



TSB Bank plc

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2014 Full Year Results

Paul Pester, Chief Executive Office

Good morning and welcome to our 2014 Full Year Results presentation. I'm Paul Pester, the CEO of TSB, and I'm joined on-stage by Darren Pope, our Chief Financial Officer.

I'll start this morning by giving you my perspectives on our performance in 2014 - and the outlook for 2015. I'll then hand over to Darren who will give you more detail on the financials. And of course we will both be very happy to answer any questions you may have as we get to the end of the presentation.

So I'm pleased to say that we've made great progress in 2014 in establishing TSB as Britain's challenger bank. We IPO'd the business successfully in June, and I'm pleased with both our financial and strategic performance in 2014, which has either met or exceeded the expectations we set at the time of the IPO.

For instance, we've been successful in attracting new current account customers to TSB and as planned we launched the TSB intermediary mortgage channel in January this year.

However, as you know competition amongst lenders stepped up markedly through 2014, and TSB is certainly not immune to that nor to the continuing "lower for longer" interest rate environment.

So whilst this only had a modest impact in 2014, we did, of course, start to mitigate the impact of these "headwinds" on our financial results. This has led to us incurring less costs during 2014 than we had planned with our costs for the year coming in about £25m less than our original guidance.

Looking ahead to 2015, of course growth remains our priority.

We'll continue to focus on growing our current account market share, as well as growing our lending, and continuing to differentiate TSB and build the TSB brand.

We do anticipate a continuation of the headwinds we observed towards the end of 2014, meaning that we'll continue to focus on the way in which we manage our costs so that we can deliver our strategy efficiently for our customers and of course for our shareholders.

Let's look at a summary of our financial progress in 2014 on Slide 2.

Overall movements in our balance sheet were in line with our expectations. Franchise customer lending fell to £18.8bn as TSB mortgages were not available through mortgage intermediaries through 2014. And, as you know, mortgage intermediaries represent about 60% of the UK mortgage market in 2014.

Meanwhile, our deposits increased to £24.6bn from both new and existing current account customers and savings customers, attracted by a combination of our straightforward, competitive products and a very clear brand and marketing message.

Our franchise margin remained broadly flat at 3.6%, despite lending margin pressure, whilst the favourable economic environment resulted in our asset quality ratio, or AQR, falling to 44 basis points.

The business generated profit in line with expectations, achieving a management profit of £134m in 2014, just over half of which came from the mortgage enhancement.

So we have clear headroom for growth. With our Franchise loan to deposit ratio falling to 76.5% and with our pro-forma common equity tier 1 ratio of almost 20%, we are one of the strongest capitalised banks in the UK. So, overall, our financial performance in 2014 was certainly in line with, if not exceeding, our expectations.

Let's look now in a little more detail at the progress we've made in delivering our growth strategy in 2014 on Slide 3.

As you know there are three pillars to our growth strategy.

The first is to provide great banking to more people, thereby growing our current account market share. We've made strong progress in 2014, opening almost half a million new current accounts. This was driven by the launch of TSB's "Classic Plus" account at the end of March, and supported by a strong media and advertising campaign. As a consequence, TSB took 8.4% share of flow of current accounts opening and switching across the market in 2014. This is well above our long-term target of 6% share of flow.

Supported by this PCA growth, customer deposits grew by 7% over the year. This means that, on average from April 2014 onwards, we've received more than £150m of additional deposits per month. This is a huge testament to the successful launch, or depending on how old you are, like some of us, the re-launch of the TSB brand, and I believe, reinforces the deposit "pulling power" of the brand and franchise.

This growth was achieved at the same time as the average cost of deposits fell to 77 basis points.

Moving on to Slide 4 and the second pillar of our growth strategy, which is of course to help more people to borrow well with TSB, thereby growing our stock of lending by 40% to 50% in the five years from IPO.

In 2014, our stock of Franchise lending, as expected, reduced by 6%, given that we were not able to provide TSB mortgages through mortgage brokers. However, whilst our stock reduced, our performance through our branch network and our other channels improved through the year, both in terms of volume and share of the non-broker market flow, which rose from 1.6% in Q1 to 2.2% in Q4.

