TSB Bank plc

Half Year 2014 Results Conference Call Transcript

Thursday 31st July 2014, 08:30 BST

Paul Pester - Chief Executive Officer

Thanks to everyone for joining the call and it's great to be able to talk about TSB Bank's 2014 First Half Results.

Now, we had the pleasure of meeting many of you as part of the IPO process, but I know many others dialling into this call this morning will be hearing from us for the first time, and therefore I will take the opportunity this morning to talk you through our strategy and our plans to grow TSB Bank, whilst Darren will give you more detailed information on the accounts and financials.

So we should have plenty of time at the end of the call for any questions you might have on the business. So let me start off by turning to Slide 1, where we will see an overview of the key highlights for H1 2014.

So, in H1 2014 we believe we have made significant progress in establishing TSB as 'Britain's Challenger Bank.' Why do I say this? Well, firstly we achieved a premium listing on the London Stock Exchange, and after seeing significant investor interest in the listing of TSB Bank, Lloyds Banking Group were able to divest a larger than expected stake of 38.5% of the business.

Secondly, TSB has delivered first half results in line with expectations and consistent with the messages we delivered in the prospectus and the analyst presentations as part of the IPO process.

And thirdly, and perhaps most importantly, the delivery of our strategy is on track with some encouraging early progress seen during the first half. In particular, our share of PCA, or Personal Current Accounts, market flow for the latest quarter for which we have data, reached 9.2%. So whilst this was during the launch period of our new Classic Plus Account, it's well ahead of our long-term target of 6% of flow.

In addition, we've seen our brand consideration for TSB increase from 12% to 18%.

So all in all, an encouraging first half of 2014 for TSB, during which we have made significant progress in establishing the Bank.

Now let me move on to Slide 2 and to Darren for a more detailed look at our financial performance.

Darren Pope - Chief Financial Officer

Thank you very much Paul. Good morning to everyone on the phone and on the webcast.

In setting TSB's performance for the first half of 2014, we focused on comparing it to the second half of 2013. This gives us a much clearer sense of the business trend as the first half of 2013 saw several significant balance sheet transfers on TSB's journey to becoming a standalone business, and these transfers do somewhat confuse the underlying trends. And even this comparison needs to be considered with some care.

So I'm going to take a little bit of time to remind you of some of the more significant developments in the first half of 2014 that have contributed to the shape of our half year financial results.

Firstly, on the 1st January, we switched from operating within the Lloyds Banking Group shared service model to a transitional service agreement for the provision of IT and some other operational activities from Lloyds. These costs, combined with the additional costs of running a standalone business, impact on the absolute level, and indeed, the outlook for our cost base.

Secondly, with effect from 28th February, Lloyds provided TSB with the Mortgage Enhancement Portfolio, so that's a £3.4bn mortgage book designed to boost TSB's profitability by about £230m over approximately four years. The profitability of this portfolio is designed to enable further investment in our growth strategy than would otherwise be possible.

Thirdly, on 31st March, our colleagues, or 'Partners' as we now refer to them, transferred across to TSB from Lloyds. This transfer resulted in a below the line one-off gain of £63.7m, given our withdrawal from the LBG defined benefit pension schemes and the corresponding right-off of the residual on the balance sheet liability to those schemes. This of course has the impact of significantly enhancing our statutory profit for the period.

And then finally, on 1st May, TSB issued £385m of Tier 2 sub debt, and on 19th May we issued 445m ordinary shares for proceeds of £200m. Both of these capital issuances were wholly subscribed for by Lloyds Banking Group, and again, clearly had the impact of increasing the Group's capital ratios further, as well as slightly increasing the Group's interest expense.

So that's the important context, and let's now turn to the balance sheet on Slide 3.

The overall message for the balance sheet is that in the first six months of 2014 we grew deposits while Franchise lending balances continued, as expected, to reduce.

At a Group level - and you can see this midway down the table - customer lending balances grew by 11.9%, and that's mainly due to the purchase of that Mortgage Enhancement Portfolio. That portfolio reduced from £3.4bn, when we received it at the end of February, to £3.1bn at the end of June.

The portfolio remains on track to deliver that planned £730m of profit, including £30m of profit in 2017.

