Local banking
for Britain

TSB

"We provide local banking for Britain to help local people, businesses and communities thrive.

That's it. Full stop."

Paul Pester, Chief Executive Officer, TSB

TSB Banking Group plc
Annual Report and Accounts 2014

“2014 at a glance.”

£133.7m
Profit before taxation (management basis)*

£170.2m
Profit before taxation (statutory basis)*

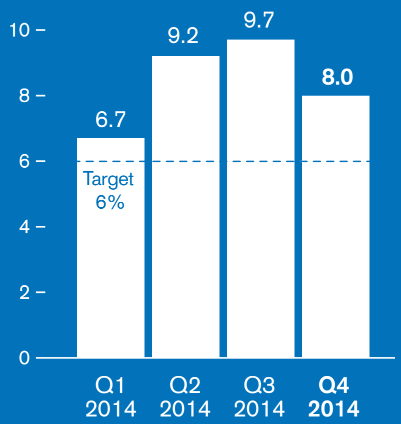
3.62%
Franchise banking net interest margin*

0.44%
Group asset quality ratio*

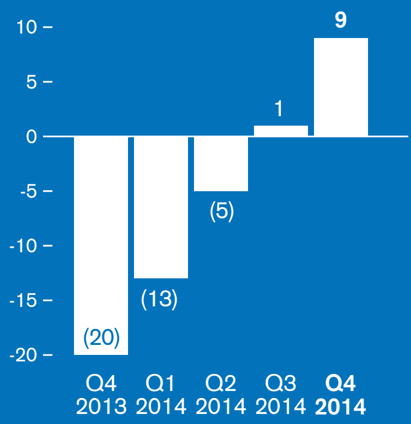
76.5%
Franchise loan to deposit ratio*

19.7%
Pro forma Common Equity Tier 1 Capital ratio (fully loaded)*

Share of personal bank account gross flow** (%)



Customer advocacy – net promoter score***



* See financial highlights on page 18.
** See explanatory note 4 on page 10.
*** See explanatory note 6 on page 10.

At TSB we're clear why we're here: to bring more choice and competition to UK banking and ultimately make banking better for everybody.

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Find us online
www.tsb.co.uk

"A strong start."

Will Samuel, Chairman

TSB has taken a number of important steps this year in establishing itself as an independent listed entity and in starting to deliver its growth strategy.

This is TSB Banking Group's first Annual Report and Accounts as a listed business.

Ahead of the Company's listing in June, the Board was enlarged to provide an appropriate balance of skills, experience, independence and knowledge of the company and the UK retail banking market. The Board is now comprised of nine Non-executive Directors, five of whom are independent Non-executive Directors, and two Executive Directors. Details of each Board member and their background can be found in the Governance section on pages 38 to 39.

TSB was created to further competition in the UK retail banking market and will seek to do so through providing a different and better kind of service to its customers. To achieve this, TSB has identified five values which all TSB colleagues, or as we call them, Partners, are expected to exhibit in conducting business. They are to be Responsible, Transparent, Collaborative, Straightforward and Pioneering. I believe that it is through the behaviour of our Partners that TSB will truly differentiate itself and increasingly bring higher standards of service to its customers.

As we explained in our Initial Public Offering (IPO) Prospectus, TSB's balance sheet is sub-scale relative to the cost of its infrastructure, resulting in low underlying profitability and returns. We therefore have an economic imperative to grow to address this imbalance, bringing the size of TSB's balance sheet into proportion with the scale of its infrastructure. As a result, our strategy is one of growth and the strength of our infrastructure is one of the key reasons why we believe this strategy can be achieved.

2014 was a year of solid progress in this regard with a pleasing demonstration of the Group's ability to grow its deposit base supported in part by the successful launch of our 'Classic Plus' bank account.

In January 2015, we also made TSB mortgages available through brokers which will allow TSB to access the 60% of the UK mortgage market previously unavailable to it. This channel is of great importance in achieving the asset growth targeted through our strategy and 2015 will be an important year in establishing this capability.

While TSB has made an encouraging start on its journey to establish itself and in pursuing its strategy of growth, I do not underestimate the longer term challenges posed to growing profitably given the prevailing competitive lending environment and the potential impact of an extended low interest rate outlook. Both remain important influences on the shape of TSB's future financial success.