This partly reflects our Borrow Well campaign launched in the third quarter, which promotes and reinforces TSB as a destination for mortgages.

Consequently, TSB's mortgage brand consideration also rose from 4% to 11% over the year. However competition for assets has continued to increase through 2014, and prices offered by UK lenders, including TSB, continued to fall as new and existing lenders sought to grow, as liquidity remained cheap and available, and of course as the risk environment remained benign.

So whilst we continue to focus on improving our performance through our own channels in 2015, the most significant impact on our ability to grow assets will come from our re-entry into the mortgage broker market. Following a successful pilot with London and Country in the late 2014 we officially launched TSB into the mortgage broker channel on 19th January 2015. I have to say I've been delighted with the initial response.

We have, to date, only launched our home purchase mortgages through this channel, so we haven't yet launched re-mortgage or buy-to-let products, and we've only currently been operating with around 65% of the UK mortgage brokers.

Despite that I'm really pleased to say that we've got off to a flying start and have so far received well over £300m worth of applications. So whilst this is a great start, a fantastic start, we do need to continue to nurture our entry into this channel. We'll therefore only broaden the percentage of brokers we serve and the product range to include re-mortgage and buy-to-let as we continue to deliver a sustained performance with respect to both credit quality and, of course, the service that sits at the heart of our proposition to brokers.

So turning to Slide 5 and the third pillar of our strategy.

We aim to differentiate TSB and build the TSB brand by providing the type of banking we believe people want and deserve. Whilst this is very much at the start of the TSB journey I am delighted with the customer reaction to the brand. This has been a factor in enabling us to retain those customers that were transferred to us in 2013 and, of course, attract many more during 2014.

In further developing the brand we took a cue from our customers who told us what they wanted from their bank, and we began to respond accordingly. For instance, in June last year at the time of our IPO, we made a fundamental change in that every employee in TSB became a "partner" in the business, through awarding those employees with TSB Partnership shares. This was an important step in helping to create a culture of personal ownership and one focused on delivering great customer service to our customers.

We've reinforced this partnership ethos through the introduction of a new remuneration model, which removes the type of bonus culture found in some banks.

We've also launched our "Truth and Banking" website aimed at explaining clearly how TSB operates and how we make money – all reinforcing our brand values.

As well as these "brand defining" changes, we've also made further improvements to how our customers interact with us. We've invested in upgrading and re-launching our website, we've improved the look and feel of almost half of our branches, and we've made it easier and cheaper for customers to contact us over the phone.

Together I believe all of this is really making a difference and, these changes are being noticed by our customers. For instance in a recent *Which?* Magazine survey of customer service provided by all UK brands, not just banks, TSB was ranked as the only high street bank in the top quartile for customer service. In addition, our Bank NPS, or net promoter score, improved by 29 points during the year, meaning that more customers than ever would recommend TSB to friends and family.

So, I think we've made a great start in delivering our growth strategy in 2014, having met or exceeded the expectations we set at the time of the IPO. And I expect us to make further progress in 2015.

Moving on to Slide 6, we remain focused on our growth strategy in 2015. I expect us to continue to consistently attract more than 6% of all new and switched current accounts

during the year. I expect Franchise lending to turn the corner in 2015, ending the year around £1.5bn higher than we started the year. The key driver of this growth will be building on our successful launch of TSB into the mortgage broker channel.

Finally, we will continue to invest in the kind of banking we believe people want and deserve. This will include further investment in our digital platform, our branches, our products, and, of course, our brand profile. While investing in the business, we're also very aware of the "lower for longer" rate environment and asset margin headwinds, meaning that we'll continue to seek to achieve our planned growth at lower costs.

As a result, I expect us to spend no more than £720m in 2015, and this is around £30m less than we had originally guided in terms of costs for 2015 at the time of the IPO.

So with that I will say thank you very much and I'm now going to hand over to Darren who is going to take us through the financial results and the outlook in a bit more detail. So Darren, over to you.

Darren Pope, Chief Finance Officer

Thanks, Paul, and good morning everyone.

Today's presentation is going to focus primarily on the variance in the movements throughout the course of 2014 rather than the typical year-on-year comparisons you might expect from a full year results presentation.

