
Group Investor Relations Director
Yes, as António said, there are going to be plenty of opportunities for questions through the rest of that day and after the breakout question. So don't worry, there will be that opportunity.

Presentation

Douglas Radcliffe
Group Investor Relations Director

We'd now like to move on to the strategic update. And I'd like to introduce our Chairman, Lord Blackwell, who will provide a brief introduction to this transformational strategy that we're about to implement. Thank you.

Norman Roy Blackwell
Chairman of the Board

Thanks very much, Douglas, and welcome, therefore, to the second part of our presentation this morning where António and the team will set out the next chapter of our strategic development. This does mark an important inflection point to the group, with the significant change in gear in the transformation of our bank.

As you know, the last 2 strategic plans have focused on the recovery of the group's financial strength and on restoring our customer focus. But both António and I have repeatedly said that we could not be complacent. We've recognized that the environment we face in technology and competition is moving at pace.

So 2 years ago, the board and the executive set out together on a major exercise to create a vision for the bank of the future. And as that clarified, we've translated that into an ambitious transformation program to meet that challenge, a transformation program to which the board and the executive team are totally committed.

And the whole board believe this scale of ambition is the right approach to enable us to maintain our core purpose of supporting the U.K. economy, Helping Britain Prosper and to sustain our long-term competitiveness as the best bank for our customers, colleagues and shareholders.

So with that, let me hand over to António to take you through the components of that transformation and how we will deliver it. Thank you. António?

Antonio Lorenzo
Chief Executive of Scottish Widows and Group Director of Insurance & Wealth

Thank you, Norman. As you have heard in the results section of the presentation, 2017 closed the successful delivery of our second strategic plan and provides solid foundations for our third strategic plan, GSR3.

We have a number of structural advantages which are difficult to replicate in terms of how we meet customer needs, including our differentiated multi-brand and multichannel propositions, our customer reach as the largest banking franchise in the U.K. and our leading digital capabilities. Together, these have seen our customer Net Promoter Scores increase by almost 50% since 2011 to 62%.

At the same time, our market-leading efficiency, which is both a strategic- and culture-driven outcome, fully embedded in the organization, allows us to significantly increase investment again in our next transformation phase.

Our prudent, low-risk participation choices and strong capital position have been reflected in the recent improvement in our external credit ratings and cost of funds, and should also decrease our cost of equity going forward.

Finally, our management team discipline and rigorous execution capabilities have enabled us to deliver capital generation and profitability that are markedly stronger than our peers.

Looking ahead, it is these qualities that underpin our confidence and scale of ambition. GSR3 represents an exciting opportunity, and the entire management team is energized, committed and determined to deliver the next phase of our transformation.

Our confidence is built on the fact that we are already delivering a market-leading digital experience. We are, by far, the U.K.'s largest digital bank and are able to meet 68% of our customers' banking needs online, which is at the top end of the targeted range we set out 3 years ago.

This scale has been achieved through the best-in-class experience our customers enjoy, with market-leading functionality, resulting in being rated #1 digital banking app since 2015. And having achieved this scale, it gives us the capacity to continue investing more than our competitors in market-leading platforms, an ongoing source of competitive advantage.

While we have delivered best-in-class experience to our customers, we need to constantly evolve to meet their changing behaviors and expectations. Customers increasingly want greater personalization, more connected and seamless experience, but with higher security and safety in the online environment. They want simpler products with greater convenience and ease. The strategic plan we are presenting today aims to provide a proactive response to the opportunities created by these changes.

So let me briefly outline how our 4 strategic priorities will enhance our existing strengths and transform the group for success in a digital world. First, to continue to provide a leading customer experience, we will drive stronger customer relationships and experience, through data-driven insights, and offer more personalized products and services.

Second, in digitizing the group, we will deploy new technologies, such as cognitive and machine learning, cloud and API channels to improve our efficiency and productivity and make banking simpler and easier for customers.

Third, we will maximize our group capabilities by bringing the best of the group to all customers and delivering deeper relationships and integrated propositions. An example of this is financial planning and retirement, where we will provide our banking and insurance customers with a truly holistic proposition to meet their retirement and long-term savings needs.

And fourth, in transforming our ways of working, we will enhance our talent pool by focusing on skills of the future, whilst embracing new technologies to drive better outcomes for customers and colleagues.

We are, therefore, announcing today more than GBP 3 billion of strategic investments over the next 3 years, a 40% increase over the last plan, to deliver the scale of transformation we believe will be necessary for us to succeed in a digital world.

As I have mentioned, the scale of investment we are uniquely able to afford in building new platforms and customer propositions is a massive undertaking and provides the scope to be highly ambitious in delivering both an efficient and market-leading business.

So what will these priorities deliver? By enhancing our digital capabilities, we want to remain the #1 digital bank in the U.K. with open banking functionality. We are proud of being the only large U.K. bank to have complied with the open banking implementation deadline earlier in the year. And the frequency of customer interactions with their digital bank provides increasing opportunities for offering relevant online information and guidance to help customers identify propositions that can serve additional needs, a very effective and cost-efficient way of widening our relationship with them.

We continue to be committed to our multichannel model and see branches as another customer-driven resource, where we want to retain the #1 branch network in the U.K. We will, therefore, refocus our branch network to meet more complex and value-added banking needs, such as mortgages to first-time buyers, financial planning and retirement and business banking.

With one of the largest databases in the U.K, we'll invest significantly in our data capabilities to ensure we are able to harness this resource more effectively and provide more personalized propositions to better meet our customers' needs. Vim and Jakob will take you through these later in one of the breakout sessions.

