

# Annual Results Presentation

Year ended 4 April 2010

Graham Beale  
Chief Executive

Mark Rennison  
Group Finance Director

## Agenda

- Review of Business Performance & Strategy - Graham Beale
- Financial Results - Mark Rennison
  - ▶ Results Summary
  - ▶ Asset Quality
  - ▶ Liquidity & Funding
  - ▶ Capital
- Outlook - Graham Beale
- Q&As

# Resilient Performance

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- Difficult trading conditions
  - ▶ Principal markets contracted
  - ▶ Economic recession
  
- Underlying pre-provisioning profit of £811m (2009: £846m)
  - ▶ Stable income performance
  
- Underlying profit of £212m (2009: £393m)
  - ▶ Proactive margin management
  - ▶ Increased impairment charges
  
- Pre-tax profit of £341m (2009: £190m)
  - ▶ Revised phasing of FSCS levies consistent with industry practice
  - ▶ FV adjustments
  - ▶ Transformation costs

# Strength of Balance Sheet

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## ■ Strong capital base

▶ Core Tier 1 ratio	12.2%
▶ Tier 1 ratio	15.3%
▶ Total capital	19.4%

## ■ Core Liquidity ratio

▶ Increased	13.8%
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## ■ Wholesale funding

▶ Sterling equivalent	£8.5bn
▶ Funding ratio	27.8%
▶ ST:LT	50%:50%

## ■ Asset quality

▶ Residential arrears	0.68%
▶ LTV new loans	63%
▶ LTV indexed stock	48%

# Retail Highlights

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## ■ Savings and Investments

- ▶ 60% increase in sales of protection & investment products
- ▶ Market leading & innovative products - Champion Saver
- ▶ Fair ISAs
- ▶ Protected Equity Bonds - £1.2bn

## ■ Borrowers

- ▶ BMR guarantee - £450m
- ▶ Waiver of tracker floor - £100m
- ▶ FTB - discounts and LTV incentives

## ■ Consumer banking

- ▶ Loyalty benefits for prime current accounts
- ▶ Positive order of payments

## ■ General insurance

- ▶ Home and motor Defaqto 5 Star

# Strategy

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- UK's leading mutual financial services provider
  - ▶ Long term good value customer proposition
  - ▶ Encourage broader and deeper customer relationships
  - ▶ Focused distribution of value
  
- Optimise profit
  - ▶ Maintain prudent balance sheet
  - ▶ Allow investment for the future
  
- Diversify business mix & reduce reliance on margin income
  - ▶ Extend capability & market presence in non mortgage and savings markets
  - ▶ New current account products - 2011/12
  - ▶ New internet bank - 2011/12
  
- Commitment to cost efficiency & customer service
  - ▶ Medium term target CIR 50% - 2012/13
  - ▶ Significant investment in replacement of core legacy systems

**Mark Rennison**

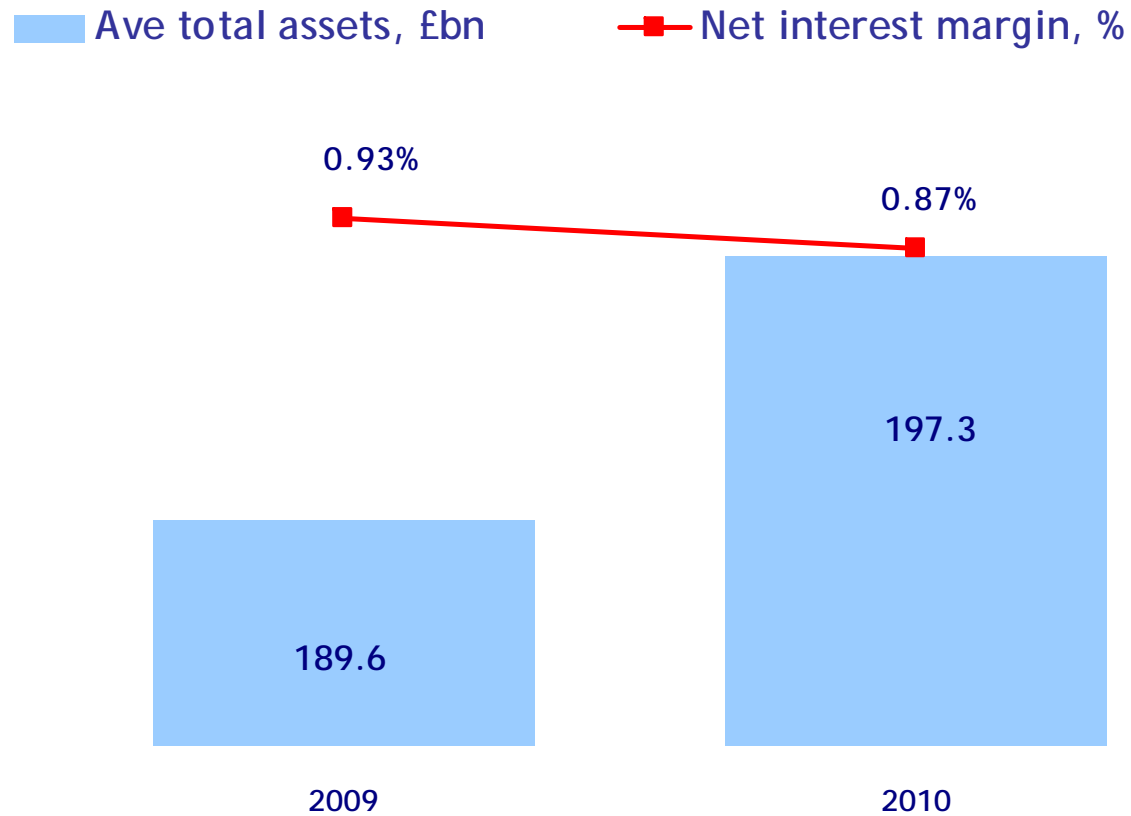
**Group Finance Director**

# Income Statement

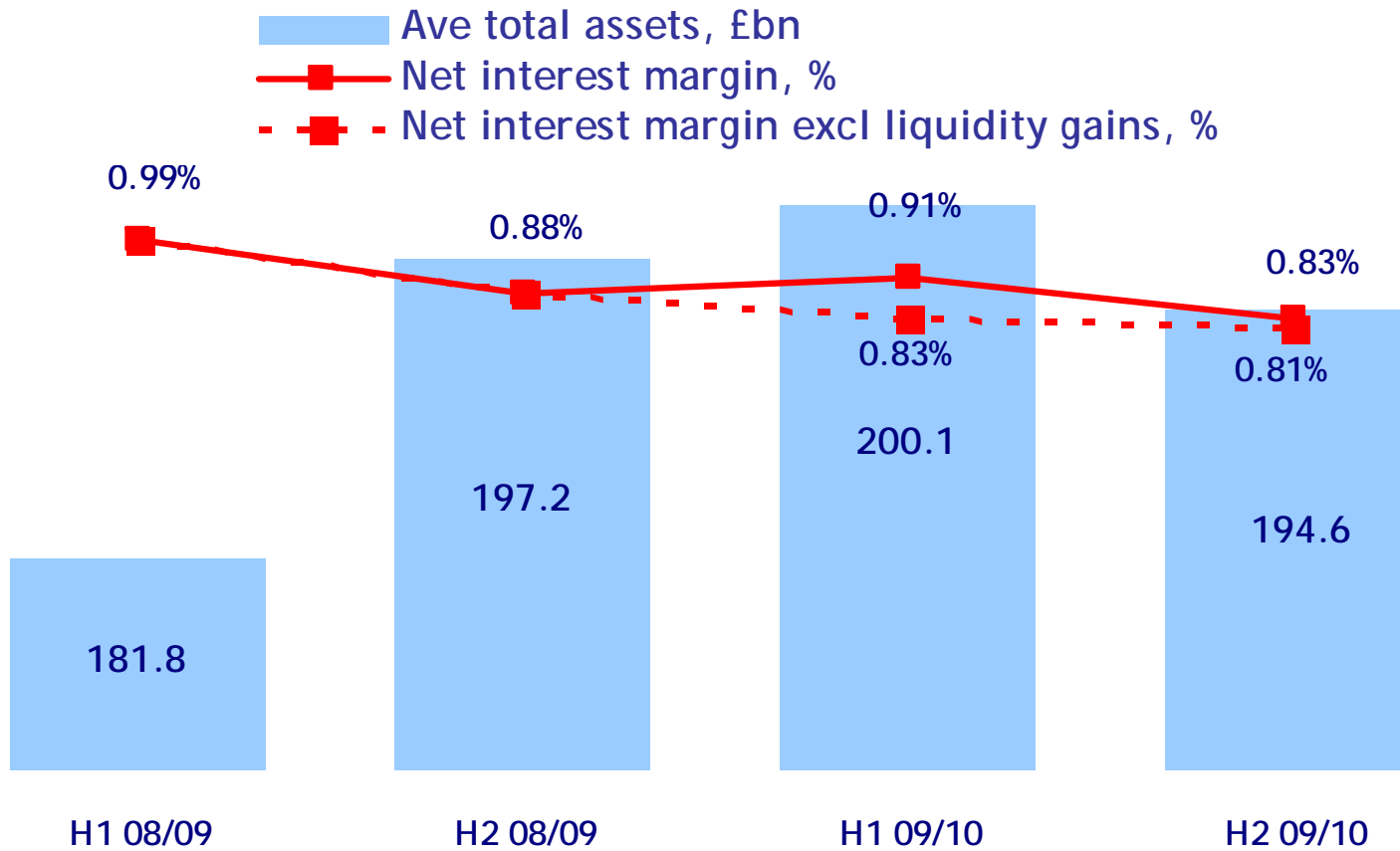
£m	2009	2010	
Total income	2,117	2,095	↓ 1%
Expenses	(1,271)	(1,284)	↑ 1%
Underlying pre-provisioning profit	846	811	↓ 4%
Impairment and other provisions	(453)	(599)	
Underlying profit before tax	393	212	↓ 46%
Transformation costs	(107)	(62)	
Gains on business combinations	135	40	
Other adjustments	10	34	
FSCS costs	(241)	117	
Reported profit before tax	190	341	↑ 79%