Just as a reminder to everyone, once that £230m of profit has been achieved, it will trigger Lloyds' ability to redeem the portfolio through a call option.

Okay, let's move up to the top of the balance sheet. You can see here that Franchise lending fell 3.6% with balances declining across all of the retail lending portfolios, but particularly, and as expected, in the Franchise Mortgage portfolio. The Franchise Mortgage portfolio fell by over £600m, and given our temporary inability to write new business in the mortgage intermediary market. We've got circa £7bn of mortgages that were originally written through the intermediary market and those continue to repay and refinance.

We also saw a small decrease in unsecured lending and that's largely reflecting some seasonal trends, with overdrafts and card balances tending to peak in December.

Now to Business Banking lending, which is very small in absolute terms, so only about 1% of our customer lending, but it has reduced by 15.7%. This reduction primarily related to the planned repatriation back to Lloyds of customers who have got more complex banking requirements and those are no longer fully met by the TSB Business Banking proposition. This process is very nearly finished and it will be complete by the end of the year.

While Franchise lending continues to reduce, we grew deposits by 2.6% in the first half, and that's mainly through the very successful Classic Plus Current account launch that Paul described. This underlying customer growth will clearly support future asset growth, particularly unsecured asset growth.

So overall, those movements have helped strengthen our funding position, the Franchise loan to deposit ratio has reduced 5.2 percentage points to 81.8%, and the Group ratio remains below 100 at 94.9%.

Clearly, the business is well funded for future balance sheet growth.

If we turn to Slide 4 let's look at the capital position of the Group. And here you can see that the Group is also well capitalised to support that future growth.

In the first six months of the year, the Common Equity Tier One capital base of the business increased by £411m to £1.59bn. This was driven by the equity capital injection of £200m in May, over £100m of statutory profits generated in the period, and just less than £100m decrease in excess expected losses as our unsecured book moved onto a standardised basis from IRB on the listing.

At the same time as the capital base went up, the RWAs reduced by £547m. This reduction in RWAs reflected three factors.

Firstly, as we've already described, we had a lower franchise asset base.

Secondly, the impact of separating from Lloyds Banking Group. In 2013, risk weighted assets were calculated under Lloyds IRB approach for all asset classes. While TSB has achieved an IRB waiver, as a standalone business it's currently only moved its franchise mortgages on to this waiver, while unsecured assets have reverted to a standardised basis, but just for now. This has the impact of reducing RWAs.

And then finally, there's the offsetting impact of the Mortgage Enhancement coming on to the balance sheet. That's calculated on a standardised basis and reflects over £1bn of additional RWAs.

Clearly, if you combine the impact of higher capital resources and lower RWAs, we've seen Common Equity Tier One capital increase from 19% to 28.1%. However, if we assume that TSB had fully completed that transition to IRB across all of its Franchise asset classes, then we estimate that the pro-forma Capital Equity Tier One ratio would reduce down to about 18.2%, which, whilst significantly lower, still represents a very strong position for growth.

By way of addition, that pro-forma number has also been adjusted to represent operational risk weighted assets based on projected income levels rather than the lower historic average income levels that the capital is currently calculated on.

So that's the balance sheet and the capital. Let's move to the Earnings Performance on Slide 5.

Franchise management profit reduced, as expected, and statuary profit increased, and largely as a result of the one-off pension gain.

Franchise income increased 2.2%, and that's driven primarily by lower deposit costs as we continue to benefit from the full year impact of the market-wide re-pricing trends that were seen in 2013.

At the same time, our cost base increased by 23% as we continued to develop our standalone operations. Now this cost base is going to build and that build will continue into the second half of 2014 as our planned investment spend of about £50m per annum will be much more heavily skewed to the second half, having spent only £10m of that £50m in the first half.

In addition to the investment spend; we continue to recruit, particularly to build our intermediary mortgage capability, which, as you will know, comes on stream in Q1 2015.

I'm going to expand on our specific expectations for 2014 costs in a moment.

Impairment was 10.1% lower, reflecting lower levels of underlying arrears and the impact of the improving economic environment.