As many of you will remember, the creation of TSB involved a large number of product transfers and accounting adjustments in 2013, and for this reason year-on-year comparisons are fraught with complexity and largely unhelpful. They will of course be available in today's fuller RNS announcement and in the Annual Report and Accounts in due course.

So let's start with an overview of TSB's balance sheet on Slide 7.

And the balance sheet is once again characterised by the expected reduction in mortgages and the success of our strategy in attracting current account customers, as already described by Paul.

Franchise lending balances declined by over 3% in both the first and second half of the year, given that we didn't have access to the mortgage broker channel. At the start of the year, over £7bn of our mortgage balances had been originated via intermediaries. Now these intermediary customers, when they seek to refinance their mortgage through a broker, don't have an option to take out a TSB mortgage, and so they naturally move to a different lender, effectively placing this part of the book in run-off.

Now the successful launch of TSB's mortgages into the broker channel will start to reverse this declining trend, and we therefore expect around £1.5bn of net lending to be added to our franchise balance sheet in 2015; and that growth is expected to become evident mid-way through the year.

Unsecured and business banking lending fell modestly. The key driver was the redirection of about 2,000 business banking customers back to Lloyds during the year, as we were unable to provide them with the more kind of complex products and services that those customers required.

Retail loans, credit cards and overdraft balances remained stable, despite the extremely competitive environment.

Meanwhile, having received the Mortgage Enhancement from Lloyds in February 2014, this closed book has begun to run-off, broadly in line with our expectations, reducing by 10% in the second half year.

Moving to the liability side of the balance sheet, the launch of TSB's 'Classic Plus' clearly received a strong response from people looking to switch their current account or, indeed, open a new one. And this, combined with continued current account back book growth, drove the current account deposits higher by £1bn, or 17% across 2014

At the same time, savings balances also increased, albeit broadly in line with the market in the second half.

Now the combination of these asset and liability movements resulted in TSB's Franchise loan to deposit ratio falling by over 10 percentage points through 2014, ending the year at 76.5%.

So let's look at TSB's profitability overview on Slide 8.

As expected, with a shrinking balance sheet, excess liabilities and a growing cost base as we built our Intermediary business, both Franchise and Group profits were markedly lower in the second half of 2014.

So let's work our way down the Franchise P&L.

On total income, the lower lending balances were the main driver of the modest 2% reduction in the second half of 2014, while the Franchise Net Interest Margin remained broadly stable, you can see at the bottom there, at 363 basis points.

As previously guided, costs rose by 9% in the second half as we continued to build out that mortgage broker capability, which contributed to an additional 377 partners recruited across the year. Post IPO, we also focused on our investments with spend considerably higher in the second half of the year. The impairment charge and the asset quality ratio both fell as the economic environment continued to improve.

As a result of these movements, and as expected, the franchise management profit reduced by 68% half-on-half to £15m.

The Mortgage Enhancement profits increased 27% in the second half, reflecting a full six months of profit, albeit on a declining book. Now that Mortgage Enhancement has generated £72m in profit. That's almost a third of its total objective of £230m. And as a reminder for those of you in the room, once that objective has been achieved, and in 2017 we made at least £30m of profit, the portfolio can be "called" back to Lloyds Banking Group.

So at a Group level, the reduction in franchise profits was mitigated by the introduction of the Mortgage Enhancement mid-way through the first half, resulting in the Group's management profits decreasing by 30%.

So that's the forest level view of the P&L, and I now want to take the opportunity to break down the franchise P&L in a little bit more detail, starting with the deposit costs on Slide 9.

The strength of TSB's liability gathering franchise has been illustrated in 2014 as TSB continues to attract deposits at low and reducing customer rates. The first half of 2014, TSB saw an inflow of £600m in deposits, primarily driven by the strong customer response to the Classic Plus current account. The average cost of deposits was 83 basis points in the first half. And during the second half, TSB grew deposits by a further £925m, but, like much of the market, managed to reduce overall funding costs by 6 basis points, largely through re-pricing activity.

So let's break the analysis down between current accounts and savings accounts. And we can see that in the second half, the cost of current accounts rose to 65 basis points from 57 basis points, driven by some, but not all, new balances earning the 5% rate available on the 'Classic Plus' account. The average cost of savings, however, fell by 11 basis points to 82 basis points, due to the already noted market-wide re-pricing activity.