# Net Interest Margin

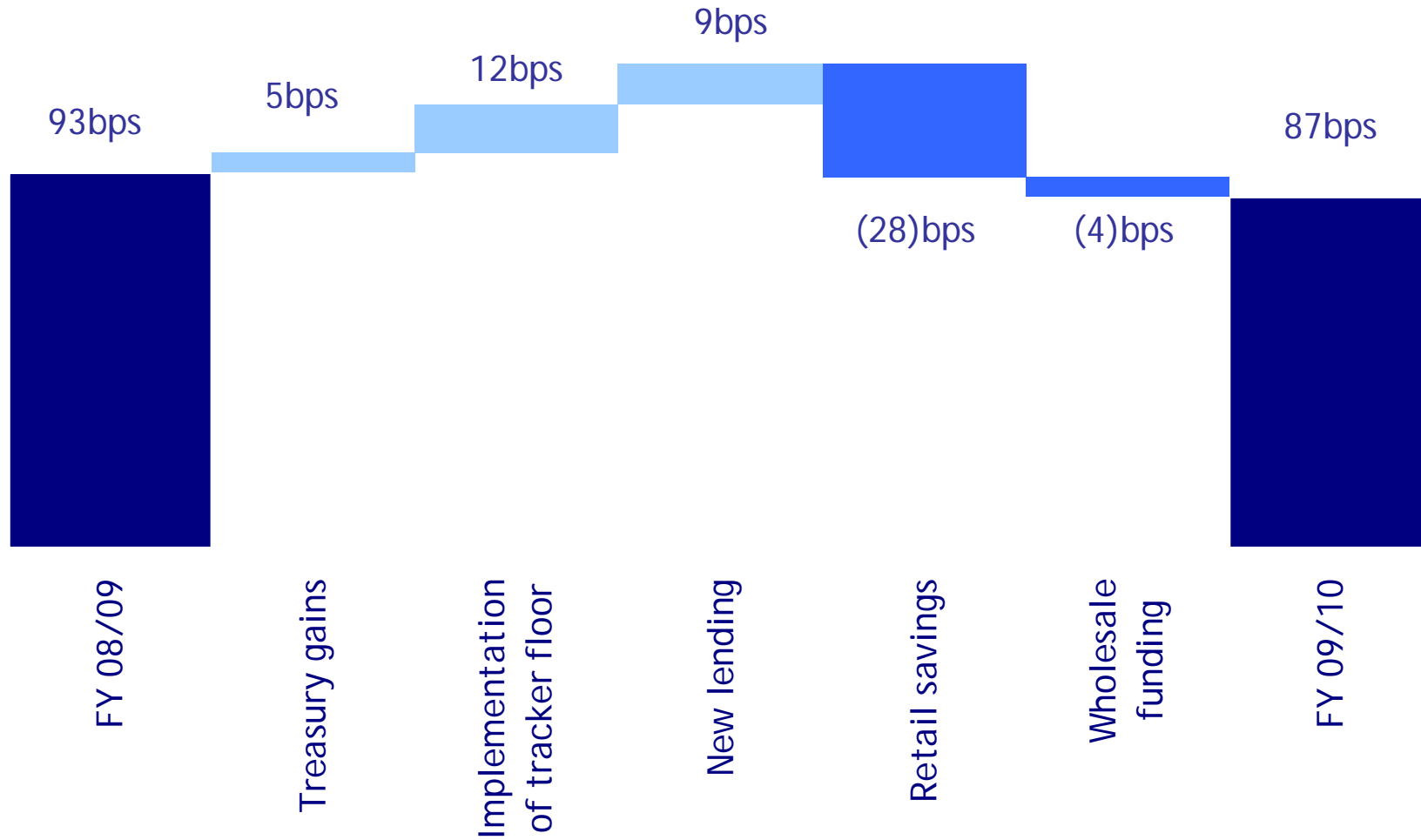
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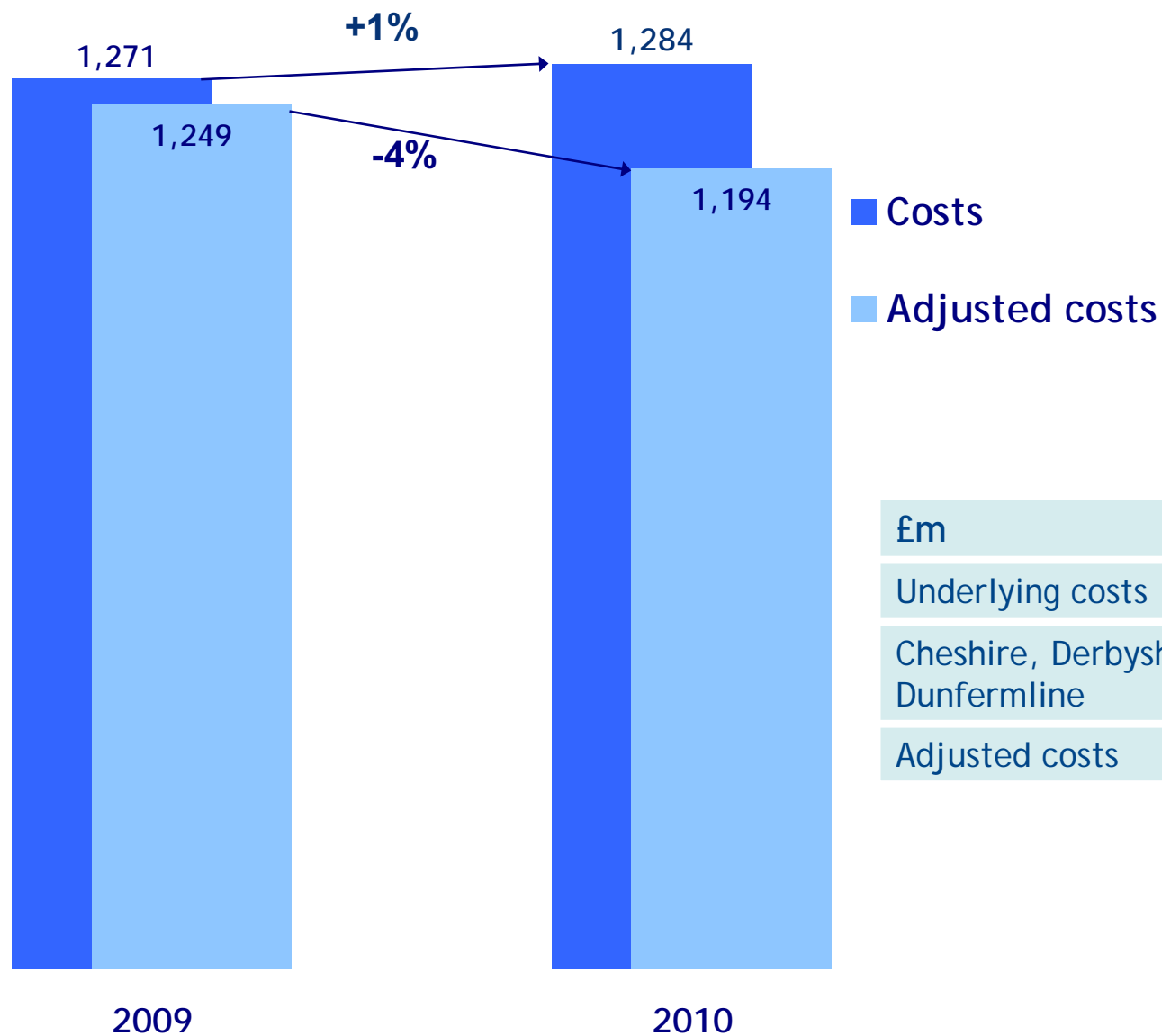
# Net Interest Margin