These factors combined reduced Franchise management profit by 50% in the first half, which once again is very much in line with our expectations.

In its first four months on the TSB balance sheet, the Mortgage Enhancement delivered £31.6m of management profit to the Group, which is about 40% of the total management profit for the period.

At a statutory level, profit before tax was higher at £128.5m, compared to £48.7m for the second half of 2013 as we benefited from the one-off gain of £64m on that withdrawal from the defined benefit pension schemes.

In addition to that gain, we've also established hedge accounting relationships at the beginning of the year which reduced the volatility across the majority of the derivatives that make up our structural hedge portfolio. Prior to this, we didn't designate any of the derivatives in hedge relationships, and as a result you can see that £39m accounting volatility loss in the second half of 2013.

Now let's focus in a little bit more on income on Slide 6.

We've already noted Franchise income was up 2.2%, and this increase was driven by Franchise net interest income rising by 3.3% to £356.5m, and that again is primarily on the back of 2013's deposit re-pricing impact.

Other income for the Franchise business has reduced by 3.1% to £74.5m. Now that decline was primarily due to the ongoing reduction in income from the added value accounts, which is part of our current account proposition, and that product is not currently available for sale in the branch network.

With respect to NIM, the banking margin increased to 3.62%, which is in line with both the Q1 pro-forma that was shown in the prospectus and indeed consistent with guidance that it will remain broadly stable through 2014.

Just touching on that NIM increase, the increase in '14 has been driven by the positive effects of the deposit re-pricing, and to a lesser extent by the declining mortgage book. This has more than offset the greater than anticipated balances that we've seen on the Classic Plus account, and the increased competitive pressure we're seeing in the unsecured market.

At Group level, income increased by 9.8% to £463.2m, and again that's primarily as result of the purchase of the Mortgage Enhancement which contributed almost 80% of the total Group Management income growth.

I talked very briefly about the improvement in impairment, let’s move to Slide 7 and look at impairment in a little bit more detail.

You can see here that asset quality for the Group improved in the first half of 2014, and that reflects the sustained improvement in the UK economic environment as well as the Group’s strong control of credit risk. The impairment charge for the first half of 2014 was 9.1% lower at £51.1m. Franchise impairment was 10.1% lower at £50.5m. Now this included a net recovery, as you can see, of £0.6m there at the top of the slide on the Franchise mortgage book, and that’s just due to the favourable economic conditions, and in particular rising house prices, being applied to a very high quality book.

Unsecured impairment charge increased marginally to £48.2m, and that’s a combination of the benefit of the improving economy being offset by increased provision rates that we’re applying while TSB embeds its own recoveries function, which has now been built.

The business banking impairment was 34% lower and that's driven by the lower balances that we described earlier.

Overall the asset quality ratio for the group is 47bps compared with 57bps for the second half of 2013.

Impaired loans have reduced now to only 1% of gross lending and our coverage ratios have just increased modestly to 41.6%.

So drawing all of those messages together what does it tell us about our expectations for the rest of 2014?

On slide 8 you can see that we very much expect the key trends in the first half to continue for the remainder of the year and as guided in the prospectus.

We expect to see costs continue to rise as we build the corporate core and intermediary mortgage channel and invest in enhancing the TSB proposition. However we now expect costs incurred for the full year to be in the region of £700m, some £20m lower than previously guided.

Primarily this is a timing issue we’re taking a very disciplined approach to recruitment and our investment spend, but it does reflect a modest amount of underlying improvements in the cost base.

With respect to asset quality you've seen that the asset quality has benefited from the better than expected economic conditions, the environment in the first half of 2014, these conditions are expected to remain favourable throughout the rest of the year.

And then finally with respect to the Franchise margin we’ve discussed the drivers which pushed the margin higher in the first half of the year and we expect many of those same drivers to leave the Franchise margin broadly unchanged in the second half compared to the first half.

So overall the first half financial performance was consistent with our expectations but we continue to maintain a very strong level of capital and liquidity to support our medium-term growth targets. So that's all from me thank you and I’ll now hand back to Paul.

Paul Pester

Great thanks Darren. Now let me take you through a brief summary of the growth strategy for TSB and explain why, as we said during the IPO investor presentations, patience is required.