But while deposits grew, lending balances fell, as did the average yield on those balances, and we can see this in a bit more detail on Slide 10.

The average portfolio yield across all franchise lending fell marginally by 3 basis points in the second half of the year to 3.87%, partly as a result of lower funding costs, but also driven by intense competition continuing to push down new business and re-financing rates. At the same time, overall lending balances gross of impairments fell by £1.3bn, primarily through the expected run-off of the back book of intermediary mortgages.

If we now look at secured and unsecured lending balances independently, we can see that secured yields fell 3 basis points to 2.72%, driven by these funding costs and competitive factors. On unsecured, increased competition, most notably in the highly competitive credit card and personal loan markets, has resulted in the average yield falling 32 basis points to 12.72% on relatively flat volumes.

Now while more new business rates across the market have fallen by somewhat more than this, it will take some time for this to be fully reflected in the portfolio's average yield and net interest margin calculation.

So now let's look at the net interest margin on Slide 11.

The Franchise net interest margins were broadly stable through 2014 at around 360 basis points, but despite that overall consistency, a number of factors have, and will continue to influence the net interest margin.

Firstly, the combination of lower deposit costs and lower yields on assets have broadly offset each other.

Secondly, the run-off of the mortgage book has changed the mix in our balance sheet, with the resulting greater portion of higher yielding unsecured lending benefiting the net interest margin by 7 basis points in H2. .

Thirdly, a full six months of interest costs relating to £400m of TSB's Tier II securities, which were only issued in May, has a negative 4 basis points impact on the net interest margin.

And then finally, we've got a 4 basis point negative impact from other movements. It's a combination of a number of items, including lower returns on surplus liquidity and the negative effect of the monthly refinancing of the net fee reserve portion of TSB's structural hedge.

Many of these factors persist into 2015.

So now let's have a look at the outlook for net interest margin on Slide 12.

Here we look at the possible evolution of the net interest margin in 2015. Now as we've previously guided, we expect the average franchise margin to remain broadly flat in 2015 compared to 2014.

We are expecting it, however, to expand in the early months of the year as we continue to benefit from the same positive mix effects, and the additional savings re-pricing as seen in the second half of 2014. But the balance of those tailwinds and headwinds will then shift, with pressure consistently building throughout the year in three main areas: new business lending margins, the structural hedge position, and the asset mix.

Firstly, pressure on lending margins is market-wide and has been consistently sustained through 2014 as both new entrants and incumbents look to build their balance sheets. These downward trends may continue, albeit it at a slower pace and in a growing market. Secondly, in 2014 we continued to manage the interest rate risk on our non-dated, rate insensitive liabilities by investing a notional balance of just over £7bn into five year swaps, what we call "The Structural Hedge".

As a reminder, each month, one-sixtieth of this hedge matures and is replaced with a new five year swap at the then prevailing interest rates. Overall, this structure has the effect of smoothing net interest income over time and the position currently yields - as you can see on the graph - 1.6%. But swaps that were effectively taken out five years ago are currently yielding 3%, and as they mature they're being replaced with new five year swaps at the prevailing rate which is currently around 1.4%. Without an increase in rate expectations we would expect TSB's structural hedge refinancing to continue to have a negative impact on income for some time.

And with regard to the timing of potential future interest rates, ever since the time of our IPO last summer, rate expectations have reduced significantly. In the last nine months, expected rates for 2019 reduced by 1.5 percentage points, a significant change in a relatively short period of time which I think underlines the uncertainty we all face in trying to predict future interest rates. Lower rates impact on future expected revenues from that structural hedge and on TSB's ability to widen its net interest margin through re-pricing its liabilities as base rates rise.

Then finally we have mix effects which reverse the impacts we've seen in 2014. As we grow the franchise balance sheet by £1.5bn most of this growth will be in the form of secured lending. This is lower yielding than unsecured, and will therefore have a dilutive effect on the margin as the relative proportion of secured balances on our balance sheet grows.

Let's look at other income on Slide 13.