# Net Interest Margin

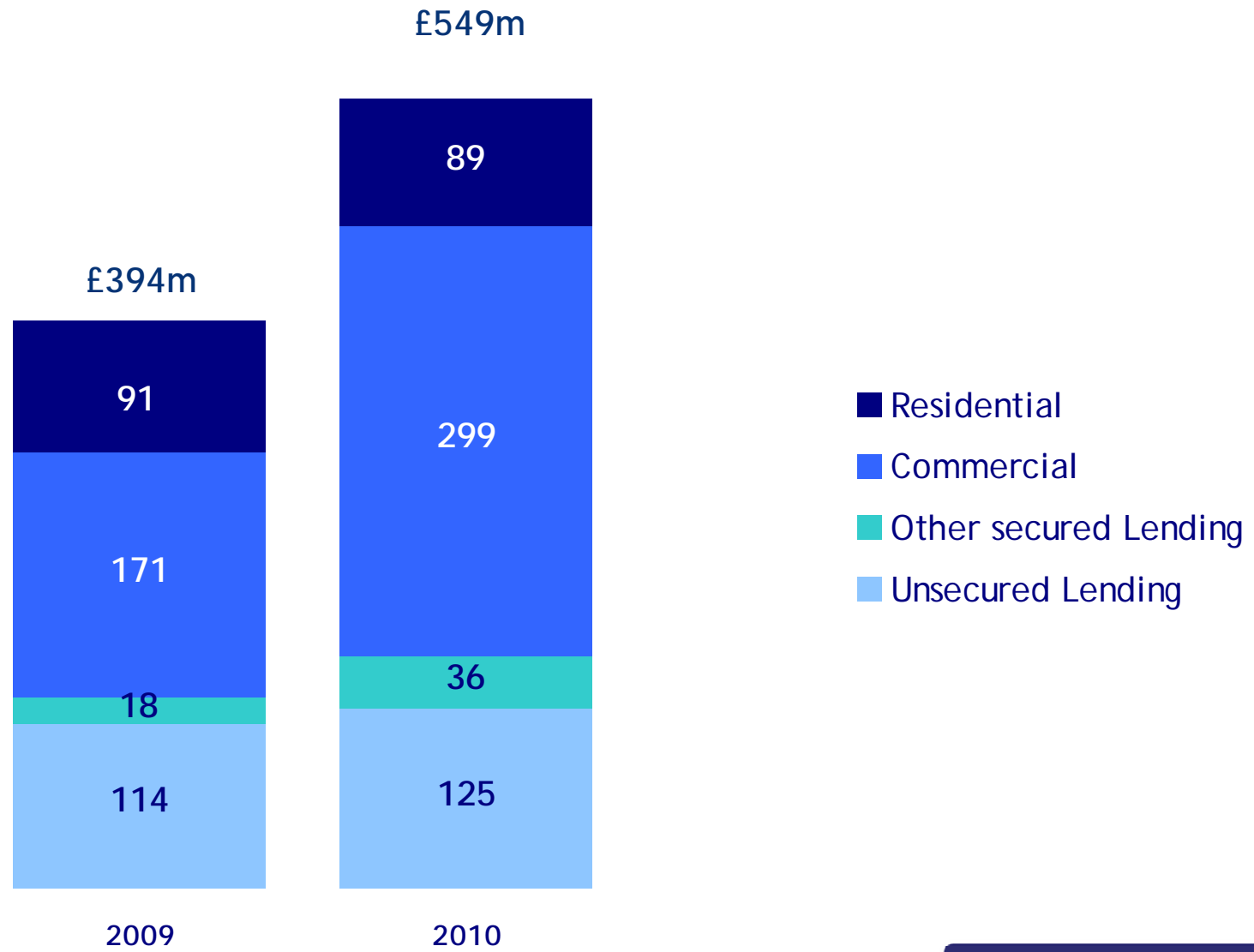


# Expenses

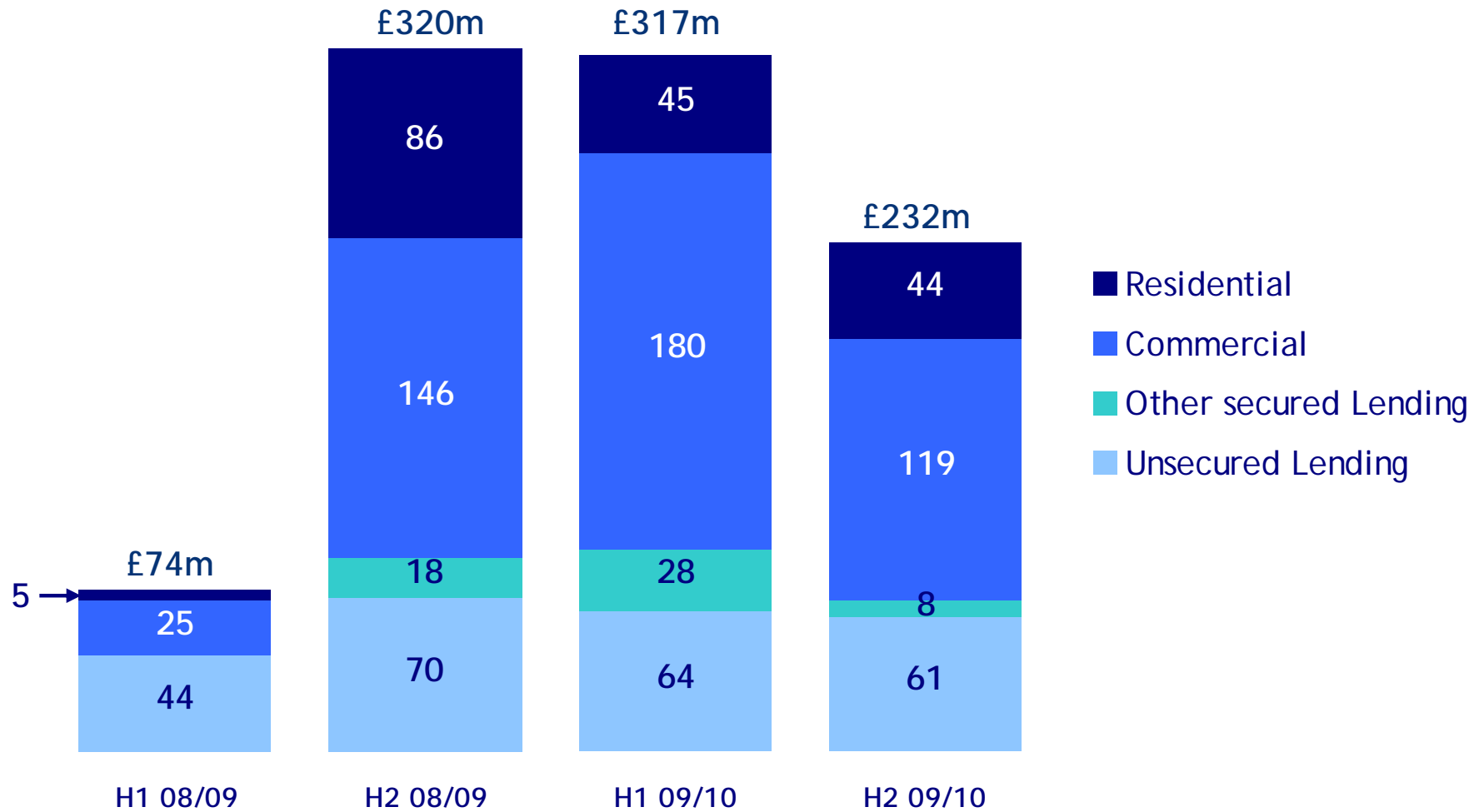


£m	2009	2010	
Underlying costs	1,271	1,284	↑ 1%
Cheshire, Derbyshire & Dunfermline	(22)	(90)	
Adjusted costs	1,249	1,194	↓ 4%