Turning to Slide 9 TSB's strategy is one of growth. The components of the strategy are to grow our market share of current accounts, to grow lending to customers right across Britain and continue to enhance and differentiate the TSB proposition. Let me say a little about each of these components:

So over the next five years we aim to utilise TSB's substantial distribution capability to grow our share of current accounts by consistently achieving more than 6% share of flow of new and switching current accounts across the UK markets. This will translate into our share of stock growing to 6% and beyond over time.

Secondly, over the same five year period, we plan to grow TSB's Franchise lending by 40% to 50% or by about £8bn to £10bn. The biggest single driver of this asset growth will be our re-entry into the intermediary or mortgage broker channel. Our plan is to re-enter this channel in early 2015.

And then thirdly we intend to continue to enhance and differentiate the TSB proposition.

Now achieving these three objectives in a rising base rate environment will, we believe, see the business reach a double digit ROE in 5 years' time.

So, how are we doing in delivering this growth strategy?

Let's take a look on Slide 10.

Well early progress in delivering the strategy is encouraging. Taking each component of the strategy in turn if we look at growing current accounts, in April this year, for the first time, we actively promoted TSB as a destination for personal current accounts. As part of this we launched the new "Classic Plus" current account – which as you'll know, offers 5% interest on qualifying balances up to £2,000 – and we supported this with a strong media and advertising campaign.

Now the customer reaction to this campaign and to the new Classic Plus product enabled TSB to take a 9.2% share of flow of current accounts opened and switched across the market from February to April – the latest reported three month period, well ahead of our long-term target of 6% share of flow. Now whilst we're very pleased with the share of flow seen, we expect over time this will normalise to around 6%.

In terms of growing customer lending, we have implemented the reforms required under the Mortgage Market Review in the first half whilst continuing to build TSB's intermediary mortgage capability. I'm pleased to report that this build remains on track for TSB re-entering the intermediary mortgage channel in early 2015.

In order to achieve the long-term sustainable growth of TSB we intend to continue to enhance and differentiate the TSB proposition and there are a number of initiatives we've taken in the first half of 2014 to enable us to do this.

So for instance as of the 25th June – when we issued every employee with an equity stake in TSB – every employee is now a Partner in the business. We have made our employees Partners in order to reinforce the right behaviours and to help us differentiate our customer service.

We continue to deploy TSB's significant digital capability - seeing the number of new current account customers who are registering to use online banking increase to 84%. This is supported by the digital characteristics built into the design of the 'Classic Plus' current account.

Meanwhile, we are making the final touches to our new TSB.co.uk public website, so keep an eye open for the launch of that very soon.

Together, these initiatives have contributed to an increase in the proportion of UK consumers who would consider banking with TSB – our brand consideration score. This figure has moved from 12% to 18%.

The increasingly positive opinion of TSB is echoed in our Bank net promoter score, which measures the likelihood of our customers recommending TSB to their friends and colleagues. This has increased by 8 percentage points over the period.

So, finally to Slide 11, and to summarise. And the first half of 2014 has been a strong period for TSB during which we have made good progress in establishing TSB as Britain's Challenger Bank.

We have successfully listed the bank on the London Stock Exchange.

We have delivered our H1 performance in line with expectations, and we are seeing strategic delivery on track.

With that I'm very happy to open for questions...

Q & A

Question 1

Robin Down - HSBC

Good morning I've got two questions. First on the cost side, perhaps if you could give us a bit more colour as to why you've slowed the recruitment down and whether you expect to catch up in 2015, so when we look out to 2015 costs what the expectation should be there?

Then the second question just more generally, obviously a lot of the strategy is dependent on the intermediary mortgage market next year. Could you tell us at what stage you are in discussions with the big mortgage panels out there? Do you expect day one when you've got the platform in place to be able to offer mortgages through those panels, or is that something that might have a time delay attached to it?

Darren Pope

Good morning Robin and thank you for the question. In terms of the costs slowing down, I think it's not a delay of any variety, we're merely making sure that we prudently only bring in people into the business when we really need them. There is a lead time to train people ready to support our intermediary mortgage business, and we will ramp up that intermediary mortgage business gradually during 2015. So it doesn't infer any delay at all, it's merely that we're being careful about how we recruit them.