Franchise other income remained broadly flat in 2014. Current account fees declined as added value accounts, which represent the majority of our current account income reduced, and the cost to TSB of customers using other banks' ATMs increased as a result of our growing active current account base. Income from debit and credit cards mainly relates to interchange fees which were up slightly due to seasonality and new business flows. And other fees and commissions, which are mainly GI, were broadly flat. However, looking ahead, once again, to 2015, other income will also be under some pressure given the continued roll-off of added value income, but more materially the earlier than expected implementation of changes to interchange fees.

The Europe-wide change in interchange fee structures will be fully introduced in 2016. However, an earlier than expected phased introduction from the card scheme providers will now result in a reduction in 2015 interchange fees, and these combined with the lower AVA income are expected to push franchise other income lower by around £15m in 2015 when compared to 2014.

Let's move onto Slide 14 and have a look at TSB's cost base.

As previously guided, costs increased 9% in the second half, or 15% if you include the cost relating to the UK's Financial Services Compensation Scheme, which is incurred in the second quarter of each year. That underlying increase was driven by higher levels of staffing primarily as we completed the build of our mortgage intermediary function. In all, employees increased by 377 in 2014, and that drives a £15.8m increase in staff costs in the second half. Of course, these employee-related costs incurred gradually over the second half, and the incremental costs shown here do not fully reflect a full six months at these higher levels of staffing, and that's going to be one of the key drivers behind the overall cost uplift in 2015.

Investment and marketing costs were also significantly higher in the second half, albeit again consistent with our previous guidance for the full year. This was due to the marketing cost from the Classic Plus account and the Borrow Well campaigns being skewed towards the second half, as well as the majority of our investment spends which largely came on-stream post the IPO. We anticipate the phasing of all costs to be significantly flatter in 2015 and do not expect those costs to exceed £720m in the year. As noted by Paul, that's about £30m below the guided level at the time of the IPO, which reflects our continuing commitment to ensure TSB is growing, but is operating as efficiently as possible when it delivers that growth.

Turning to Slide 15 and impairment.

The Franchise asset quality ratio reduced by 3 basis points to 48 in the second half, driven by an improvement in the unsecured portfolio. This improvement was mainly driven by lower levels of unsecured arrears in an improving macroeconomic environment, and particularly higher levels of employment. On the secured portfolio, robust house price inflation of 8% in 2014 followed a similarly strong year in 2013, and this further underpins the already high quality mortgage portfolio that we have. Our average index debt-to-value reduced to 42% as 92% of our loans are now less than an 80% DTV. Only 3% of loans have a DTV of more than 90%, and of those only 1% is greater than 100%. We've seen a stable to improving underlying trend through 2014, and these conditions supporting this trend are expected to continue through 2015.

Let's move to Slide 16. The Group remains very strongly capitalised as we prepare for the lending growth in 2015 and indeed beyond.

TSB's headline Common Equity Tier 1 ratio stands at 23%. This figure reduced from 28.1% in June and there are three main drivers of this movement.

The first is a 60 basis points increase in capital as a result of our profits for the period. The next two drivers have always been in our pro-forma capital calculation, but they're now included in the actual calculation as well.

- The first of these is a 1.9 percentage point reduction primarily from moving our personal loan book from a standardised to an advanced IRB basis, resulting in this portfolio now incurring higher risk weighted assets. This means that only cards,

overdrafts, mortgage enhancement and business banking remain on a standardised basis.

- And finally, a negative 3.8 percentage points of other movements, primarily the required change in the methodology for calculating operational risk weights where we now calculate them based on a percentage of prospective rather than historic income, and this better reflects the ongoing scale of our business.

If we assume that all of the franchise standardised books move onto an advanced IRB basis, then our proforma Core Equity Tier 1 ratio is 19.7%. These moves to IRB are expected to happen through the course of 2015.

So overall there's quite a lot there. Let me take the opportunity to pull together all of our expectations with respect to 2015 on Slide 17. We continue to expect the franchise margin to be broadly flat in 2015 compared to 2014 at 3.62%. We expect early margin expansion in 2015 to be offset by negative factors in the second half of the year such that 2016 margins are likely to start somewhat lower than the 2015 average.