# Loan Impairments By Full Year



# Loan Impairments By Half Year

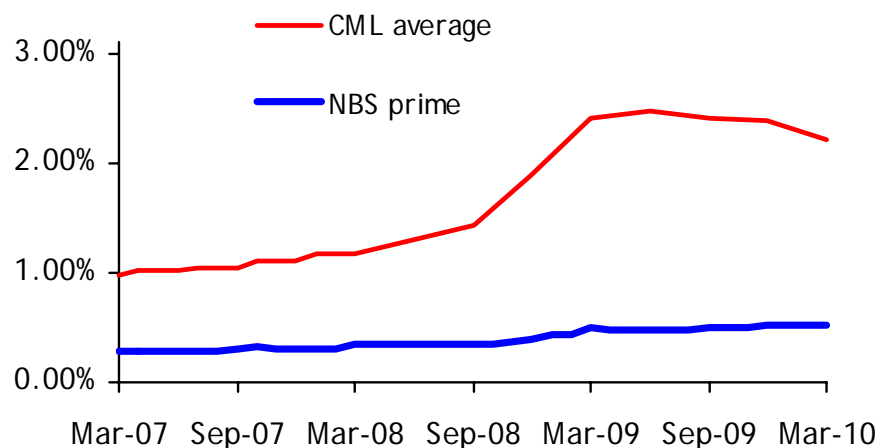


# Retail - Mortgage Asset Quality

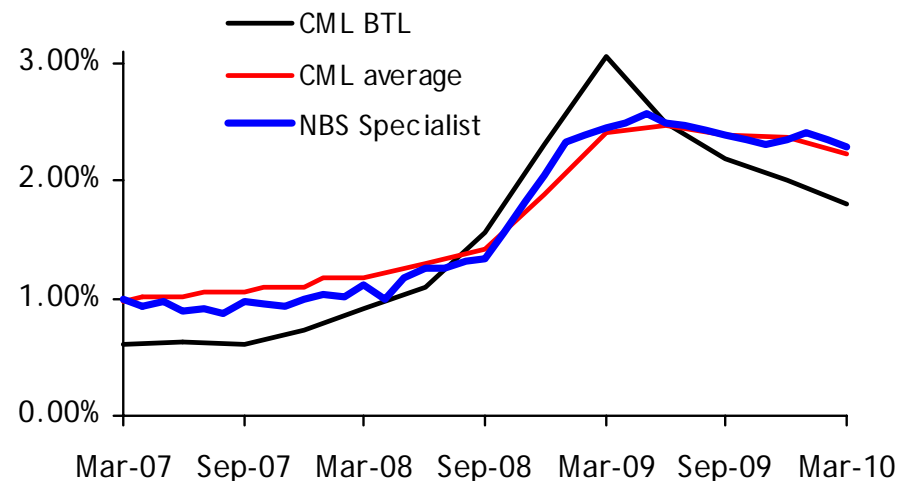
PRIME	April 09	April 10
Total balance	£111.9bn	£108.7bn
Balance as % Total loans & advances	72.1%	71.3%
Balance of 3m+ arrears	£502m	£565m
Balance of 3m+ arrears cases with >100% LTV	£92m	£64m

SPECIALIST	April 09	April 10
Total balance	£18.2bn	£18.7bn
Balance as % Total loans & advances	11.7%	12.2%
Balance of 3m+ arrears	£1,095m	£1,006m
Balance of 3m+ arrears cases with >100% LTV	£402m	£213m

Proportion of prime mortgage arrears (3mth+)



Proportion of specialist mortgage arrears (3mth+)



## Retail - Unsecured Lending

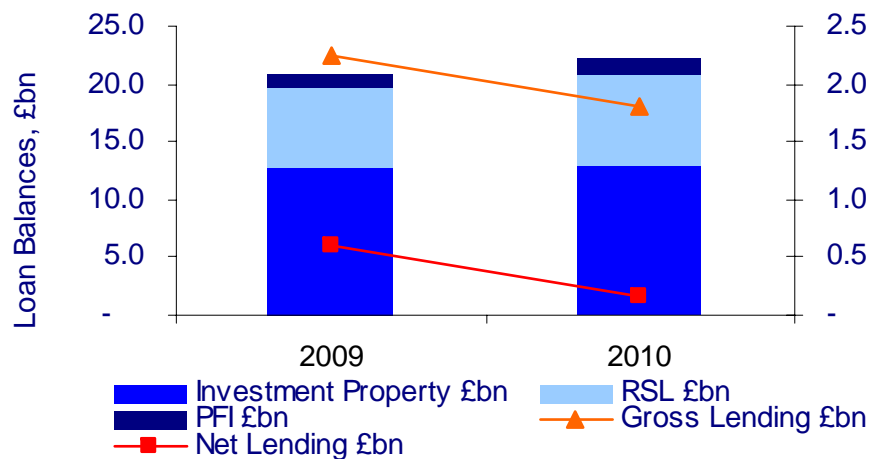
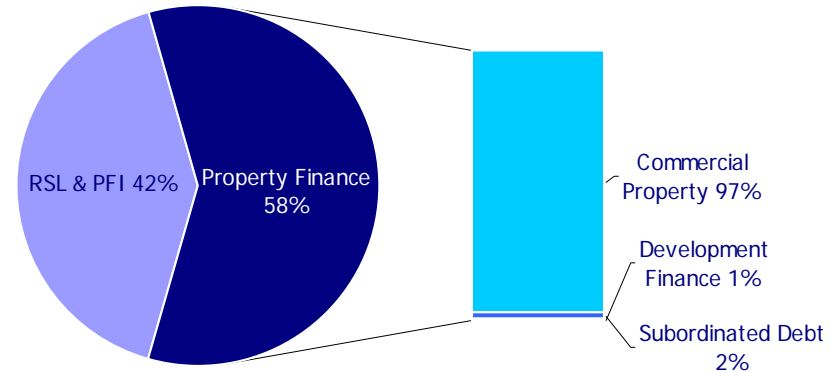
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Percentage of accounts more than 30 days in arrears	April 09	April 10
Personal Loans	7.15%	7.07%
Industry Average (FLA)	15.8%	19.6%
Credit Card	5.70%	5.15%
Industry Average (exc. LPA cases)	8.06%	6.64%

- Significantly better than industry average
- Balance of accounts more than 30 days in arrears has remained broadly static

# Commercial Lending

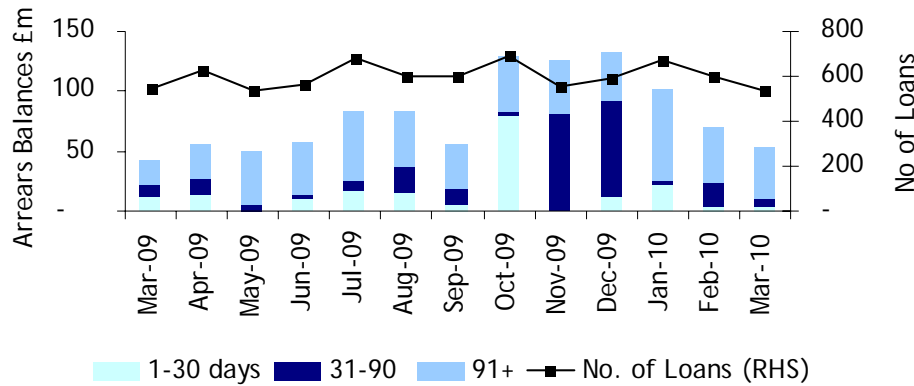
- Commercial portfolio of £22.2bn
- No exposure to housebuilders
- No equity exposures
- No unsecured business loans
- Very limited exposure to subordinated debt and development finance



- Lending criteria remains strict but open to selective new lending

# Commercial Lending

Arrears Balances Trend



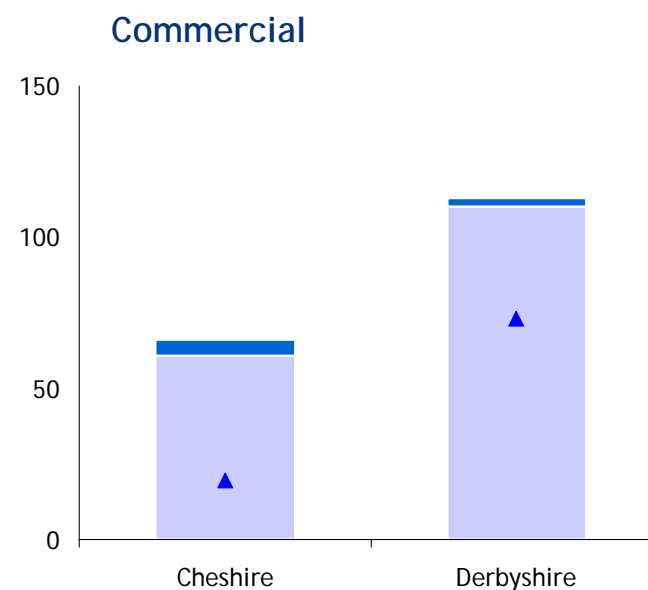
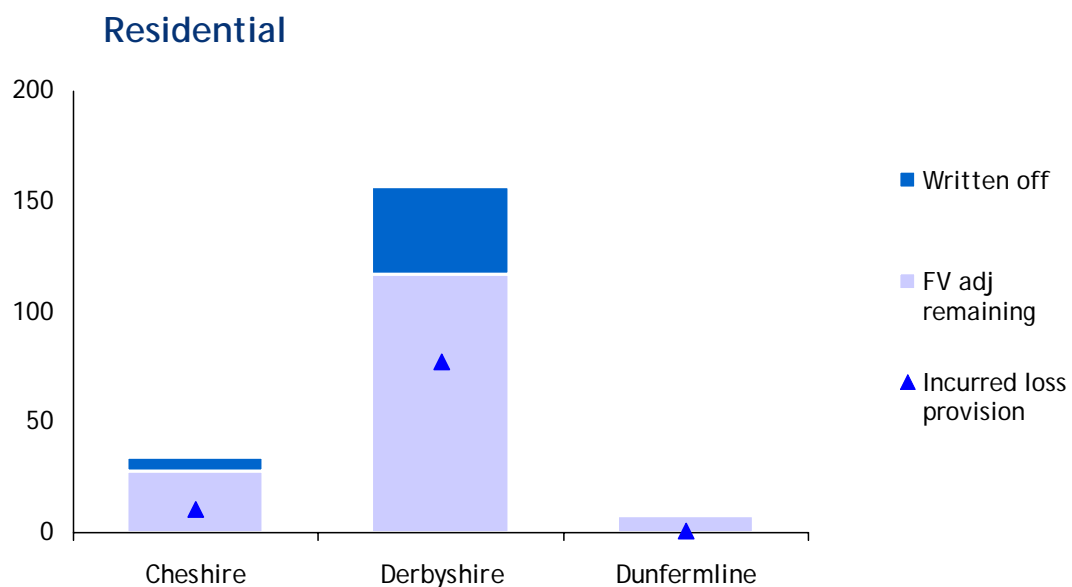
Commercial Property Finance Portfolio