The Board has paid particular regard to this environment when considering dividend policy, as well as the sub-scale nature of the business and the need to preserve capital to safely support the growth strategy. Taking all of this into account, and consistent with our expectation as first set out at the time of TSB's IPO, the Board continues to expect that TSB's inaugural dividend will be no earlier than 2018, in relation to the financial year ending 31 December 2017. The Board will keep the timing and quantum of dividend payments under review in the light of progress on delivery of TSB's strategy and the evolution of the broader economic environment.

As recently announced, Godfrey Robson will not seek re-election as a Non-executive Director at the Company's 2015 Annual General Meeting (AGM) and will step down from our Board at that time. Godfrey's association with TSB has spanned 14 years, having first been appointed to the Board of TSB Bank plc (Bank), then known as Lloyds TSB Scotland plc, in 2001.

The Board would like to thank Godfrey for his significant contribution to the build of TSB and to the Company's successful IPO in 2014. Godfrey has made a major contribution to the Company during his time on its Board and that of the Bank, having overseen the development of TSB. Godfrey has provided invaluable support and insight to the Company's Board in the period since IPO and we wish him well in his future endeavours.

In conclusion, I am pleased with the start TSB has made in implementing the strategy set out at the time of its listing. I would like to thank our management team and all our Partners for all they have done to make 2014 a year of great progress for TSB. I look forward to a year of further progress in 2015.

Will Samuel

Will Samuel
Chairman

"A clear strategy and sense of purpose."

Paul Pester, Chief Executive Officer

I'm delighted with customers' initial reaction to TSB's transparent and straightforward approach to banking. This positions us well to deliver our planned growth strategy.

Positioned for growth

At its heart, TSB is a large scale, full capability, UK retail bank. The business benefits from 8,700 Partners, a nationwide network of branches serving around 600 retail centres, a strong online and mobile banking capability and a full service telephone bank. In addition, the Group provides a full range of retail banking products from bank accounts and savings accounts through to credit cards, loans and mortgages. When measured by its share of branches, TSB is the UK's seventh largest banking group.

Whilst in absolute terms TSB's £21.6 billion of loans and £24.6 billion of customer deposits means its balance sheet size is significant, the balance sheet is smaller than would normally be expected for a bank with a network of branches as extensive as TSB's and with the sophistication and capacity of TSB's systems and digital banking. This mismatch is a function of TSB's creation but explains why growth is a key priority for TSB.

TSB was created to bring more competition to UK banking. Delivering this well, through our growth strategy, will create value for our shareholders. We will ultimately demonstrate our success by attracting new bank account customers to TSB and through growing TSB's Franchise lending balances by 40% to 50% in the five years from our IPO.

As any bank grows it requires capital to support a larger loan book and this is an area in which TSB is particularly strong. TSB currently has common equity capital equivalent to 19.7% of its risk adjusted loan book on a pro forma basis. This is very high compared to many other banks and together with our loan to deposit ratio of 76.5% ensures that we are pre-positioned to support our lending growth targets.

However, in addition to growth, TSB's profitability is sensitive to the UK interest rate environment. The current view on base rates is that they will rise but more slowly than was thought at the time of our IPO. Whilst this doesn't change our overall strategy or focus on growth, it does mean cost management will have a greater role to play in delivering our targeted return on equity of 10% in 2019.

The combination of TSB's distribution capability, products, and engaged workforce of shareholding Partners, coupled with its strategy of growth supported by strong levels of capital and liquidity is why I believe TSB holds a unique position as Britain's strongest challenger bank.

A transparent and straightforward local banking business model

At TSB we believe that bringing more competition to UK banking will ultimately make banking better for all UK consumers. We are doing this by building the sort of bank that customers have told us they want. A transparent and straightforward bank that focuses on being true to the original purpose of banks – to support local economic growth and to help local people help themselves. We call this 'Local Banking for Britain'.

Banking is based on the effective evaluation of risks, ensuring an appropriate return is earned for taking them. The overall level of risk we are willing to take, our 'risk appetite', is determined by our Board, and robust systems and practices are in place to ensure we operate in line with these predetermined parameters. This helps protect our customers' and shareholders' interests.