For franchise lending and deposits 2015 will be the year that we start to see mortgage lending growth of around £1.5bn, and while this level of growth is really very comfortably funded by the existing liquidity and capital in the business, we will continue to seek to attract more deposits and more current account customers to fund our longer-term growth and to grow our customer base. We therefore continue to target consistently taking more than 6% of the market flow of current accounts each quarter. Other income will come under modest pressure given the early implementation of reduced interchange fees, driving a circa £15m or 10% reduction in Franchise other income. And finally, we expect no more than £720m of costs in 2015 as a result of careful cost management while we meet our growth targets.

So overall, if 2014 was the year of decent financial delivery against expectations and the laying down of a strong customer and liability base to support future growth, 2015 will be characterised by the start of that asset growth.

Thank you very much, and I'll now hand back to Paul to summarise.

Paul Pester

Great. Thank you, Darren. So we set out with a really clear mission when we established TSB, to bring more competition to UK banking and ultimately make banking better for all UK consumers. So we believe succeeding in this mission is going to create a valuable business and actually a very valuable set of returns for our shareholders. And I think we're off to a fantastic start in 2014. We've had more customers than we expected join us through our current account, so 8.4% market share of flow is well ahead of our plan of 6%. We've grown our deposits by 7%. On the asset side of the balance sheet we've got off to a flying start in our mortgage intermediary channel with over £300m worth of applications and, of course, the brand is starting to be noticed to be different.

So as we move into 2015 we're going to continue doing that; we're going to continue growing the business, we're going to continue focus on growing into our infrastructure, and we're going to continue to focus on establishing TSB as Britain's challenger bank.

So with that I think we're pretty much done in terms of our presentation. We're very happy to open up for questions. Obviously it would be really helpful if when the microphone turns up you can introduce yourself before asking your question. Thank you very much.

Q&A session

Question 1

Ian Gordon, Investec

Can I have two please: one on mortgage intermediary channel; and one on costs. On the mortgages you've always talked a softly approach and I'm sure you'll tell us not to extrapolate your stunning one month debut performance. But can you just give me a little bit more granularity on firstly your expectations for the timing of the rollout of re-mortgage and buy-to-let products which will have not just a volume impact but obviously a margin mix impact? And then secondly coming back to the simple volume point do you not feel in the context of the performance you're already achieving without pricing particularly competitively that your £4bn medium term gross target is, shall I say, conservative?

Then, secondly on costs, thank you for the reduced guidance for 2015, can you just provide a little bit more breakdown on that; and in particular I wonder if there's an element of phasing or even reduction in investment spend at the branch network which personally you haven't told us it's that but I wouldn't find that offensive given the reduced footfall we're seeing across the industry through branches. Thanks.

Paul Pester

Okay let me try and answer that and I'll hand over to Darren on the cost points. So timing on our buy-to-let and re-mortgage entry; we've got very clear self-imposed gateways that we're going through in terms of customer service. One of the reasons I genuinely believe we've got off to a flying start is what we said when we were building the mortgage broker channel, about the importance of customer service, is what we're delivering. So, Ian, it's interesting that *Mortgage Strategy* magazine have already identified us as 'Lender of the Quarter' when we've only been going for a few weeks. And the citation for that award actually referenced our service to brokers - you know how brokers can speak to our underwriters etc. So what we will not do is sacrifice long-term sustainable growth at good margin in order to get those products out there quickly. That said, without giving you too much today, but when do I think we'll get there? Certainly within the first half would be our plan to be within the re-mortgage and buy-to-let and opening up to pretty much 100% of the market.

Your point about is £4bn still the right target; well we are, and I think I'm going to use your phrase completely, you know don't use four weeks or six weeks' worth of data to extrapolate for the next four to five years. We're delighted by the reaction but at this stage we're not changing our view that we'll build towards a steady state flow of around £4bn per year.

On costs I'll hand over to Darren on the detail but particularly your point on branches; we're still seeing customers use our branches. Undoubtedly customers are moving towards serving themselves digitally, it's why our investment in digital and mobile banking is so important to us. Our new mobile banking apps are being very heavily used across our customer base. But whilst customers continue to use our branches, and about 75% of our current accounts that we opened in 2014 were opened through branches, then we'll continue to support them.