Provision Cover	Subordinated £m	Non Subordinated £m	Total £m
Provision	88	324	412*
Balance	197	12,236	12,433
Provision Cover %	44.7%	2.65%	3.31%

- Prudent impairment charge of £299m (2009: £171m)
- But some Positive signs now emerging:
  - ▶ Arrears stable for last three quarters
  - ▶ Impairments 34% lower in H2 2009/10
  - ▶ IPD index reporting capital growth of 13% since July 2009
- Cautious outlook with the recovery still exposed to weak tenant demand and interest rate rises

# Regional Brands

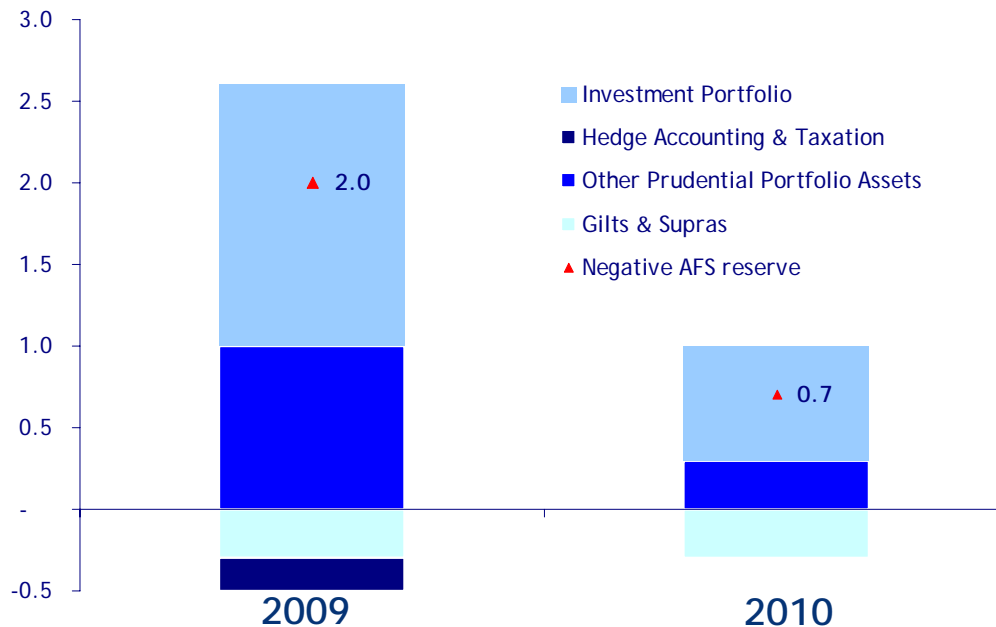
	Gross balances £m	Credit fair value adjustment £m	Amount written off £m	Credit fair value remaining £m	Credit fair value remaining as % of assets
Residential	7,675	199	49	150	1.95%
Commercial	1,537	179	14	165	10.74%
<b>Total</b>	<b>9,212</b>	<b>378</b>	<b>63</b>	<b>315</b>	<b>3.42%</b>



# Treasury

- Treasury asset portfolio of £29.4bn (2009: £34.5bn)
  - ▶ Prudential portfolio £25.7bn
  - ▶ Investment portfolio £3.7bn
  
- 75% rated AAA, 84% rated AA or above, 97% rated A or above
  
- No direct sovereign exposures to impacted Eurozone countries
  - ▶ 99% of secured exposure rated AAA or AA
  - ▶ 85% of unsecured exposure rated A or above

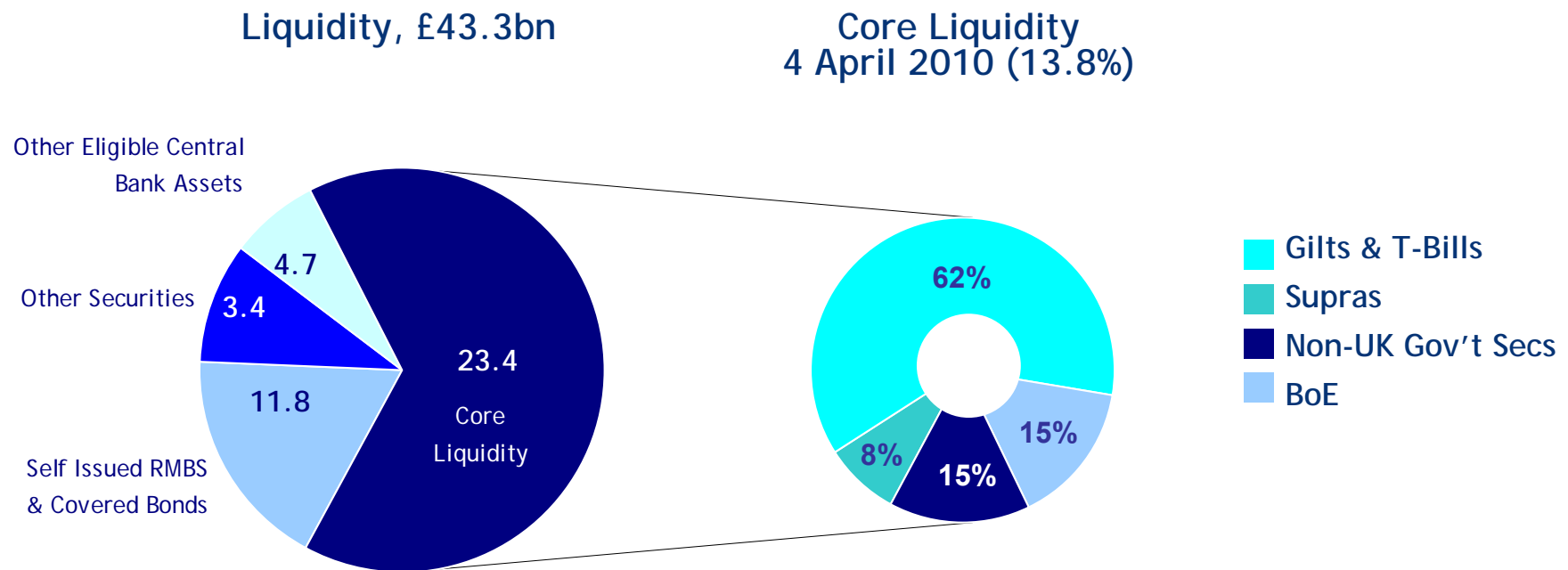
Available for Sale Reserve, £bn



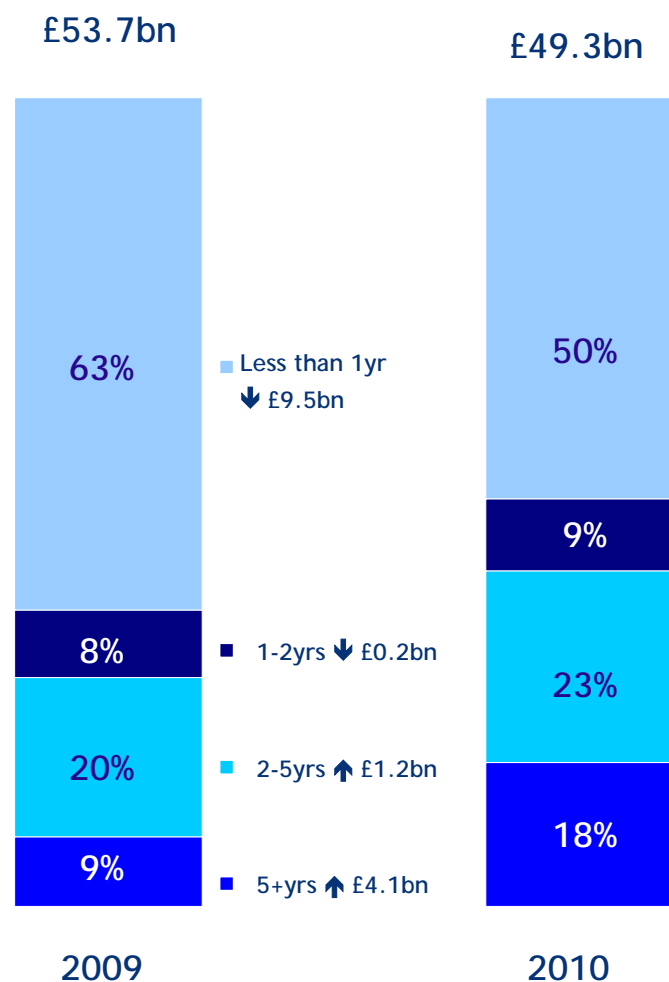
- Market values have improved since 2009 reflecting improved sentiment in global credit markets
  