The second part of that question on costs, therefore we fully expect the '15 cost base ultimately to look very much like we guided.

Paul Pester

The second question on the intermediary mortgage launch, yes absolutely we intend to work with all of the major panels pretty much from day one. We are in discussions with those major panel providers. Most of our distribution we expect to actually come from the panels as well as some of the more major directly authorised firms, so we're making good progress in agreeing terms with those panels.

<u>Question 2</u>

Claire Kane - RBC

A quick follow up on costs and maybe then just a couple on the loan book trajectory. You do mention there are some underlying cost savings, and I just wondered maybe if you would give a little bit more detail on how much of that £20m you think is real cost savings?

Darren Pope

We're not guiding to a specific amount, it's only a modest amount of that £20m, but I think it does play to our commitment that during this costs phase we will continue to look at opportunities to save costs, but we're not guiding specifically at this stage on how much of that £20m, but it is a small component.

Claire Kane

Great, thanks. And in the movement in the loan book, obviously that's been running off as you say you expected, but is there any big change in the mix of that mortgage book, be it between SVR, HVR or the fixed tracker book?

Darren Pope

The book overall is very stable Claire, so no we're seeing it coming down broadly proportionately. Particularly with respect to the SVR component of the book and the interest-only component of the book, they're very stable as a proportion of the total book, so nothing unusual happening there. Clearly the attrition in the book, if the mortgage market opens up as it did in the first part of the year, because my intermediary business is essentially a back book, I will be more exposed to a more active market until I have the intermediary mortgage capability in place.

Claire Kane

Great, thank you. And finally then, you gave some direct gross lending figures for the first half. Can you maybe give us some colour on how the quarter-on-quarter trajectory has been, and how you're seeing the new branches adapt to your new, not sales-led but essentially how much lending is being done through the new branches?

Darren Pope

Two parts to the question; the first, we've not given any particular guidance on quarter-on-quarter; I think that the sales have been relatively stable. We've seen steady growth in our mortgage sales via the branch network.

With respect to the second part of your question, the new branches, the C&G branches, have always sold mortgages anyway. So to give instance, they're not going from a zero base unlike in current accounts to a new sales flow, we've just seen incremental improvement in those branches against their historic figures. So not phenomenal growth, but our growth is very much on market at the moment through our branch network.

<u>Question 3</u>

Christopher Wheeler - Mediobanca

A couple of questions; first one really is on the new current account. I just want to get a feel for – again I think I asked you this at the presentation at Rothschild – but on the issues you're going to meet around competition, obviously with Tesco now in the market and promising that their 3% interest rate will not be a teaser but will be something that will stay in place, perhaps you could talk a little bit about what changes you may choose to make or have to make in that product in terms of rate over the next 12 months? Also perhaps what you think might happen to your market share when perhaps we see Virgin Money coming into the market with its product?

In terms of the intermediary initiative, which obviously is a fulcrum to what you're trying to achieve, I think one or two of your competitors have suggested that some of the comments that you've made are perhaps a little bit too optimistic in terms of your ability to access the broader intermediary market, and that actually it will take considerably longer to really get into the kind of levels of penetration of the various intermediaries that you need to service. Can you just talk a little about that and perhaps remind us why you think that you can ramp that business up very, very quickly? Thank you.

Paul Pester

Thanks Christopher. I'll attempt to answer those and Darren will fill in the gaps. On the new PCA, we have no intention of changing the rate that we are offering on that product. That 5% on the £2,000 of qualifying balance is not a teaser rate it's one of the key components of the product of that rate is a managed rate, so there is no intention of having to do anything with that product economics at this stage. Clearly we will continue to work on new current account propositions, but we don't intend changing that product in the very short-term.

As for the impact we're seeing from the likes of Tesco and Virgin, clearly we welcome any competition in the market, we think the more competition the more market churns, then if we continue to take 6% we should see our stock growing more quickly. But at this stage we're not seeing major impact on our growth plans from any of those challenger banks.