TSB's straightforward approach to banking can be seen on pages 6 and 7.

"How we make money."

Our business model is simple.

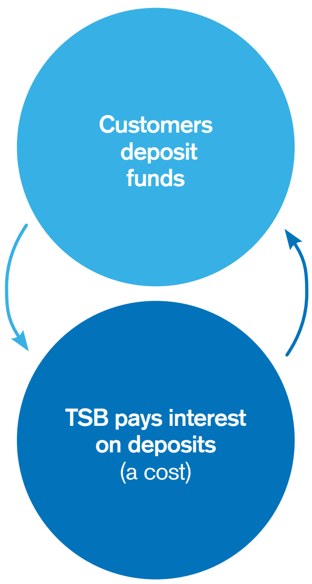
- **We use the funds from savings and bank account customers primarily to fund loans to personal and small business customers.**
- **The amount of income we earn from lending the funds exceeds the interest we pay on the deposits.**
- **The Group aims to preserve this margin and to manage the potential impact on income and reserves from changes in interest rates through the limited use of derivatives.**
- **We subtract any charges including operating costs, impairment and tax expenses to arrive at our profit.**
- **The Board then decides whether this is used to pay dividends or reinvest in the business.**
- **The execution of this business model requires the taking of certain risks and we take actions to mitigate all of them.**

See our 'Truth and banking' video
We believe our customers have the right to know what we do with their money and this is our way of showing how a bank can be more open about what it does and how it makes money.

www.tsb.co.uk/investors/about-tsb/

Sources of funding

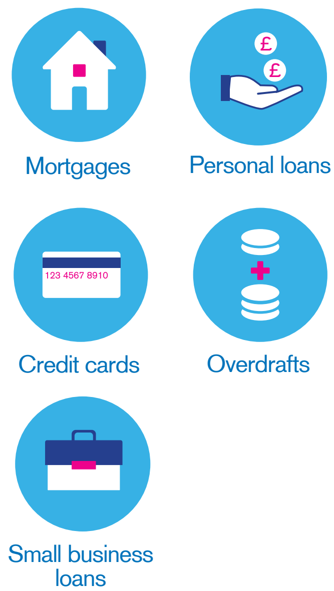
For more information:
Page 20 — Business review
Page 106 — Financial statements



Money deposited by customers into their bank and savings accounts provide the majority of the funds we use to support lending to customers. We also raise a small proportion of funds from other sources, including equity invested by shareholders.

Loans

For more information:
Page 22 — Business review
Page 109 — Financial statements



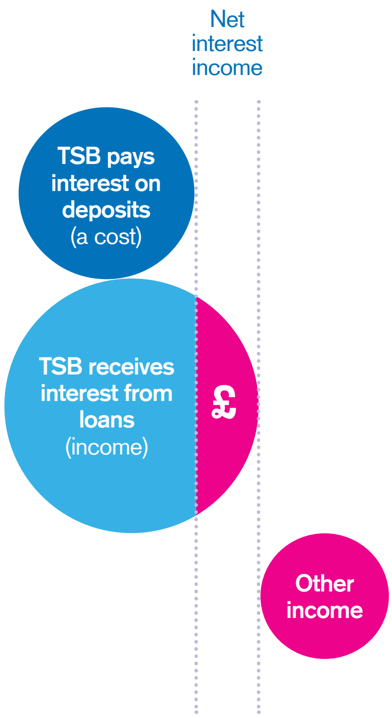
Funds deposited with TSB are used to support lending to customers who wish to borrow. A portion of deposited funds are held in reserve to meet any unexpected funding requirements.

Risk management

The Group's business model and strategy result in a number of key risks that are closely managed by the Board.

Income

For more information:
Page 24 — Business review
Page 114 — Financial statements



We earn income in the form of interest that we receive on the loans we make to customers and we pay interest to savings and bank account customers on the money they deposit with us. We also earn other income from the provision of other banking services and commissions from the sale of certain products such as general insurance.