Darren Pope

And with respect to cost guidance in 2015, to be really clear, there's not a cost reduction. What we're doing is we're growing into the cost base that we've got and we're growing as efficiently as we can. It's really, really critical that we don't prejudice the growth because the

growth is the single most important strategic feature of our business; and therefore with respect to investment spend and marketing spend we fully expect those to be at broadly the same level this year as we saw last year.

Question 2

Fiona Simpson, Morgan Stanley

Thank you very much for the presentation. Just a couple of questions on the opportunity for loan growth, I guess one to follow-up on the mortgages side. Obviously we talked a lot about the intermediary it also looks like you're making quite strong progress in the direct channel in terms of building up the market share. Is that something which we can expect to see continue to build higher as the recognition of the brand increases and so on and so forth? Or is that 2.2% market share getting to where you think that will be?

And then the second question on the unsecured lending, clearly it's not such a focus at the moment but I would just be interested in your comments on how you're thinking about the unsecured lending channel where, for example, your success in opening current accounts will enable you maybe to push harder on the unsecured going forwards. Any other sort of context on that?

Paul Pester

So we've been really pleased with our direct channel performance in mortgages. The combination of some of the great products we're coming up with, so the Fix and Flex mortgage, for instance, and the great work that our branch colleagues are doing in lifting the productivity of our mortgage advisers in branches has led to that increase in market share. We'll continue to focus on that. I don't think we'll see it materially moving above the 2.25%; it's supply driven as much as demand driven through the branches, but we will continue to focus on driving that up.

Through the unsecured lending as we build our current account market share that gives us the ability to provide more unsecured lending over time, but it is over time as the relationships with those customers develop and as we find the opportunities to speak to those customers.

Question 3

Joe Dickerson, Jefferies

I just have a couple of questions if I may? Could you give us your branch count as at the end of 2014? I didn't see it in the results.

And then secondly, there's an increase in operational risk weighted assets which you've guided to previously. Can you remind us how much of this, it's roughly about a billion inflation, how much of that increase is related to the TSA with Lloyds?

Paul Pester

So branches were in 600 centres right across the UK and about 631, or exactly 631 branches. Darren the point on RWAs

Darren Pope

Because it's a half year H1 to H2 analysis none. So there's been no change in our ICAP position. So all that happens there is we'd have a standardised operational risk rating system and that's a percentage approximately 15% of income; and we've just moved it from looking from an average of three years retrospective income to a prospective income. So that's all that's really changed there. There's no movement as a result of any assessment of our IT infrastructure.

Joe Dickerson

I recall at the time of the IPO that you had referenced that there was some operational risk inflation due to that technology arrangement. Am I mistaken on that front?

Paul Pester

There's no inflation. There's a static add-on to our capital base as a consequence of our linkage with Lloyds. But that is static. As the balance sheet grows it's a fixed amount of pounds. Obviously we can't tell you what it is but as it grows it will not grow with the balance sheet.

Question 4

Mike Trippitt, Numis

It may be in the detail, apologies if it is, at the time of the IPO you gave the actual balances, franchise balance split between direct and intermediary. Would you be able to update us on that at the end of '14, the actual balance sheet position?

Darren Pope

Yes let me do that. So we started the year with about £7bn I think as Paul said of mortgage intermediary balances and we ended the year I think at about £6bn of mortgage intermediary balances. So we lost about £1bn during the course of the year.

Mike Trippitt

Okay. And the billion and a half franchise target what's the intermediary/direct split on that for '15?

Darren Pope

We haven't guided on that but clearly given the initial progress that we've seen on intermediary I think it will be broadly proportionate.

Mike Trippitt

Okay. And I just wondered in your guidance, which is appreciated, 2015 on margin - the offset from lower deposit pricing are we done with that do you think in terms of where we are in the rate cycle; or is there more to come there?

Darren Pope

I think there may be bits and bobs to come; I think we've seen quite a lot - across the industry - of re-pricing. You can see when my average deposit cost is 77 basis points there is to some extent a natural limitation on how much more can be taken.

Question 5

Andrew Lowe, Berenberg

Could you talk a little bit more about the impact of the interchange fee cap? I understand that is being phased in in 2015 so the £15m impact is probably not full run rate; so where do you see that going in 2016 please?