In fact, I think as I would have said in some of the analyst briefings, if you go back to when we launched our product and when we initiated our campaign to promote TSB as a destination for current accounts, we were a net gainer from every bank in the UK. Now that's falling back a little bit, but we are still predominantly a gainer of current account customers.

Turning a bit to the intermediary market, why do we believe we will succeed in the intermediary market? There's a couple of key aspects. One fundamental aspect is the underlying system that we use to provide access for brokers to provide TSB mortgages. I think as many people will know that system is a clone of the Halifax system, the system that supports 25% of the intermediary mortgage lending in the UK. Brokers know how to use to the system, brokers are very familiar with the system. We have an absolute commitment to that intermediary mortgage market, and the feedback we're getting from the brokers and the broker panels and the network is very, very positive. We believe that by gradually increasing our presence in the intermediary mortgage market, we'll grow to around £4bn of gross lending a year over about a three year time period. So we've spent a lot of time talking to the panels, talking to our partners about growing our intermediary space. Whilst we don't imagine we're going to step from zero to £4bn overnight, we are confident of growing to that level of lending over time.

<u>Question 4</u>

Joseph Dickerson - Jefferies

Good morning gentlemen, I just had a quick question. You obviously have a very strong capital base and you're natural acquirer of mortgage portfolios. There was some talk in the press recently about potentially acquiring some mortgage portfolios off of UKAR, and I was wondering if you're able to comment on firstly your appetite for portfolio acquisitions, and secondly if there's any other colour you can give us on that front? Thanks.

Paul Pester

Our strategy is an organic growth strategy. We're very clear that we're growing into our infrastructure and we launched 164 new branches last September. We're building that intermediary mortgage capability, and that will enable us to grow our business and grow our key market shares by 40%-50% over the next five years or so. That said, if there are opportunities to acquire assets, then we believe if those assets are of the right quality then those asset acquisitions would potentially accelerate the growth of our balance sheet and to a degree de-risk the delivery of our growth strategy. So we absolutely have an appetite to look at asset acquisition, and if the right assets come along then we would obviously participate in those processes. But it's very hard for me to say any more than that at this stage.

<u>Question 5</u>

Chintan Joshi - Nomura

I have three questions please. The first one is, is it fair to say that without the intermediary platform the TSB franchise mortgages it'll be difficult to grow them on an organic basis? We've seen numbers from year-end through to first quarter and second quarter coming down. I'm just wondering if we can see mortgage growth without the intermediary platform.

The second question is, just to follow up on Claire's question from earlier on, could you highlight the amortisation rates that you are seeing in the fixed book, and also if you can give us a sense of where the back book is in the first half? I believe last year it was at 4.7% and front book is at 3.5%, so I just want to see how much are you getting through to the front book?

Then finally the third question is, rates go up from say the end of this year or start of next year, how do you expect mortgage rates to move with policy rates? Do you expect a one-to-one ratio or do you expect some lag before mortgage rates can move up? I just wanted to understand how you are thinking about this issue. Thank you.

Darren Pope

I think as we've guided already we are seeing, in terms of gross new business flow, gradual increases in our volumes through our franchise, both our branch and our telephony distribution capability, that is relatively modest. I would say that a lot of our marketing firepower and attention has been directed on building our PCA base in the first part of the year, and you'll note campaigns at the moment out to move that attention towards lending both secured and unsecured. So we would expect to see improvement in the second half of the year over the performance in the first half of the year for franchise mortgages. So we do believe that there is scope to grow that. Clearly the intermediary mortgage growth will be by far the dominant factor in the overall balance sheet growth over the next few years.

With respect to amortisation rates, and I struggled slightly to catch the question, we're not seeing any significant shift in any trends with respect to attrition of our mortgage portfolios, either front book or back book, nor do we expect to, to be honest, until either market pricing changes, which I don't expect, or base rates move, which of course over time will start to drive out some of the back book managed rate products, although we will be a follower of the market because of our lower SVR rate.

Then thirdly, in terms of the question you asked on mortgage rates, they're very stable at the moment in terms of both rates and margins. Clearly when interest rates go up there is a brief lag when we have to give 30 days' notice typically on a change to a mortgage rate, whereas often we pass on the rate increases instantaneously to our liability side, so in periods where there are a large number of small rate increases there is a lag in catching the benefit. I don't expect mortgage rates however after that natural lag period, our current assumption is that mortgage margins overall will remain relatively stable.