Charges

For more information:
Page 26 — Business review
Page 116 — Financial statements

Running a bank with 4.5 million customers comes with overheads. Charges we incur include the costs of paying our 8,700 TSB Partners, running our branches and paying for advertising and marketing. Occasionally, our customers are unable to repay the money they borrow from us, this is also a cost to the bank in the form of our impairment charge. Finally, the Group pays tax to Her Majesty's Revenue and Customs (HMRC).

Profits and returns to shareholders

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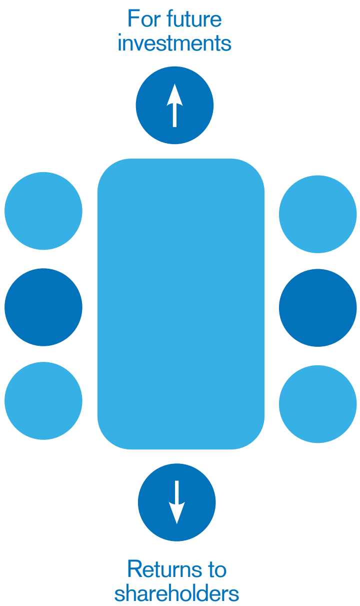
Page 122 — Financial statements



The Board reviews the Group's performance. It decides whether profits are put aside for future investment in the business or for protection against the uncertainties that the Group faces, or the profits may be returned to shareholders. Currently all returns are being reinvested back into the business.

Conduct | Funding and liquidity | Credit | Capital | Market | Operational

For more information:
Page 12 — Risk overview
Page 85 — Risk report

"A strategy to grow."

TSB has both the capability and opportunity for significant growth.

Our growth strategy

Our strategy is to grow by using our strong mobile and online banking facilities, our nationwide network of branches, our full range of retail banking products, the scalability of our IT platform, and an increasingly differentiated service delivered by our Partners. We want to provide great banking to more people.

Over the next five years, we expect TSB to be consistently chosen by at least 6% of all those moving their bank account or opening a new one. This will allow TSB to grow its share of all bank accounts from 4.3% today towards 6% with the pace of progression dependent on the number of accounts being opened and switched across the market.

Over the same period, we want to help more people to borrow well by lending to more people right across Britain. We expect the Group's Franchise lending balances to be 40% to 50% higher in 2019 than they were at the IPO in June 2014. A key step in achieving this growth will be TSB's re-entry into the intermediary mortgage market, giving people the option of acquiring a TSB mortgage through a mortgage broker. We continue to expect to provide around £4 billion of mortgages through brokers in 2017.

We will focus on using TSB's existing capability to support the growth of the business while also seeking opportunities for greater operational efficiency. Our focus on customer service and investments to enhance further our products and services, including our online and mobile banking services, will help TSB to continue to attract more customers and to grow.

We continue to focus on the delivery of our organic strategy but remain open to considering appropriate inorganic growth opportunities as they arise.

We expect the successful delivery of our strategy, supported by increasing UK interest rates, to enable TSB to reach 10% return on equity in 2019, with returns expected to increase further in the longer term.

Promising early progress

We have made a strong start with our strategy to grow TSB. We opened almost half a million new bank accounts in 2014, supported by the launch of 'Classic Plus' at the end of March and its associated media and advertising campaign. Consequently, TSB attracted 8.4% of all new and switching bank accounts over the last 12 months*. This is well above our long term target of 6%.

I believe that the development of TSB's intermediary mortgage market capability, successfully launched in January 2015, is an important step in enabling more people right across Britain to borrow well with TSB. Alongside this we continue to build UK consumers' consideration of TSB as a destination for mortgages through our increased profile as a lender, including our 'Borrow Well' marketing campaign.

While this is very much the start of the TSB journey, I am delighted with customers' reaction to our brand as much has been achieved in our drive to help TSB stand out when compared to other banks. Our investment in the business is already beginning to deliver on a number of programmes to further enhance the Group's digital channels, upgrade branches and reduce the cost for customers who call us. Most importantly, we are differentiating ourselves through the great service we offer as a result of our culture of personal ownership among our highly engaged team of Partners.

We believe TSB's Partners will be the single greatest difference between TSB and other banks. Our successes in 2014 are a direct result of their ability, commitment, collaboration and belief in what we are seeking to achieve at TSB.

* See explanatory note 4 on page 10.