Moving on to our second priority of digitizing the group. We will continue to simplify and modernize our IT architecture, scaling up end-to-end customer journey transformation to cover more than 70% of our cost base compared to 12% during GSR2. You will hear more on this from Zak in one of the breakout sessions as well.

Our third strategic priority of maximizing group capabilities will deliver targeted growth, and we expect to see a GBP 6 billion increase in net lending to start-ups, SMEs and Mid Market clients, as you will hear from David in the breakout sessions, and over 1 million additional pension customers and GBP 50 billion of asset growth in our open book financial planning and retirement propositions.

We see a significant opportunity as the U.K.'s only integrated financial services provider to meet our customers' banking and insurance needs holistically, as you will hear in more detail from Antonio Lorenzo in another breakout session.

Last but not least, transforming ways of working will focus on how we will deliver our bold transformation agenda itself. As part of this, we will adopt Agile methodologies for more than 1/2 of our change projects, significantly improving productivity and responsiveness. Jen Tippin will take you through this and define Agile characteristics during one of the breakout sessions.

Importantly, the success of our transformation will depend on our people. We will, therefore, significantly increase our investments in developing in-house capabilities and increase training hours by over 50% compared to the previous plan, focusing on the key skills our workforce will need for the future.

Importantly, our strategic plan will also deliver greater value for our shareholders. While we are targeting a significant increase of 40% in our strategic investments to over GBP 3 billion over the plan period, we will achieve a net reduction in our cost base to less than GBP 8 billion in 2020.

Our continued focus on efficiency has created capacity for increased strategic investments in the business while achieving superior returns for our shareholders. We will be able to more than offset inflationary cost pressures being faced by the sector and expect to achieve a low 40s cost-to-income ratio as we exit 2020, inclusive of any future remediation costs.

In addition, whilst we expect to grow in key targeted areas, we are improving our expected through-the-cycle AQR guidance from 40 to 35 basis points, with an expectation that this will be less than 30 basis points throughout the plan period.

Whilst investing significantly further in the business, we are committed to generating superior returns for our shareholders and are increasing our ROTE target to a range of 14% to 15% from 2019 onwards, despite this being based on a higher target CET1 ratio of circa 13%, plus around 1% management buffer.

Finally, we are reconfirming our existing guidance of generating between 170 and 200 basis points of CET1 capital per year. As we discussed in the 2017 results section, we are committed to a progressive and sustainable ordinary dividend while retaining the flexibility to return surplus capital.

In recent years, we have successfully delivered on the overall targets we set ourselves in early 2014 within our Helping Britain Prosper Plan, providing ongoing support to the people, business and communities in the U.K.

To highlight just a few. We have provided more than GBP 10 billion of lending per year to first-time buyers since we launched the plan 4 years ago, and our target is to provide a further GBP 30 billion over the next 3 years. In recognition of the evolving skills needs of the U.K, we have trained over 700,000 individuals, businesses and charities in digital skills since last year, and are looking to increase this to 1.8 million by 2020.

We have increased net lending to SMEs by 15% since 2014, significantly outperforming the 1% growth seen in the market. Recognizing the critical importance of start-ups, SMEs and Mid Market businesses to employment and experts in the U.K. economy, we are targeting an additional GBP 6 billion of net lending in this space by 2020.

We also became the largest U.K. corporate taxpayer in 2015, and will further increase our total taxes paid in coming years. And we have made great progress in our gender diversity target, up from 29% in 2014 to 34% in 2017. These are just a few examples of our commitment to the U.K. economy as the largest U.K. financial services provider focused -- completely focused on Helping Britain Prosper.

The external environment is evolving rapidly, and the team and I are confident that this exciting and ambitious plan, with the significant additional investments, will mean we remain at the forefront of U.K. financial services. We will continue to be a simple, low-risk, customer-focused business while transforming the group into a leading, digitized U.K. financial services provider.

As Norman and I have said, this is a bold and ambitious program, but the sound platform we have now established gives us the confidence that we are ready to deliver the pace and scale of the transformation required.

I would now like to turn over to Juan Colombás, our Chief Operating Officer, who will give you some more detail on how we are investing to transform the business.

Juan Colombás
COO & Executive Director

Thank you, António. As António has just outlined, GSR3 constitutes an ambitious transformation for our group. I would like to briefly explain to you how we have prepared successfully to deliver our transformation of this scale.

Let me start by introducing our current model, which distinguishes us from our peers. We are focused on a single geography. We have a simple operating model, and we have a centralized management team who have a proven track record in managing transformation. In a world where you need to be nimble to respond quickly to external changes, we believe our model gives us considerable structural advantages.

Last July, we announced changes to our organizational design to prepare us for the successful delivery of GSR3. As a result of these changes, we have brought together under one umbrella all the critical components needed to implement the transformation. This simplified structure is unique and provides a more consistent approach to the end-to-end transformation of customer journeys, alongside our greater focus on our digital and transformation agenda.

Investment decisions are now organized around customer journeys. This ensures better allocation of resources and a greater focus on group-wide outcomes. We have also moved from the traditional annual investment allocation process to one where investments are reviewed more frequently. This will allow us to adapt to a changing environment and reprioritize if required, depending on customer behavior and market dynamics.

On the ground, we are co-locating teams from across the business, bringing together all the capabilities required to deliver the transformation. These teams are adopting an Agile approach and focusing on outcomes to be achieved rather than initiatives to be delivered. This helps to ensure faster and more efficient delivery of change for our customers. As an executive team, we are committed and excited to position our group as a leader in transformation.

As you have heard from António, over the next 3 years, we will deploy more than GBP 3 billion of -- in strategic investments, representing a 40% increase on GSR2. To get a sense of the scale of the transformation, on an annual basis, this is roughly the same as the GBP 1.3 billion invested in FinTech companies in the U.K. in 2017.