Darren Pope

You're right it's being phased in. Remember the £15m guidance is a combination of factors the most material of which is interchange. So clearly, we're not guiding into '16, but clearly if it's being phased in during the course of the year the interchange element of that in '16 will be slightly bigger than the 15, but we're not giving specific guidance on that at this point in time.

Andrew Lowe

And has that phase-in already begun or how do you expect that to develop throughout the year?

Darren Pope

I think it will develop fairly smoothly throughout the period of the next twelve months.

Question 6

Chris Cant, Autonomous

I just wanted to ask about your branches. You said to a previous question you've got 631 at the end of the year; are you still expecting to open more branches or is that the cost save we're looking at going into '15?

And then a related point: your 8.4% share of current account flows is obviously comfortably ahead of your 6% target. I understand the importance of the branch network in achieving your strategy of building your deposit base and franchise around a current account relationship, but given that you're comfortably ahead of target does that mean that you have scope to cut branches and still achieve that target? If you could speak to that. Thanks.

Paul Pester

In terms of branches they're still clearly really important to customers. What we are seeing is roughly three quarters of the current accounts we opened in 2014 coming through branches. As you look at our network across the UK we definitely have some gaps particularly inside the M25. If we can find ways of putting a TSB physical presence particularly inside the M25 in the South East then we're doing that. We're in the process of looking for those locations. So I wouldn't see any material change in our branch footprint yet. It's only been 18 months that our customers have been using this TSB footprint. You'll know it was put together from Lloyds TSB Scotland, from Lloyds TSB, parts of England and Wales, and then from C&G; so

there's a building of our understanding of how customers are using the branches. At this stage we think branches have an important role to play.

From our point on 8.4% share of flow of PCAs, what they're really doing is enabling us to contemplate growing the asset side of the balance sheet quicker. We see the funding costs for us are those liabilities in the 77 basis points; it makes sense to us at this stage to keep growing that PCA market share at around sort of 6% plus. So we've no intention of winding down from that target or changing our branch network to support it.

Chris Cant

So just to follow on then so assuming you can continue to maintain an above 6% market share of flow are you saying that you would look to go beyond your 40 to 50% loan growth target?

Paul Pester

Well, it's ultimately if our current account market share is consistently returning 6% but if it's consistently way above then clearly we'll have excess liabilities and we'll find a way of deploying them.

Question 7

Ivan Jevremovic, UBS

Two questions please. The first one on costs on which the new guidance is very welcome. I was just wondering beyond 2015, I think it was at the IPO you guided to keeping costs within 3% growth per year, but even 3% seems a bit high so I was wondering if you could just talk to that in terms of your efficient growth strategy?

And the other question actually just following on from before do you have any comments to make about your approach to inorganic growth opportunities?

Paul Pester

On our costs we did guide at the IPO that once our cost base was built we would keep it at a growth of up to 3% excluding the change in our long-term servicing costs to Lloyds Banking Group. You know that our IT costs to Lloyds go up by about £100m in 2017 and we're still sticking to that sort of guidance. So within 3% growth but obviously from a lower base that we're talking about.

In terms of inorganic, we're here to grow. And the way that we're growing at the moment is through our organic growth strategy; we're delighted by the reaction of customers through both the liability side of our balance sheet, through current accounts and savings. And actually frankly on the asset side of the balance sheet as we're growing into the intermediary space. That said we have the infrastructure, you know we have the excess liabilities, you know we have the funding so we will be out there and we'll look at opportunities as they come along. If they're the right assets at the right price and they create value for our shareholders then obviously we'll look at them.

Concluding comments: Paul Pester

It sounds like we're dried up on questions which is good. Any other questions coming? If not I think we're going to pretty much wrap up. Last opportunity?

Thanks for coming today. It's been a fantastic opportunity to talk to you about the progress we've made in establishing TSB as Britain's challenger bank. What messages would I leave you with? I would leave you with the fact that we've made great progress in establishing or starting certainly to establish TSB in terms of our ability to grow liabilities at a very reasonable or low cost; our ability to deploy those liabilities particularly through our own direct channels but through the mortgage broker channel; and differentiating TSB brand positioning and making TSB Britain's challenger bank.

So thank you for coming today. Any further questions please come in through our investor relations team. Thank you very much.