Our priorities are to

"How are we doing so far?"

Strategic priorities

1 Provide great banking to more people

Grow market share of bank accounts by consistently taking a greater than 6% share of gross flow over a five year period.

- Over the four most recent quarters, TSB has taken 8.4% share of flow, or 1 in 12 of all new and switching bank accounts.
- This strong performance was supported by the continued customer response to the 'Classic Plus' bank account and the associated media and advertising campaign.
- As the initial launch campaign has ended, we are intending that over time TSB's share of flow should normalise closer to the long term target of 6%.

2 Help more people borrow well

Grow Franchise customer lending by 40% to 50% over a five year period from IPO.

- As expected, given the absence of a mortgage intermediary distribution channel, mortgage lending balances to TSB Franchise customers reduced by £1.1 billion to £16.6 billion over 2014.
- However, we successfully launched the mortgage intermediary channel in January 2015 receiving over £300 million of applications so far.
- In 2014 we launched our 'Borrow Well' marketing campaign and ran separate mortgage campaigns offering to pay customers' stamp duty on their house purchase and their council tax bill for a year. Customer reaction to these campaigns has been positive, reflected in the brand's mortgage consideration score improving from 4% to 11%(1) over the 12 month period and the share of direct mortgages increasing from 1.6% in Q1 2014 to 2.2% in Q4 2014(2).
- However, unsecured lending remained relatively flat in a very congested, competitive environment.

3 Provide the kind of banking experience people want and deserve

Deploy TSB's strong digital capability. Build greater consideration of the TSB brand. Deliver a differentiated customer experience through our Partners.

- We further improved our online and mobile banking service, with the launch of the TSB.co.uk website which optimises itself on each user's device.
- The percentage of customers signing up to online banking when they open a bank account increased to 84% as we continue to support customers' use of digital services.
- Over 300 branches were enhanced in 2014.
- We launched the TSB 'Truth and banking' initiative, which clearly explains how TSB operates and makes money.
- '0345' telephone numbers were introduced, making it cheaper for customers to call us.
- Every employee was made a Partner in the business by awarding them TSB shares, and the incentive to deliver shareholder value through a differentiated customer experience.
- A new remuneration approach, aligned to and reinforcing TSB's values, was announced for the Group's executive which was further rolled out to all TSB Partners in early 2015.

TSB's efforts to differentiate its customer experience are now starting to be recognised. In a recent survey by *Which?* magazine on the customer service provided by UK brands, TSB was the only high street bank to be ranked in the top quartile.

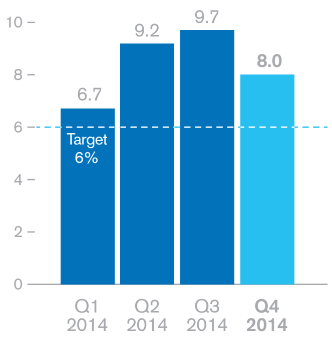
Our progress is also evident from a 29 point increase in our customer net promoter score (NPS) since December 2013, which turned positive in the second half of the year.

Banking complaints have remained stable at 1.0 per 1,000 accounts(3) through 2014 as TSB works to improve customer service.

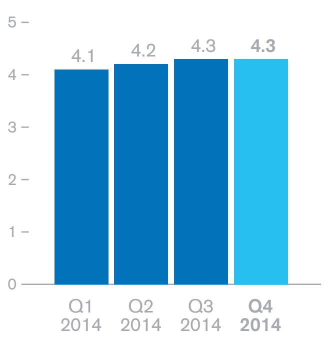
(1) © GfK NOP Ltd, Financial Research Survey (FRS) six months ending December 2013 and December 2014. Circa 440 adults considering taking out/switching a mortgage in the next 12 months were interviewed for each six month period. Results show percentage who would consider TSB.
(2) Market share has increased between Q1 and Q4 in 2014 using a market size based on Bank of England data for total flow and Council of Mortgage Lenders' data for a split of the Direct part of the market.
(3) Figures exclude reportable banking complaints relating to packaged bank accounts sold prior to TSB's separation from LBG. Including reportable complaints relating to packaged bank accounts sold under TSB's banking licence, reportable banking complaints rose from 1.1 in the first half to 1.2 in the second half of 2014.
(4) 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. Membership of CSDB changed in January 2014. Presented on a two month lag.
(5) Source: CACI. Data presented on a two month lag, e.g. Q4 2014 refers to October 2014.
(6) 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.
(7) Source: Ipsos Mori Brand Tracking, c.110 interviews per week conducted online with GB bank account holders, non-customers of TSB: Q1 Jan-Mar (1,426), Q2 Apr-Jun (1,559), Q3 Jul-Sep (2,896), Q4 Oct-Dec (2,012). Q1-Q4 data recalibrated by Ipsos Mori to reflect restructured questionnaire in Q4.