Importantly, as we increase our strategic investments, we are not giving up on our ambition to deliver market-leading efficiency. Over the GSR3 period, we will bring down our operating cost base to less than GBP 8 billion in 2020. We will do so by maintaining our cost discipline, and by redeploying the efficiency gains we will generate from technology-enabled productivity improvements.

Our largest-ever strategic investment will focus on 3 main areas, all of which will support our GSR3 strategic priorities: technology, people and data. In GSR2, we built the U.K.'s largest digital bank. In GSR3, we will go beyond this to create a leading digitized, simple, low-risk, customer-focused U.K. financial services provider.

We would like you to -- we would like to invite you to 3 breakout sessions hosted by the business and transformation leads. This will take place in smaller groups, and you will have the opportunity to hear more about each of our strategic priorities and ask questions to the team that will deliver the transformation.

After a short lunch break, George will then present our financial projections and targets, before António provides some closing thoughts on our strategic plan. You will then have the opportunity to ask questions.

Douglas Radcliffe
Group Investor Relations Director

Thank you, Juan. As you've no doubt realized, we'll be running the 3 breakout sessions concurrently. And we're, therefore, now going to break you into 3 separate groups.

You've all been giving these lovely lanyards that we'll have. You will notice they're either blue, purple or green, and they respond to your individual breakout groups. Our hosts are on site, have got signs around the room as to where they're going to be. And essentially, those hosts will also ensure that you're taken onto the next section directly afterwards.

So if you have a blue lanyard, you'll be heading to -- initially to the door over there. If you have a purple lanyard, please make your way over to -- by the white panels in the corner. And if you have a green lanyard, please make your way to the doors where you came in.

So if you'd like to kindly make your way to the corresponding host, we're now delighted to start the breakout sessions. Thank you.

[Break]

M. Culmer

Okay. Should we get going again? Afternoon, everybody. I hope you found lunch plentiful and the breakout sessions useful. You will be pleased to hear that the end is now in sight.

Look, what I'm going to do now is very briefly summarize the financial business performance that we'll be delivering over the next phase of our strategy.

But firstly, as António mentioned today earlier on, the U.K. economy has been resilient and going forward, while we have prepared for contingencies, our base plan and projections assume this performance continues with a steady increase in base rates to 1.25% by the end of 2020, as I think as I said earlier.

Now against this backdrop, as you've heard, we have a clear strategy that will deliver superior returns and create greater value for our shareholders. Over the next 3 years, as you've heard, we'll be investing over GBP 3 billion of strategic investment to support our priorities of delivering a leading customer experience, further digitizing the group, maximizing capabilities and transforming the way we work.

These priorities will, in turn, drive sustainable and low-risk growth, further improve our market-leading efficiency, deliver superior returns and a lower cost of equity and enable strong capital generation and an attractive capital return policy.

In terms of sustainable growth. Going forward, we have clear targets to remain the #1 digital bank and the #1 branch network. And across the group, we'll maintain our strategy of targeted growth in both channels and products, where we are below our natural market share and which are attractive to us.

As you've heard in the breakouts this morning, these areas include in insurance; the financial planning and retirement and the target of a GBP 50 billion of open book asset growth; home insurance and protection; and individual annuities.

In commercial, we're targeting the GBP 6 billion net lending growth for start-up, SME and Mid Market businesses and we're improving our product ranges across trade, working capital, payments and cash management.

In retail, we'll deliver targeted growth in motor finance, continue to deliver on the integration of MBNA and use enhanced capabilities and personalized propositions to grow in attractive, underrepresented market segments.

And in mortgages, while we expect the market to remain competitive and we will continue to balance volume and margin considerations, we'd still expect to grow the open book over the plan period.

Finally, we'll also retain the flexibility to consider inorganic growth opportunities that enhance our product or capability offering, and where our financial strength, low-cost operating model and proven integration skills give us clear competitive advantage.

In terms of risk profile, this targeted growth will be in line with our low-risk business model. This model is underpinned by our prudent participation choices and the portfolio derisking that we've undertaken over the last few years.

As a business, over 95% of our assets are in the U.K. Over 2/3 of our portfolio is in secured assets with an average LTV of 44% across our mortgage portfolio. Our high-quality unsecured portfolio represents just 6% of total loans, and our run-off assets are down by over 95% since 2010 and comprise just 2% of loans and advances.

And finally, we have very limited exposure to high volatility business lines. At our last strategy update, we talked about a through-the-cycle AQR of around 40 basis points. Going forward, IFRS 9 will, obviously, introduce greater short-term volatility and the acquisition of MBNA will also add around 4 basis points to our annual charge. However, we believe that with our low-risk model, our active derisking, the benefits of enhanced data and analytics capabilities that the through-the-cycle AQR has fallen to around 35 basis points and, as mentioned this morning, we currently expect an AQR of less than 30 over the planned period.

On cost, as you know, we have a strong record for reducing costs and this will continue in the next phase of our strategy. Our strategic investments and management actions in changing the way we work, transforming more than 70% of the cost base and driving a 30% improvement in change efficiency and reduction in external contractors, will deliver operating costs of less than GBP 8 billion by 2020 compared with more than GBP 10 billion in 2011.

This action on costs and our targeted top line growth will drive further improvements in our cost:income ratio. And going forward, the cost:income ratio will include both operating and remediation costs as well as, of course, the cost of the strategic investments that we've announced today.

And on this basis, we're targeting a cost:income ratio in the low 40s as we exit 2020, compared with the 51.8% in 2017, and we will continue to target cost-income reductions each year.