Chintan Joshi

Thank you. Just back on the second question; your back book was at 4.7% in 2013 and front book was 3.5%. Where were you at the first half stage?

Darren Pope

We haven't disclosed those rates specifically by book, so I'd be reluctant to do that now.

<u>Question 6</u>

Mike Trippitt - Numis Securities

Two questions; first one just on savings balances ex-current accounts, which were flat, I just wondered if you could comment on first of all how you see growth going forward, if any at all this year? I'm trying to just understand a bit more about your margin assumption in terms of what you're expecting in terms of growth in savings outside of current accounts.

Then secondly on capital, £0.5bn of operational RWAs, I just wondered if you could give any colour or guidance on how much of that is the additional risk weight because of the perceived contagion risk between TSB and Lloyds in terms of operational risk.

Darren Pope

Taking those in order, Mike, thanks for your questions. In terms of savings balances, I think because we're in this low interest rate environment I think sometimes the distinction between savings balance and current account balance growth can become slightly distorted because of the relatively low incentive for a customer to move money from a current account into a savings account. I don't expect any significant changes in savings growth over the period. I do think that continued acquisition of PCA balances in the second half will see the PCA balances continue to grow, although not I think at the same rate as we might have seen in the first part of the year.

With capital, the word of warning on the £0.5bn of RWA. So firstly, only a small element of the operational risk is a factor of regulatory add-ons, but as you'll be aware I can't disclose specific numbers on that. However, as I guided with respect to the pro-forma capital position, those operational risk RWAs, which are calculated on a standardised basis, are currently based on historic income levels. There's a factor that gets applied to income to calculate standardised operational risk RWAs.

In our pro-forma number of 18.2%, we use prospective income numbers because clearly the historic numbers effectively look at the statutory entity which was Lloyds TSB Scotland and had significantly lower income levels historically. So one of the adjustments we made was to look at the future income levels, which increases that standardised operational RWA quite considerably. I'm happy to guide that that's about a £1bn more RWA if you use prospective rather than retrospective incomes.

<u>Question 7</u>

Chris Cant – Autonomous

Hi, I have two questions if I might. On Slide 5 you said that income was up due to lower deposit costs following the re-pricing and you mentioned that part of this at least was some of the follow-through of last year's re-pricing downwards across the system and I noted that RBS recently indicated that they thought that the re-pricing benefit was running out of steam and I was just interested to know whether you think you've got further to go on the margin benefit from deposit re-pricing in the second half?

And then following on from that when your guiding to a flat margin in the second half what are you anticipating in terms of asset margin trends?

Darren Pope

Okay thank you so if we take the first question I agree with the RBS view so that pricing because it was historic pricing effectively we're now seeing the benefit year to date in '14, the full year benefit and I don't expect any more benefit to be emerging from that historic re-pricing through the rest of the year.

In terms of margin trends, and I didn't quite catch the question but if it was in respect of margin trends beyond '14 we're not guiding beyond this year. In terms of the asset margin component of that again I'm not expecting significant movements in asset margins although I am watchful of the unsecured part of the balance sheet where we are seeing some very competitive pricing in the market at the moment and we are anticipating that to be somewhat more aggressive than we did at the beginning of the year.

Chris Cant

But is it fair to say then that the risk to your margin guidance being flat in the second half is probably to the downside if deposit margins are flat and you see a risk of asset margin pressure?

Darren Pope

At the moment I'd regard them as balanced, clearly with the back book on the unsecured side that is already largely on a fixed margin particularly on the loan book so I would rather it was balanced at this point in time.

Closing Comments – Paul Pester

Great thanks Tyler and thanks to everyone for dialling into the call. So it sounds like we've run out of questions I suggest we cut the call there so again thanks everyone for dialling in and I think H1 2014 has been a good period for TSB as we completed the listing, we delivered our financials as planned and have guided and thirdly we're making good progress in delivering our strategy. So thanks to everyone for dialling in and thanks for the call time.