Key performance indicators

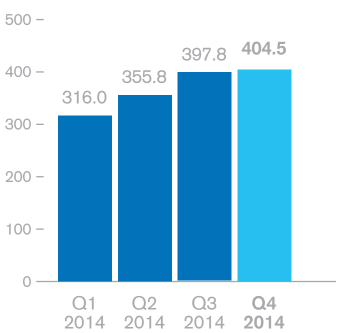
Share of personal bank account gross flow (%)[4]



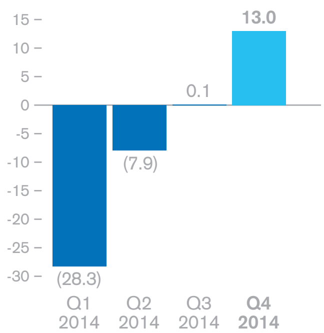
Share of PCA stock (%)[5]



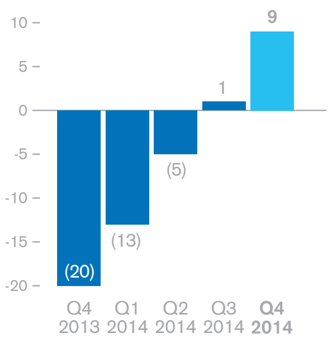
Mortgage gross new lending (£m)



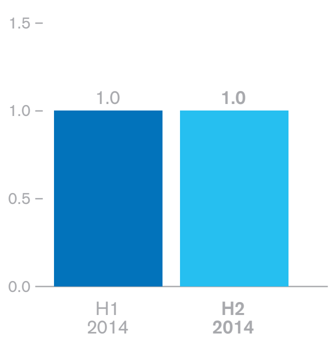
Unsecured lending growth (£m)



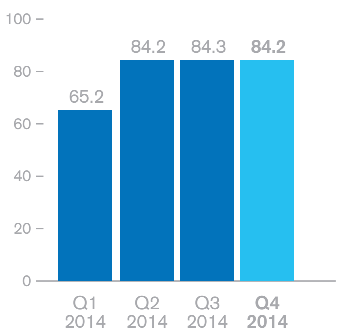
Customer advocacy (NPS)[6]



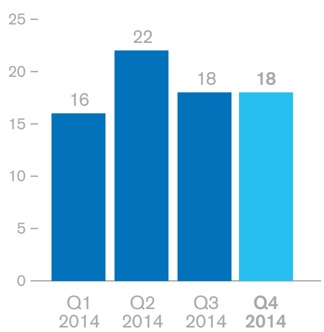
Reportable banking complaints (per 1,000 customers)[3]



Digital penetration of new PCA customers (%)



Non-customer PCA brand consideration (%)[7]



Outlook in a competitive environment

In 2014, headwinds emerged that pose some challenges to TSB's profit growth. Competition amongst lenders stepped up markedly and expectations increased for a lower for longer base rate environment. While we expect to see a continuation of these headwinds, we expect to make further progress in line with our strategic plan in 2015. Growth remains our key strategic focus and we expect TSB to continue to consistently attract more than 6% of all new and switching bank accounts each quarter.

Following the promising launch of our intermediary channel, we expect net lending to grow from mid-way through the year. Franchise lending balances are expected to end 2015 around £1.5 billion higher than they started.

We expect the average Franchise margin to remain broadly flat in 2015 compared to 2014. We anticipate margin expansion in the early months of the year, reflecting the continued benefit from liability repricing and the mix effect of a reducing mortgage book. Subsequently, we expect margin compression pressure to build consistently throughout the rest of the year as a result of competition for new loans, the lower interest rate environment and margin dilution from a growing proportion of mortgages on TSB's balance sheet.