In terms of profits. Over the last few years, we've delivered consistent and strong underlying profits and increasing statutory returns as we've resolved legacy and dealt with remediation.

Looking forward, our targeted growth, resilient net interest margin, low-risk business model and lower operating and remediation costs will drive strong statutory profit growth. And after tax profits will further benefit from an effective tax rate of around 25% compared with more than 30% in 2017, and our previous guidance of around 27%.

Looking at return on capital. Again, as you've heard, we're firstly increasing our targeted capital requirements to circa 13% plus a management buffer of around 1%. We're a prudent bank and this increase will make us even stronger and more resilient. And this capital increase should theoretically reduce our statutory returns by around 90 basis points. We are, however, today announcing that with the actions we're taking and our confidence in the delivery, that we are increasing our ROTE guidance to 14% to 15% from 2019 onwards.

And this market-leading returns were generated by a bank with a clear low cost of equity. Our simple differentiated business model with its U.K. focused, reshaped and derisked business, market-leading efficiency, strengthened capital base and ambitious transformation plan will drive both higher returns and a lower cost of equity and therefore, superior returns for our shareholders.

Finally, on capital. As you know, we'll continue to target annual capital generation of 170 to 200 basis points with our strong profit growth, giving us headroom to fund business and RWA growth and absorb any capital headwinds. We have a clear framework and track record for capital return to shareholders.

Ordinary dividend will provide a progressive and sustainable earnings stream, reflective of the consistent strength of our underlying earnings, while we will continue to return our capital surplus by an appropriate means, which we currently see as share buybacks.

With that, I'll hand over to António for the close.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

As George said, we hope the sessions with our management team today have helped you gain a better understanding of our capabilities and priorities for our next strategic plan.

We are confident the 4 strategic priorities we set out will deliver a further fundamental transformation of the group. GSR3 is a bold and ambitious plan and represents a very significant step-up in our strategic investments over the next 3 years.

We have all the critical components required for successful delivery of this transformation. We have solid foundations on which we can build: our strong track record and expertise of delivering large and complex change programs; our experience of building the largest digital bank in the U.K. and delivering customer journey transformation; and the experience and dedication of our management team, which will allow us to seize the opportunities that lie ahead.

GSR3 represents an exciting opportunity for us. And our entire management team and the senior leadership team across the group are energized, committed and determined to delivering across the 4 priorities of this strategic plan.

And we are confident that the delivery of this ambition will translate into greater value for our shareholders as outlined in our revised financial targets.
That concludes the presentation. Many thanks for joining us here today. And we will now take your additional questions.

Question and Answer

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Please. Jonathan.

Jonathan Richard Kuczynski Pierce
Exane BNP Paribas, Research Division

It's Jonathan Pierce from Exane BNP Paribas. I've got 3 questions. I'm sorry to focus on numbers as opposed to the qualitative aspects of the strategy. But I'm just thinking about your numerical targets. Firstly, I wonder, George, if you could set out for us, for the spreadsheets, the sort of size of the amortization of purchased intangibles, fair value unwind and any additional restructuring that might come below the line over the course of the next year or 2. And I guess, related to that, can I just check the investment spend of GBP 3 billion, is that all going to be expensed or will a portion of that be capitalized? And will it be above the line and so on and so forth? So that's the first. Do you want me to give you the other 2?

M. Culmer

That sounded like 2 questions. How many were there?

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

So you have one more.

M. Culmer

We've got one more.

Jonathan Richard Kuczynski Pierce
Exane BNP Paribas, Research Division

Okay. I mean, I guess, the -- if I've got one more, I'll ask quite a crude question and it simply relates to where your targets appear to be pointing 2, 3 years out relative to consensus. Because if I just simply take the 2020 exit numbers, I'm getting to a revenue that's GBP 1.5 billion or so above where consensus is. Impairment probably a little bit lower, and you're ending up with an EPS number that's substantially above consensus at the statutory level at the moment. And we can also give you on impairment. But maybe you could give us a bit more confidence as to why you think revenue is going to be that much better than what the market has it?

M. Culmer

Okay. Well, dealing those in order. In terms of the, sort of, below the line. So you'd have seen this year, I think we had about sort of GBP 0.6 billion, which I think was about GBP 0.3 billion of ring fencing and about GBP 0.1 billion of property and about GBP 0.1 billion of MBNA amortization. For 2018, dealing with the short term, I'd expect there to be about another GBP 0.2 billion, GBP 0.3 billion on ring fencing, probably about another GBP 0.1 billion in terms of property and probably about a GBP 0.1 billion in terms of the MBNA integration spend. Fair value unwind, without precise numbers in my head, the GBP 0.2 million, GBP 0.3 billion of that type order, sort of below the line. Those are the sorts of numbers that we're talking about below the line. The more than GBP 3 billion, yes, we're going to take that above the line. Yes, an element of that we're going to capitalize, of course, we will. If we're going to analyze, that relates to revenue generation, latest costs takeout, et cetera, et cetera, but all that will go in and all that is in the number. When we talk about our operating costs of below GBP 8 billion, that was below that GBP 3 billion or the more than GBP 3 billion, the element that I'm expensing, the element that I'm capitalizing and then depreciating, that will go -- that is all in that number. The only numbers I would take below the line would be were there any redundancy or anything like that. As I said, we don't know what's going to happen on headcounts, so I haven't put any predictions in for that, but that would -- but the more than GBP 3 billion will be dealt with above the line and is in the number. In terms of -- I haven't looked to what the guidance is for 2020, so I can't sort of comment on what that does for implied revenue-type numbers, but, I mean, I think we've been quite clear in terms of our low 40s. I think we've been quite clear that, that is a change of definition which we haven't majored on, but that will include remediation. But the reason we've given the sort of hard target as well, which I think is helpful for people and we're below the GBP 8 billion, below the GBP 8 billion for those operating costs and that's operating costs including all the consequences of that investment spend but excluding the remediation, but my low 40s is both those elements. Operating costs, investment plus remediation will be in the sort of the low 40s. That is our expectation. Look, in terms of how that pans out and back solve it into income numbers, as I say, I don't know what consensus is for '20 so I can't comment on, but that's right for our business and...

