Strong asset growth fuelled by the mortgage brokerage platform and the acquisition of the UKAR portfolio.

Overview

The TSB franchise (TSB Banking Group PLC), which was acquired by the group in June 2015, engages in retail banking in the United Kingdom, including current and savings accounts, personal loans, cards and mortgages.

TSB has a nationwide multichannel distribution model including 614 branches in England, Wales and Scotland. At the end of the year, it had 4.8 million customers and 8,224 employees.

Its business is divided into two distinct segments: franchise comprises the multichannel commercial banking business, and Mortgage Enhancement comprises the mortgage loan book that was spun off to TSB in the context of the Lloyds restructuring and is designed to enhance profitability by over £230 million.

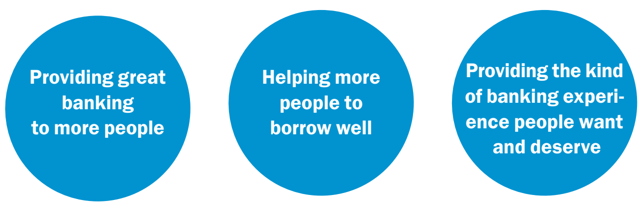
In December 2015, TSB acquired a portfolio of ex-Northern Rock mortgages (UKAR portfolio) from Cerberus.

Key developments in 2015

Line of business

The year 2015 was a significant one for TSB: it achieved organic growth in customer numbers and the balance sheet in excess of its objectives, acquired over £3,000 million in mortgages and joined the Banco Sabadell group.

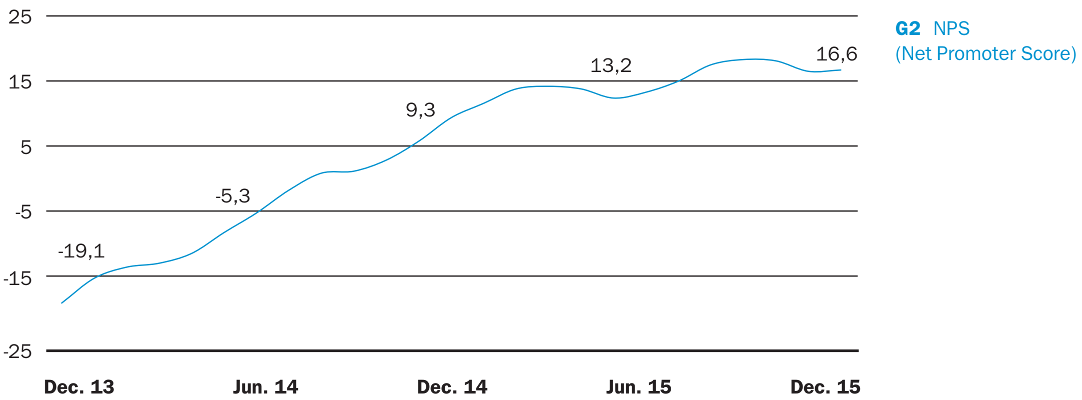
G1 TSB strategy



Based on TSB's three main strategy lines (G1), which were launched in 2013, it achieved the following results in 2015:

- 6.8% of all customers who opened a new current account or switched banks in the UK in 2015 chose TSB, resulting in eight consecutive quarters in which it beat its 6% target (source: CACI Current and Savings Account Market Database—CSDB—which includes current, packaged, youth, student and basic bank accounts, and new account openings excluding account upgrades; data presented on a 2 month lag).
- Take-up of the new '555' Classic Plus current account maintained its momentum.
- The mortgage brokerage platform boosted asset growth.
- £4.8 billion of mortgage granted.
- Growth in Franchise lending of £2.3 billion was ahead of the £1.5 billion planned for 2015, following the successful launch of the mortgage broker service in January 2015.
- Additional growth in lending following acquisition of the UKAR portfolio.
- More people than ever before are willing to recommend TSB: the NPS (Net Promoter Score) increased to 17 in 2015, from 9 at the beginning of the year (G2).
- Best high street bank for customer service (TSB ranked joint best high street bank for customer service, according to Which? magazine).

Excellent market perception of TSB's business model.



Note: NPS is based on the question “On a scale of 0-10, where 0 is not at all likely and 10 is extremely likely, how likely is it that you would recommend TSB to a friend or colleague?” NPS is the percentage of TSB customers who score 9-10 after subtracting the percentage who score 0-6.

In 2015, TSB expanded lending due to good sales dynamics; its funding sources hinge basically on growing and successfully diversifying customer deposits.

Most of the growth in customer deposits was in current accounts, due to successful take-up of the 'Classic Plus' account.

Also, on 12 November, TSB completed its first residential mortgage backed securitisation. This transaction raised £537 million, and TSB has retained £1,362 million of AAA/Aaa rated notes on the balance sheet.

TSB maintains a very sound capital position, with a core equity Tier 1 ratio of 17.9%. The decline in the year primarily reflects the acquisition of the ex-Northern Rock loans, growth in lending, and the migration of the overdraft and credit card portfolios to an internal ratings based method.

Results

TSB reported £67.6 million in profit before taxes, a decrease of 20.9%, largely reflecting volume growth, the run-off of the Mortgage Enhancement portfolio, lower fee income on bank accounts, and lower interchange rates, as expected.

As for net interest margins, the average rate earned on loans declined from 3.89% to 3.76%, while the average rate on mortgages fell from 2.74% to 2.70%. The cost of customer deposits decreased by 14 basis points, reflecting basically the run-off of historic fixed-rate business at higher pay rates and the change in mix in savings and current account balances.

Other income decreased, as expected, reflecting the effect of market reforms on interchange fee income and lower income from added value current accounts, which remain available only through the digital channel.

Operating expenses increased in 2015 as a result of higher investment, driven by development costs to enable personal loans to be offered to non-Franchise customers, and costs and an increase in the headcount. Expenses also rose due to the costs related to the Sabadell acquisition of TSB and other business restructuring costs, including branch co-locations.

Provisioning was lower than in 2014; specifically, reserves for unsecured personal loans declined, partly as a result of good economic performance, better asset quality and the fact that several extraordinary charges were booked under this heading in 2014.

TSB results during the 6 months in which it formed part of the group are shown in table T7.

T7 United Kingdom

€ million

	2014	2015	% 15/14
Net interest income		**539.62**	**—**
Fees and commissions (net)		78.83	—
Other income		(3.72)	—
Gross income		**614.73**	**—**
Operating expenses		(493.57)	—
Operating profit/(loss)		**121.16**	**—**
Provisioning expense (net)		—	—
Impairment losses		(59.50)	—
Other profit/(loss)		—	—
Profit/(loss) before tax		**61.66**	**—**
Ratios (%)			
ROE (profit/average shareholders' equity)		5.3	
Cost:income (general administrative expenses/ gross income)		77.9	
Loan loss ratio		0.6	
Loan loss coverage ratio		44.8	
Business volumes			
Loans and advances		36,062	
Customer funds		40,699	
Other information			
Employees		8,224	
Branches		614	

The group acquired control of TSB Banking Group PLC on 30 June 2015, with the result that only six months' results are included.
Sterling exchange rates of 0.7340 applied to the balance sheet and 0.7201 to the income statement (average of last six months). Accounting own funds used for the purposes of ROE.