- Total mark to market deficit on available for sale assets portfolio (£23.4bn) improved by £1.3bn to £0.7bn

# Liquidity

- Significant liquidity holdings of £43.3bn which includes unencumbered self-issuance
- Core Liquidity ratio is 13.8% (2009: 12.8%), all rated AAA
- 100% of the £23.4bn core liquidity portfolio is eligible collateral for narrow BoE operations or reserves held at the BoE
- Compliance with new liquidity risk management framework has been a key priority

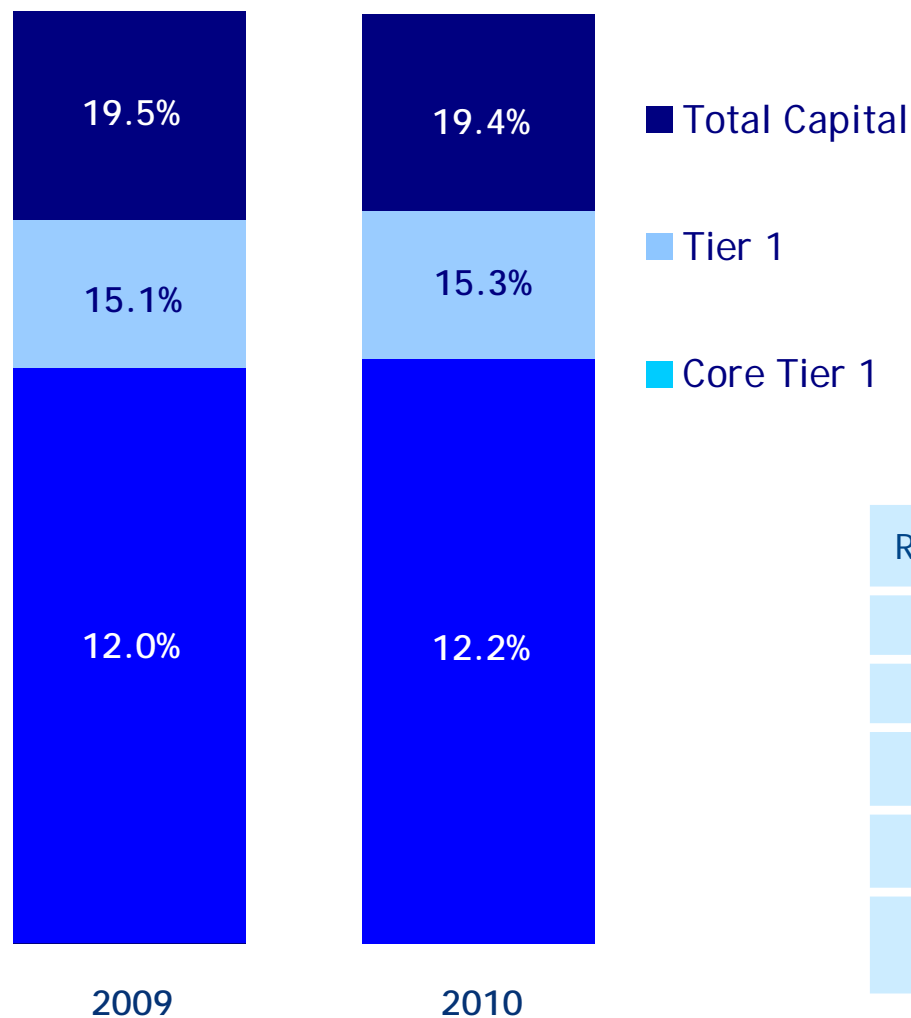


# Funding



- £8.5bn equivalent of long term issuance in 2009/10 relative to £4bn maturing term debt
  - ▶ Includes £2.8bn equivalent of senior unsecured funding across €, \$ and £
- Significant reduction of short term funding
  - ▶ Average short term funding at issuance 155 days (2009: 125 days)
- Improvement in ST:LT ratio to 50:50 (2009: 63:37)
- Average residual maturity of wholesale funding increased from 21 to 26 months
- Only £1.8bn equivalent of maturing wholesale term debt for 2010/11

# Capital & Solvency



	2009 IRB	2010 IRB
Risk Weighted Assets	£49.8bn	£50.1bn
Core Tier 1 Capital	£6.0bn	£6.1bn
PIBs	£1.5bn	£1.5bn
Tier 2 Capital	£2.2bn	£2.1bn
Total Capital	£9.7bn	£9.7bn
Core Tier 1 as % of Total Capital	62%	63%

# Capital Developments

	CP09/29	CRD 2/3	CP27	CRD 4*	CP164*
2010	2011			2012	
QIS - July 2010	Re-definition of capital			Going/gone concern capital	
	Counter-cyclical capital			All deductions from Core Tier 1	
	Increased disclosure			Dynamic provisioning	
				Cyclical LTV limits	
				Leverage Ratio	

## ■ Potential Impacts 2010/11

- ▶ Lack of Core Tier 1 instrument with adequate loss absorbency that is equivalent to ordinary share
- ▶ Hybrid capital instrument (PIBS) “grandfathered” for up to 30 years
- ▶ Coupons - mutuals exemption for caps (dependent on national law)
- ▶ Changes to capital limits

# Graham Beale

Chief Executive

# Outlook

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- Weak economic conditions to continue
  - ▶ Slow pace of growth
  - ▶ Public sector redundancies
  - ▶ Fiscal tightening
  
- Lower levels of profitability throughout 2010/11
  - ▶ Consistent with last 18 months
  
- Commercial property sector
  - ▶ Exposed to weak tenant demand
  
- Residential property sector
  - ▶ Broadly stable
  - ▶ Low single digit growth
  - ▶ Limited upside/downside

# Outlook

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- Resilient performance in difficult market conditions
  - ▶ Proven capability
  
- Response to market conditions
  - ▶ Increase income diversification
  - ▶ New internet bank and current accounts
  - ▶ Tight cost control
  - ▶ High levels of customer service
  - ▶ Focused delivery of value
  
- Maintain robust balance sheet
  - ▶ Core Tier 1 12.2% vs. peer group average 9.4%
  - ▶ Strong retail and wholesale funding capacity
  - ▶ High Core liquidity - 13.8%
  - ▶ Strong asset quality
  
- Medium term return to normalised interest rates
  - ▶ Strong upturn in Group profitability