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

I think the only thing I would add to what George said is that, obviously, cost-to-income is a ratio of 2 numbers, and the guidance we gave was below GBP 8 billion. That's what I would add. Any more questions? Please, Alvaro?

Alvaro Serrano Saenz de Tejada
Morgan Stanley, Research Division

Alvaro Serrano from Morgan Stanley. Just on cost, staying with cost. Obviously, the below 8 -- as you say, below GBP 8 billion leaves a certain leeway. You're making GBP 3 billion investments which is a very large number. Can you give us a sense of how the cost ranges of staff costs, maybe depreciation and amortization, how the -- sort of the different lines might change the shape of the usual traditional banking versus what you see going forward? And also, given it seems like the 40% target is the key target, I would -- if what -- where do you see more flexibly if revenues disappoint or revenues do better? What would you flex in that GBP 8 billion? And the second, just a clarification, the below GBP 8 billion, that includes remediation costs?

M. Culmer

No. As I was just saying, that's operating costs, okay? So that excludes remediation. The low 40s cost income includes remediation, okay? But that below GBP 8 billion excludes remediation, okay? To your first bit, it's a sort of yes or no. I mean, thematically, what you might expect to see and we've done this for the last few years and we talked about it in the presentation, but to create the capacity to make this level of investment, we've driven down BAU costs. And we will continue to do that as we drive efficiencies through the business, and that can replace, to a certain extent, as I -- going to previous question, as I capitalize and amortize, all that type of stuff come through, but you would continue to see a drive down in what we would call those business-as-usual expense, and you'll continue to see an increase in things like depreciation come through because that is the nature of the cost base in terms of increased automation, and that is the nature of our spend. So I'm not going to give you the precise breakdown of the number, but that is something we've seen over the last few years, and you will see that continue. Drive down BAU, create the capacity to invest, and you'll see a pickup in things like depreciation charges coming through. In terms of how we flex, look, we will deal with it if and when we get there. I think, again, we showed over the last few years, and I know it's hard to perceive this from the outside looking in, but the real advantage that Lloyds has is operate as a single entity, the stuff that Juan talked about and being able to respond. I've worked in multinational businesses and it takes you a quarter to work out what's going on, a quarter to work out what to do with it, and by then, the year's nearly gone type of stuff. Being able to actually meet weekly, have the business in front of you, see the results and as a management team, determine action and take that early enough in the year to have 11-months impact or 10-months impact on stuff makes a massive difference in terms of how you run the business. I know we talk a lot about how we utilize that for managing the sort of spread, but how you utilize that for managing the day-to-day operations of the business as well, it's a big structural advantage. I know it's easy me saying help you to realize, but that is how it works.

António Mota de Sousa Horta-Osório

Group Chief Executive & Executive Director

And Alvaro, I would like to add a point to what George just said, which is, I mean, as I said in my introductory remarks, this is a critical strategic advantage, which is both strategical and cultural. To have a culture of austerity in the sense that you don't spend more than what you should is what enables us to release money, to have higher and higher levels of investment over each of the last 3 plans we did. And it becomes a virtuous cycle because the more we invest, the better we have products for customers, the higher the NPS, also the investments which are driven at productivity, they lower the costs. And the more we release to further invest and you are on a virtual circle, where our cost-to-income allows us to both invest greater amounts of money to the benefit of our customers and deliver superior returns for our shareholders. We have been repeating this for 6 years, and it is now a reality, with a 46% cost-to-income, and the average of the sector is 60%. Of course, you can adapt for different business mixes. You can adapt for costs in the center. You'll not get a very different picture. And this is a critical strategic advantage and even more critical in a digital world. Please.

David John Lock
Deutsche Bank AG, Research Division

It's David Lock from Deutsche. I've got 2, please. First one's on the capital generation target you've given, 170 to 200 bps. I note that, obviously, you've raised the ROTE target and the capital generation is pretty similar to where we are today. You talked about pensions being a drag on that. You talked about IFRS 9. I just wondered if you baked in any risk-weighted assets inflation in there?

M. Culmer

A bit, yes. And you're right, I mean, we talk about stat profits sort of doing that and my capital guidance says that, and that is because of that. As we move forward -- the last few years, rather, kind of markets go away. Markets will do what they will do as we move forward, but in terms of reducing my balance sheet, as you've seen in the reconciliation earlier today, we've had a fundamental benefit from RWA. As I go forward, I sort of both will be growing my book, RWA growth. I think RWA intensity will improve -- well, sorry, will increase as well, bit of mix, but as we deal with the regulation. On top of that, there's things like pensions that we've talked about as well. So -- and it also gives me a bit of flexibility to deal with capital headwinds, but that's why one goes up and one is relatively stable.

David John Lock
Deutsche Bank AG, Research Division

And just also separately on operating lease depreciation, I appreciate it's not in the cost:income ratio target. It wasn't, I don't think, in your previous strategic targets as well. How should we expect that to evolve over the coming kind of 3 or 4 years, that line item as well?

M. Culmer

I mean it is in the cost:income target. What we do is we deduct it from income. So in terms of coming to our cost:income ratios, you take that net income line and you take our costs, and so it's a deduction, so it's not excluded, so that's sort of quite important. And it's being grown 2 reasons, actually. One, predominantly the sort of commercial banking, where we've had some write-offs with some legacy assets, we had some [arrow] engines where we took some write-offs in 2016 and the residue, about GBP 30 million, I think in 2017. It also is reflective of the growth in Lex Autolease as well, so it's a sort of volume generated. So in terms of the OOI growing, then that's the cost of sale for that particular part of the business, but it's certainly been slightly higher the last couple of years we've had some write-offs in CB. Those assets are gone.

David John Lock
Deutsche Bank AG, Research Division

Okay. So that -- those write-offs are complete?

M. Culmer

Yes, that's correct.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Please, can you just give the microphone?

Fahed Irshad Kunwar
Redburn (Europe) Limited, Research Division

It's Fahed Kunwar from Redburn. I just had a question about other operating income. One of the things that was quite striking on your market share chart was a lot of stuff where you're below. Your natural market share seems to be insurance. Obviously, you had a little bit of a difficult year this year. Should we think about the insurance revenues as a growth revenue line now, i.e., as in the back book drag is going to be offset by the front book, so we're going to start to see growth there? And thinking about the operating -- other operating income line in general, you're running at about GBP 6 billion ex-treasury gains in VocaLink. It's been a difficult line, again, for the last few years. Should that -- should we think about that growing as well? Or do we think that actually, that remains flat and difficult going forward? And the second question was on return on investments. The GBP 3 billion is a big number. Obviously, the cost reduction, overinvestment's an easy thing to do. But how do you think about the revenue growth? And how much do you attribute to the investment versus loan growth and rate rises? How should we think about your ROI? Or how do you think about the ROI?

M. Culmer

Okay. Shall I do -- so OI, first, have a big thought, it's going to stay quite tough, I think in the ROI line in terms of fee income business. For 2017, I think we had said -- I think a target at the start of the year, as I said, if you strip out VocaLink, I think we'd like to be ahead of the prior year. I think we actually came up about GBP 6 million short, so we were slightly undercooked. As I look out for 2018, if I strip out VocaLink as it stands today, I think we'll be there or thereabouts '18 versus '17 in terms of OI. As I said, I think it will stay a relatively tough business. Within that, insurance is a growth business. And if you heard from António in terms of the strategy and going forward, in terms of as I build assets, as I build those revenue streams, not just the FP&R but in terms of the protection and so forth, they will build and that new business stream will build. The reality will be though in insurance, in simple speak, you've got a back book that's kind of running off, and I'm running to replace that with a front book. I think for 2018, the back book run-off may exceed the sort of front book increments. So I think you'll see insurance profits pause if not decline a bit in terms of OOI in 2018, but thereafter, that new book builds and takes you away and takes you -- and the insurance build that I hope you got from António, this isn't about actually next year or the next 3 years. In terms of what we're doing here, in terms of we're building that capability, in terms of we're building that asset base and accumulating those assets, this takes us beyond 2020. And I think António has a slide for 2025. This is about building out for the long term, but I think you won't see much of that in 2018, where I think back book will -- as I say, will sort of run off, will exceed the front book build, but thereafter, you will build and it will start -- and it will continue to build, that's the sort of beauty of it. On the return on investments, again, going back to Juan's presentation, and again, going back to the sort of structure of the branches, we manage this centrally, and when we look at our investment spend, we actually apply 3 crude lenses. One, as may not surprise you, is financials. One, we look at strategic, how close to the heart, how important this is. And the other lens we look at is in terms of our capability. So that GBP 3 billion spend, we kind of strip down certainly the first year's spend at a very granular level in terms of how we prioritize it, how we code it, what makes the cut and, obviously, stuff doesn't make the cut. And within that, to your question as well within the financial bit, I will look at those that drive cost takeout and those that generate income. And when we try to get clever about it, we'll say always it's easier to put income, so I find discount -- if I apply a healthy discount to the income stuff, can I get some form of comparable weighting? But we apply that centrally and then as a team, we, the GEC, will come and will decide where we spend the money looking at those 3 lenses. So you have a very controlled, very centralized, very deliberate process that determines where we spend our money, where we think it is to the best endeavors, the best benefit of the group. And again, in a compare and contrast, this isn't decisions being taken in faraway places, where you're not sure what the motive is and what the decision-making has been. You elevate this all up to the center, I see that list. We decide as a team, what's on the list and what's not on the list, and what we'll do as we go through the year, we'll decide how that list might change because that was moment-in-time view, we thought we'd do this. Now 80% may stay the same but there are other things that will come on, things will change. But it's done centrally, which again, I know it's always perhaps difficult to convey to people, but it's a massive advantage as you set out on a project like this in having that control over and that decision-making residing at the center.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Which means that dynamically throughout the year, some investments may crowd out other investments. And that is the right way to allocate investments, in a transparent and in line with the incentives you were trying to say. So that the best investments, dynamically, gets the most of the resources. Please.

Christopher Cant
Autonomous Research LLP

It's Chris Cant from Autonomous. If I could just ask one, please. You've given 2 pieces of cost guidance. You've given your cost:income target, which I think is an exit run rate for 2020, and you've given your sub-GBP 8 billion figure, which I think is for the full year 2020.

M. Culmer

Yes, that's correct.