# Annual Results Presentation

Year ended 4 April 2010

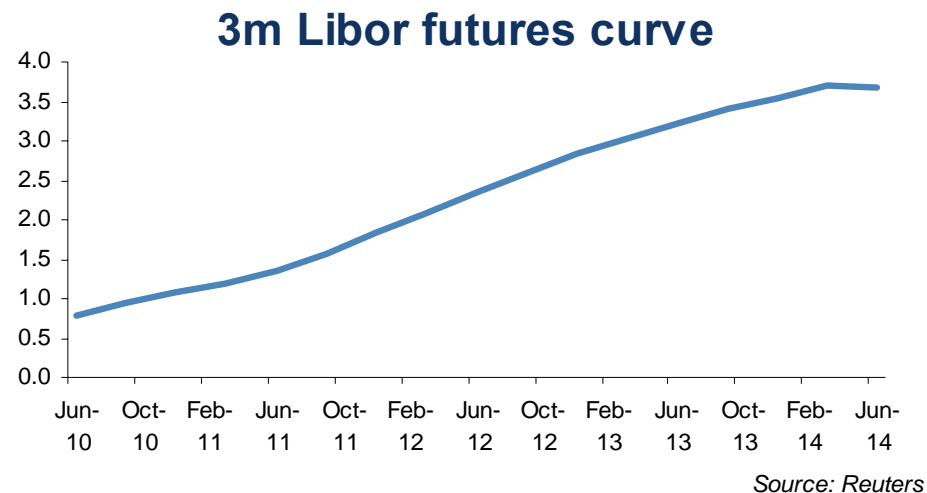
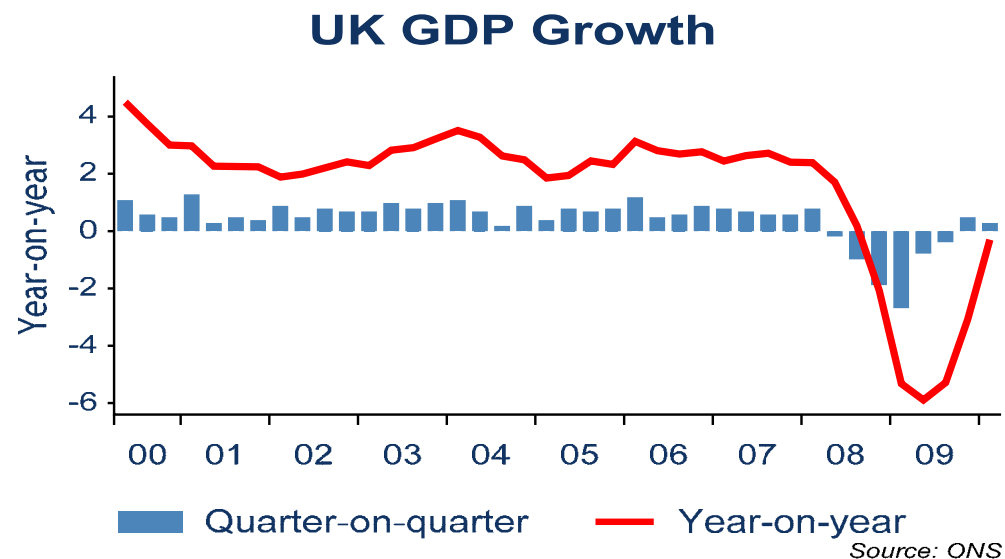
Graham Beale  
Chief Executive

Mark Rennison  
Group Finance Director

# Appendices

# Macroeconomic and interest rate outlook

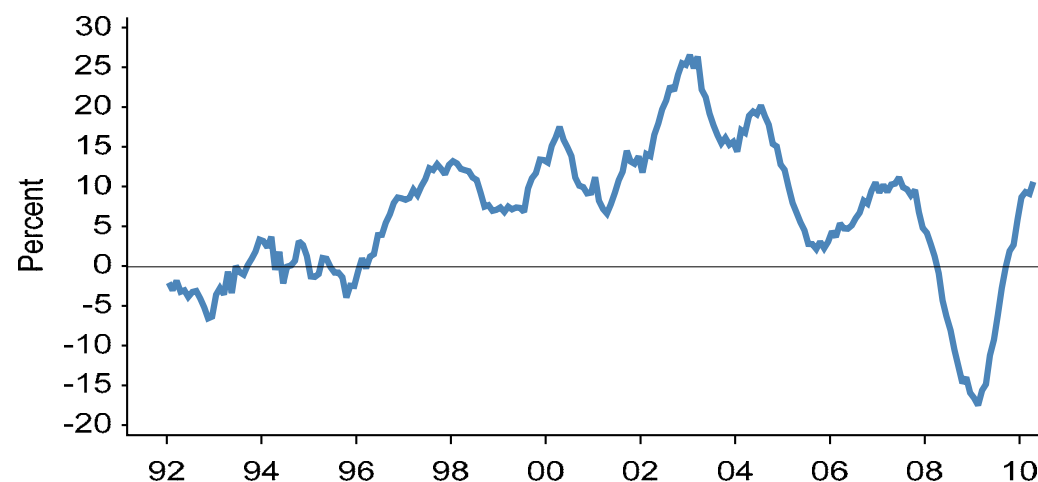
- UK economy has returned to growth but recovery will be slowed by post-election fiscal austerity measures
- Inflation is above target but MPC has remained dovish on the medium term inflation outlook
- Interest rate normalisation is likely to be slow to occur as loose monetary policy offsets fiscal tightening



# Housing Market Update

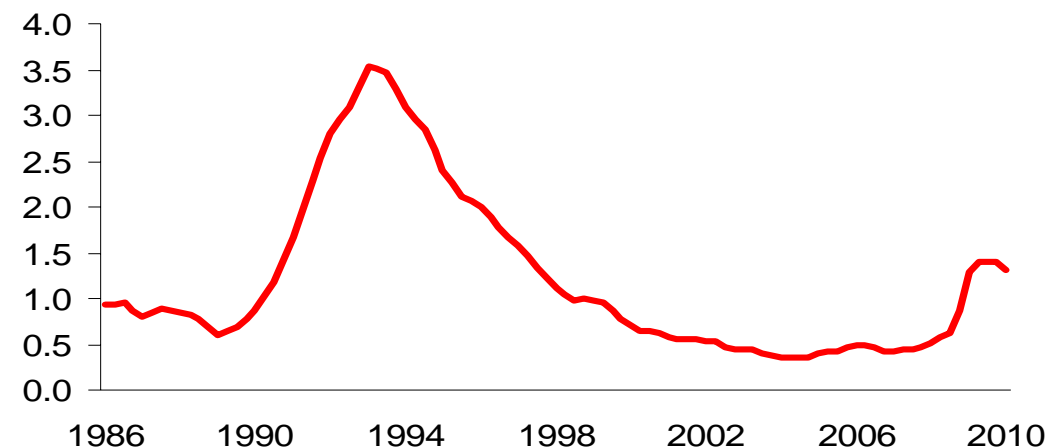
- UK house prices are up 10.5% year-on-year
- Prices are still 10.0% below the October 2007 peak but have recovered nearly half the value lost in the downturn
- Housing market remains characterised by thin transaction volumes due to tight credit conditions and a limited supply of homes for sale
- Arrears levels remain well below the early 1990s peak due to record low interest rates

## UK house price inflation



Source: Nationwide

## 6m+ mortgage arrears



Source: CML

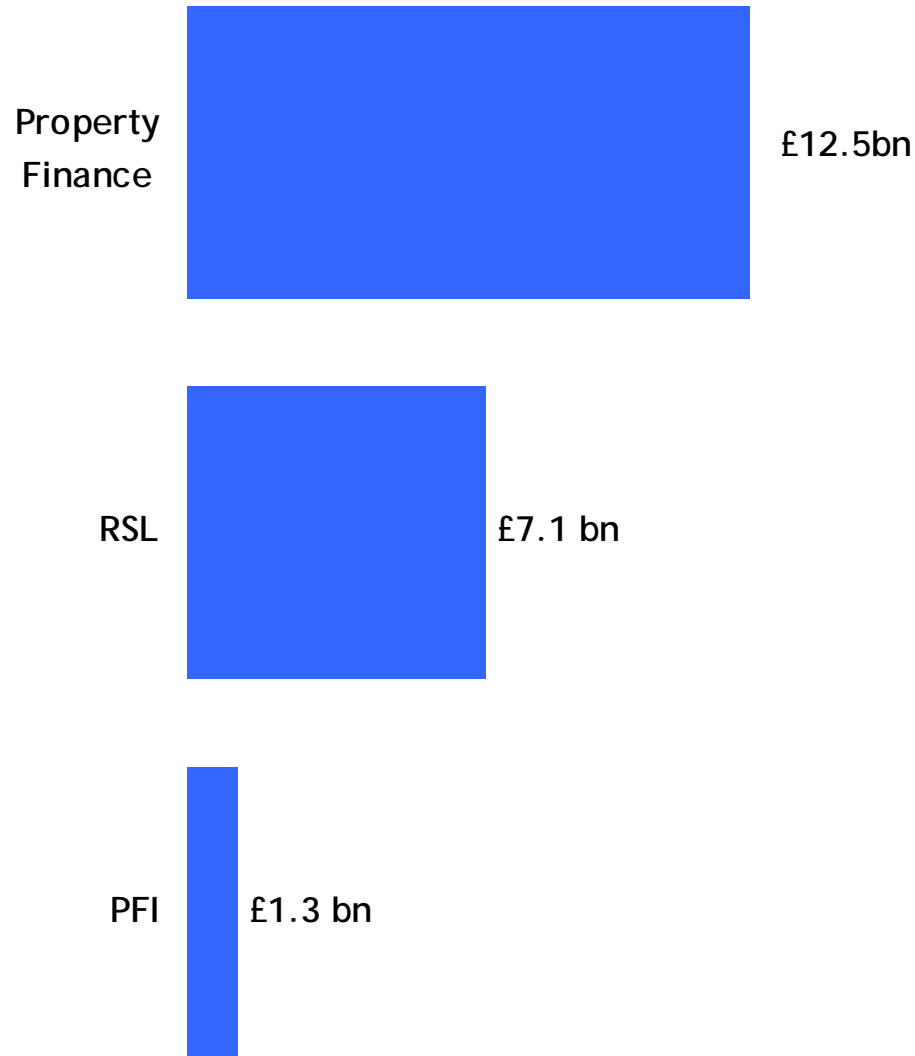
# Housing Market Outlook

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- Recent months have shown slower price increases as some sellers have returned to the market amid relatively muted demand
- The most likely outcome for the rest of 2010 is a flattening out of house price inflation within a relatively thin market
- A double-dip in prices appears unlikely at the moment as low interest rates continue to limit the supply of mortgage arrears and distressed sales