Christopher Cant
Autonomous Research LLP

So I'm just trying to square the 2 because a lot of people will be trying to look at the implied revenue number. Within that GBP 8 billion for 2020, how much is elevated investment spend going through the P&L, which will drop away when I'm thinking about your run rate into 2021? Because, obviously, some of that GBP 8 billion is part of your GBP 3 billion. I think people doing this math, so we're all going to come out with different revenue numbers. It would be really helpful if you could give us the right answer.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

You're right. Most of the investment is just the same, but…

M. Culmer

I know. I know. You're overthinking it. You're right. I mean, we've said low 40s as we exit the year, including remediation, but then we're very clear that in 2020, operating costs will be below that GBP 8 billion. Within that, going back to one of the earlier questions, as I spend the GBP 3 billion, I'm going to be expensing a fair slug of that as I move through that. Yes, there'll be an amortized bit, which is still rolling through. I don't see that the calculation sort of takes you into any particular place. There will always be a level of investment. I'm not going to sit here and try and pretend what I think that is in 2021. So I'm not going to answer your question, part of it because I'm not sure it sort of takes you anywhere. The key point to me is -- and when we thought about this, that I could have sat here and said, as we have done previously and people who asked the questions, "I'm going to deliver this much savings," then you say, "Well, okay, I don't know where you'll land. Tell me how much of that reinvesting." We try to be more helpful here and say, actually, this is what we are shooting for in terms of a run rate expense base. To your point, there will be some of that GBP 3 billion that's still on the balance sheet rolling off, et cetera, but we tried to be careful, just more helpful that below the GBP 8 billion gives people a better line of sight. And going to Chris's target, I think these are quite punchy targets in terms of where we are at the moment.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

And of course, as you also say, Chris, some of that, that will not be repeated to the point that you are making. But in crude terms, in the same way that we are committed to improving the cost-to-income every year, you should assume that if you wanted to reconcile the 2, you should assume that the exit rates of the operating costs will be lower than the average of the year, right? It will be the way to cross your [indiscernible]. Please. Martin?

Martin Leitgeb
Goldman Sachs Group Inc., Research Division

Martin Leitgeb from Goldman Sachs. I was wondering if you could shed a bit of light in terms of what you have assumed in terms of property prices in the U.K. throughout your planning in the horizon going forward? And what I was trying to understand is if there were a scenario where property prices, say in London or in the wider Southeast, were to come under some pressure, would you expect Lloyds to perform still comparatively well on that basis?

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Do you have the estimates?

M. Culmer

No. We do. We do. But not here. I can't remember what we assumed.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

I think our estimate's directionally driven are a continuation of house price increases outside London and the Southeast and some decline in London. If you remember, already 4 years ago, we were the first bank even before the FPC to lower the loan to income ratio, from 5 to 4, because it was the only way available to us of deemphasizing market share in London. And the fact is that now, 4 years later, we have more than 90% of our book in London with an LTV of lower or equal to 80%. So our book is incredibly resilient to house price in London going down. 4 years ago, we had GBP 36 billion of mortgage loans in the book above 100% LTV, in the whole of the country. Now we have GBP 1-point-something billion. 90% of our total book, just to give the final one is below or equal to 80% LTV, okay? So we can follow the strategy where given what I explained to you in terms of the strategy, in terms of mortgages, volumes, prices, risk capital, we think all reasons points to being prudent privileging capital and reading that overall strategy, we have deemphasized London already from 4 years ago. That has reflected in ourselves having lower new business at high house prices. The increase in house prices throughout this period has lowered the back book prices, and our LTV had a massive transformation where we have, as I said, above 90% of the book, equal or below an 80% LTV.

M. Culmer

And I think HPI, I think we've assumed for this year about 3% or something like that. And we've also -- to that resilience, to António's point, from memory, it used to be like a -- we, obviously -- you stress test the hell out of the thing. But I seem to remember the first 10% fall in HPI has about GBP 1 billion of RWA pickup. It's a -- that's as -- give an indication of that resilience in the book.

Martin Leitgeb
Goldman Sachs Group Inc., Research Division

Okay. It's a very small impact.

M. Culmer

Okay. Yes.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Michael?

Michael Francis Helsby
BofA Merrill Lynch, Research Division

Michael Helsby from Bank of America Merrill Lynch. I was wondering if you could give us a comment on margins. Claire, I think in your comments, you said you think margins will stay resilient. So I was wondering if you could quantify what you think resilient actually means. A request...

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

It's more than you think, Michael.

Michael Francis Helsby
BofA Merrill Lynch, Research Division

Clearly. It's a request for an average balance sheet please in your disclosure that ties into your banking NIM, so we can have a better line of sight into what's going on. But more specifically, if you could tell us what your -- the mortgage yield is on your back book, where you're currently originating mortgage prices, what the yield is on your deposit book because it looks to me like you're pretty much done from a deposit repricing perspective would be really kind?

M. Culmer

Would you like to know anything else? I mean look, resilient means resilient. I'm not being a smart ass about it. Look, we don't normally sort of give guidance beyond the 12 months, so this should -- we've gone beyond that. And that was to demonstrate our confidence in our ability to manage this business; reflection in terms of what you heard from António round where we see the U.K. economy going. And I don't have the specifics around the sort of mortgage front and back book to hand and things like that. There is still room to go and things like the deposit rates and how we actively manage that margin. So obviously, when you look at the normal rates that we give you and in terms of saving rates, I think at Q3, they were 47; Q4 I think this is -- they're just over-50-type stuff so -- and that's how we absorbed the rate increase, and the extent to which things do or don't get passed on and how we actually manage that. So we think in a -- in the gently rising environment, there will continue to be opportunities for us that we'll be able to play into in terms of how we manage the book. So I'll take your comment on average balance sheet. I think the first one of these I ever did, you asked for an average balance sheet, so I'll get back to you. So I'll look at that. So I don't know, we remain confident in how we're managing the business in terms of how the look forward appears to us in terms of the plan, in terms of benefits of MBNA coming through, in terms of utilizing market efficiencies, in terms of wholesale funding, even as the TFS rolls off given the rating upgrade, in terms of being able to access new funds. So we still see there is more mileage in basic spread management as well between the asset and liabilities of the business.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

And we have told you in quarter 4 that the margin -- in the results in quarter 3 that the margin would be around the same as quarter 3. We told you the margin would be around 285. It was 286. We are now telling you in 2018, it will be around 280, 290 -- sorry, 290. So Martin -- so Michael, you will believe it or not at your own peril.