# Commercial Lending

## Total Assets of £20.9 bn

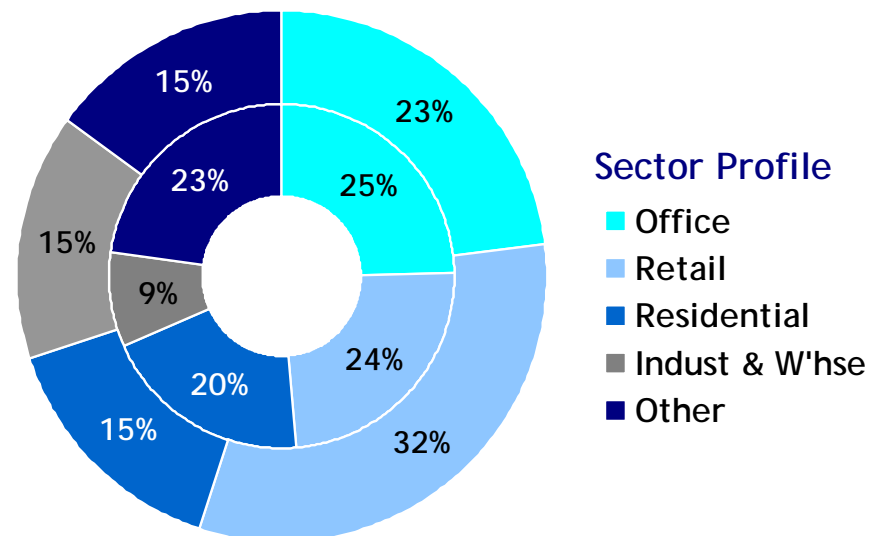
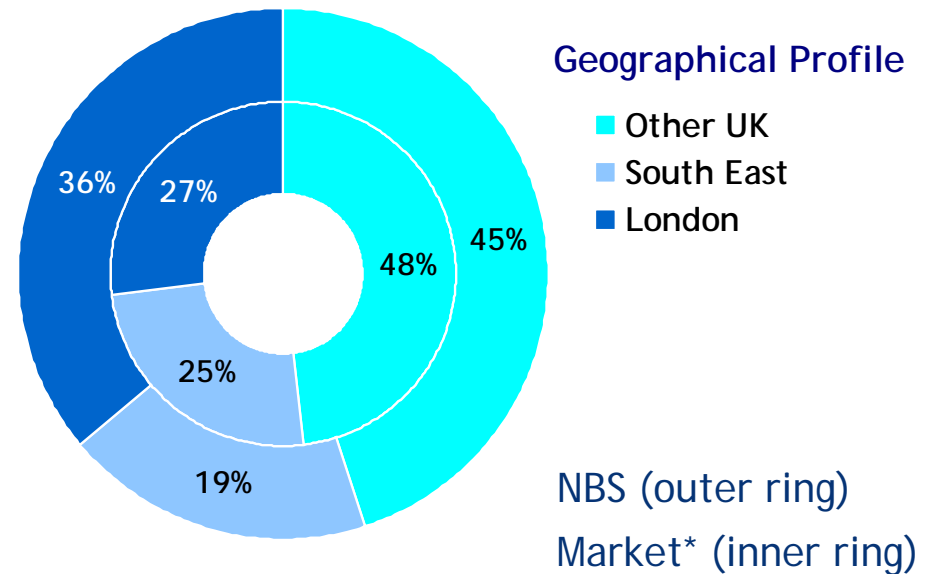


- Well diversified portfolio
- Minimal exposure to development finance of c.£155m
- £197m subordinated balance (£88m provision raised against this book)
- £1.2bn non-UK, all in EU
- £1.4bn restructured & re-priced
  
- Focus on high quality regulated housing associations
- Geographically diverse with no arrears
- Prudent LTV based lending
  
- Well diversified across 8 core PFI sectors with no arrears
- Backed by public sector cashflows with very low default risk
- No 2 lender for Mandated Lead Arranger in 2009 across 61 European banks

# Commercial Lending

## UK Investment Property

- Total assets £11.3 bn
- Focus on cashflow from diversified tenants rather than security values
- >80% of book ICR >115%
- Weighted average lease length (10 yrs) exceeds weighted average loan maturity (6 yrs)
- 27% of portfolio originated in 2007 (lower than par market share\*)

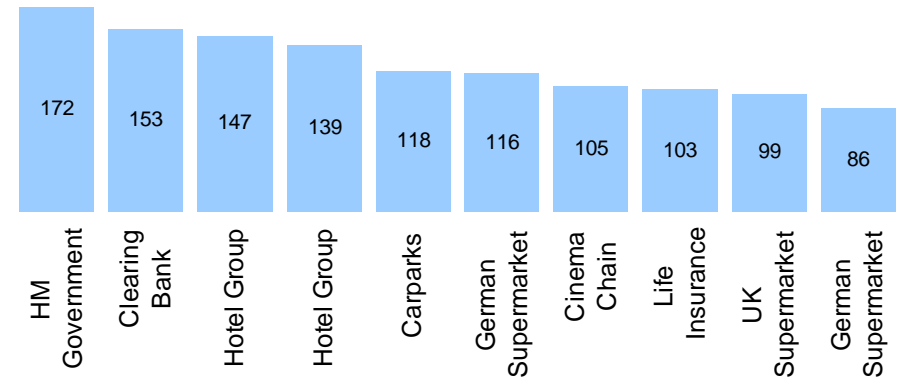


# Commercial Lending

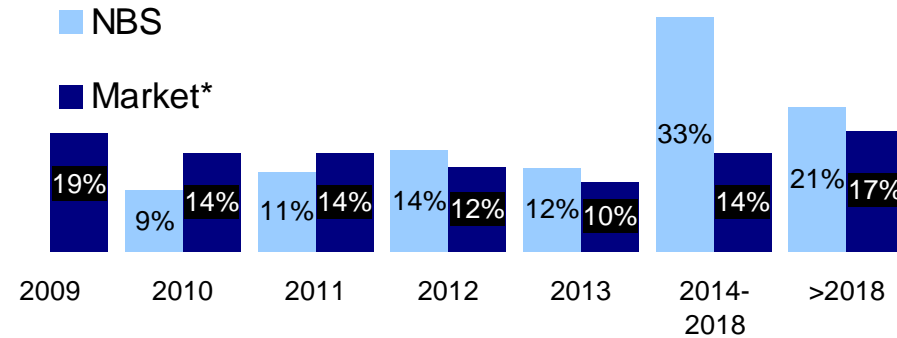
## UK Investment Property - Tenants & Maturity

- Largest tenant HM Government
- Rest of top 10 are high quality tenants - all performing well
- The majority of existing loans and leases remain in place until after the expected bottom of the market in 2010/11
- Lower exposure to short term maturing loans than the market average

**Top Tenants Exposure (£m)**  
Balances where tenant GRI is >20% of total GRI.



**Loan Maturity Profile**



## Retail - Mortgage Arrears Summary

3 month + arrears cases as % of total book <sup>(1)</sup>	April 09	Sept 09	April 10
Prime	0.49	0.50	0.52
Specialist	2.45	2.39	2.28
Group	0.64	0.66	0.68
<b>Industry Average (exc. LPA cases)</b>	<b>2.41</b>	<b>2.40</b>	<b>2.22</b>

<sup>(1)</sup> Excluding acquired Societies

Possessions Taken in as % of total book <sup>(1)</sup> (Number of Properties)	April 09(12 months)	Sept 09 (6 months)	April 10(12 months)
Group	0.070	0.054	0.097
<b>Industry Average (exc. LPA cases)</b>	<b>0.393</b>	<b>0.210</b>	<b>0.389</b>
No. of Properties Taken in	941	720	1,280
<b>Properties Taken in as % of Industry</b>	<b>2.10</b>	<b>3.12</b>	<b>2.89</b>

<sup>(1)</sup> Excluding acquired Societies

# Capital & Solvency



Recent stress test considered:	
Base rate	0.5%
Unemployment	c.12.4%
6+ CML arrears	4.6% in 2011
House Price Inflation	Peak to trough 36%
Commercial Property Prices	Peak to trough > 60%