Michael Francis Helsby
BofA Merrill Lynch, Research Division

And sorry, one more. Just on -- clearly a lot of today is about open banking and the opportunities that you think that, that brings to the group. Clearly, if open banking works and it's going to break down inertia and as the bank that's the biggest in the U.K., has got the biggest back books with some of the richest pricing, some might think that actually, that's a big threat to you. So I was just wondering, clearly, what your perspective is. We've heard from the guys but what does that do to like transparent pricing and as things start to accelerate in the turnaround?

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Well, as I think as you heard from Vim on his session, we see open banking as a significant opportunity. And we have already implemented, as I said, the first of the big banks to implement it. We think we have a fantastic customer franchise. They interact with us. It's a growing pace through a multichannel, multi-brand approach. The more they interact with us, the more insights we have on what they want and they are changing quickly what they want. And we are very well positioned to provide them with it. Open banking is another opportunity for us to provide aggregation. Our customers tell us that they like aggregation but they would prefer their main bank to do it. Well, we are the main bank to 1 out of 4 clients in the U.K. And as you heard in Vim's session, we have very interesting plans for that, which we will be panning out as we install each of the innovations that we have in our plans. More questions please. In the back?

Edward Hugo Anson Firth
Keefe, Bruyette & Woods Limited, Research Division

Ed Firth again from KBW. I was interested in your comments on RWA intensity, and I guess particularly around the mortgage risk weightings. I know the PRA have been looking at that. I don't know if you've got an update. But I noticed that it in the stress test, your mortgage book performed somewhat worse than peers, and yet, your risk weighting seems somewhat better than most people's. And I wonder should we expect some sort of uptick in that as we go forward over the next few years?

M. Culmer

Yes, there is a marginal update. This is the PRA's proposals that kick in. It's not a material amount because the company already do things like through-the-cycle RWAs as oppose to point in time. My comment also around intensity was when you look at the different mix in terms of where we expect the business to grow. And when I look at the composition of the overall book as well. So those were the sort of main things that I was sort of referring to when I talk about the RWA growth. So there'll be a bit of mix and there'll be a bit of factoring in things like the PRA proposals as well.

Edward Hugo Anson Firth
Keefe, Bruyette & Woods Limited, Research Division

Okay. So maybe I could ask the question another way then. When I hear your LTVs, et cetera, it looks like your mortgage book is very well placed to protecting any downturn, et cetera. And yet, if I look at the provisioning that came out of the stress test, it was higher than everybody else's. So I wondered what is the source of that? Is it the old Birmingham Midshires book or have you got some sort of little pockets that are a problem or something more structural?

M. Culmer

If you look at the appendices, and I have to say that and I hope we've still got the slide in, we do an analysis. There's things like the specialist book, which is a legacy book, which is rolling off, and I forget the percentage of [feign] that, that causes in the stress but an awful lot comes from that book, which is a legacy book. It's seasoned. It's rolling off. It's going to diminish as we move through time. But if you look at the size of that, that specialist book, that's one of those areas that causes a significant amount of our delta in the stress.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Thanks so much. Okay, any final questions as we approach the end? So who hasn't yet answered a question? I think you haven't. Both of you, sorry.

James Frederick Alexander Invine
Societe Generale Cross Asset Research

James Invine here from SocGen. Can you talk to us about the stages of your deal with JLR because I think if memory serves me correctly, you're now in the fifth year of your 5-year deal. Is that right? Is that going to be renegotiated this year?

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

JLR, yes. [Jim], would you like to take that question? [Jim] will answer this.

Unknown Executive

So I mean, I think we started to write new business on JLR in 2014. So you see some of the growth that you've seen on the JLR book and the Motor Finance book has been a function of the fact that, that book is still seasoning, so we saw a growth of about I think 19% last year. That will start to mature as we start to see repayments on the book that we -- the business that we wrote in '14, '15. That was a deal that runs 'til 2019. And obviously, we will be looking at continuing that relationship with JLR.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director

Okay. So it finishes next year, not this year. Please, yes?

Ian David Gordon
Investec Bank plc, Research Division

It's Ian Gordon. Just one question please. It's a point of clarification for George. I think when you were talking earlier about below-the-line items, you said you didn't know what the redundancy costs might be and that can't be true because you know everything. So I guess more seriously, my question is are we talking about redundancy costs contained within the GBP 3 billion investment? Or are we talking about redundancy costs, which might flow from the efficiency gains of the plan?

M. Culmer

It's the latter. It's the latter. And I really don't know because as we explained in the sort of first of these this morning when we talked to the media, it depends upon what our customers do. So as you would have heard today from Vim and from Jakob, et cetera, the service proposition is driven by the customer demand, and we will respond to that in terms of FTE, in terms of branch footprint, et cetera, and I will deal with that when it comes. But the more than GBP 3 million doesn't include the redundancy, yes, any redundancy.

António Mota de Sousa Horta-Osório
Group Chief Executive & Executive Director
Yes. We would not call that a strategic investment. And that's -- the strategic investment is all above the line. Okay. So I think we came to an end. I mean, thank you very much for bearing with us all this time. But we thought this time requires -- this moment requires more time together, and I hope this was useful. Thank you very much for coming.