A Europe-wide change in interchange fee structures will be fully introduced in 2016. However, an earlier than expected phased introduction from card scheme providers will reduce interchange fees in 2015 and is expected to be the primary driver in reducing Franchise other income by around £15 million in 2015.

We will, however, continue to invest in enhancing and differentiating the TSB proposition as we seek to provide the kind of banking experience people want and deserve. We expect to invest around £50 million in 2015 across our branches, digital channels, products and brand profile, whilst also ensuring that we continue to manage the efficiency of our operations.

In 2014 we began to demonstrate our focus on expenditure as we spent £696 million, around £25 million less than had been expected at the time of TSB's IPO. In 2015 we are expecting to spend no more than £720 million, a material reduction against previous guidance of £750 million as we aim to ensure that we are efficiently delivering our growth strategy for our customers and shareholders.

Conclusion

2014 has been a successful year for TSB. Strong delivery of bank account growth and our successful IPO provide us with excellent business foundations. With high levels of capital and liquidity, customer brand consideration and satisfaction continuing to grow and with our mortgage intermediary capability up and running, I remain confident in the ability of the business to deliver against our growth strategy.

Paul Pester
Chief Executive Officer

“Managing risk is at the foundation of our business.”

Risk framework and culture

Effective risk management is a key component of the Group’s strategy to deliver local banking for Britain, and is at the heart of everything the Group does for customers and communities.

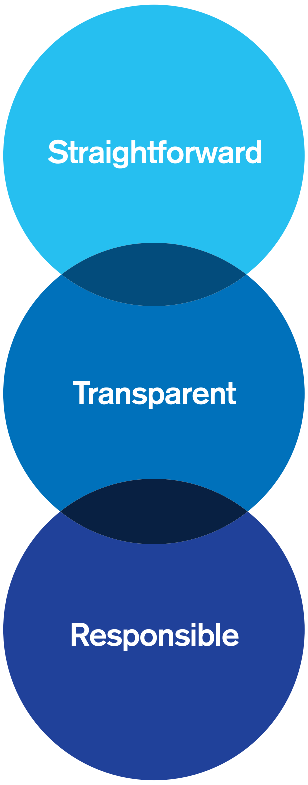
The Group’s straightforward business model is supported by a risk culture grounded in ensuring a sustainable appetite for risk.

The Group’s risk culture is designed to ensure that all Partners deliver the right outcomes for customers and other stakeholders through their approach to their work and the decisions and actions they take. Risks are owned and managed by all Partners, not just by specialist risk teams. The risk culture encourages all Partners to focus on identifying, assessing and managing risk within their areas of responsibility and supports clear escalation and reporting of risks to senior management and the Board. The Group’s risk management culture is reinforced by its approach to remuneration throughout the business.

The Board and senior management set risk appetite. This is achieved through clear and consistent communication of the approach to risk and cascading accountability to appropriately qualified individuals throughout the Group. The Board ensures that senior management implements risk policies and risk appetite that either limit or, where appropriate, prohibit activities, relationships and situations that could be detrimental to the Group’s risk profile.

The Group maintains a sustainable appetite for risk which supports the delivery of its growth strategy, whilst protecting customers, shareholders and Partners.

The Group’s risk framework is built upon three key principles



A consistent risk management approach across its business, with simple reporting requirements to provide a holistic view of risk throughout the Group’s operations.

A clear risk management approach which is understood across the business. By working collaboratively, all Partners are able to share findings and approaches to help ensure adequate controls and processes are in place.

Clear ownership of risks within the Group and empowerment of Partners to manage risk exposures in line with expected values and behaviours.

The Group manages risk using three lines of defence

The Group organises its risk management activities across three lines of defence. These aim to ensure that risk management responsibilities and accountabilities are clearly defined and effective, and independent oversight processes are in place.

First line of defence: Business line
Each business line has primary responsibility for risk decisions and actions as well as measuring, monitoring and controlling risks within its area of accountability. Business lines identify, assess, manage and mitigate the risks relevant to their lines. They establish controls to ensure compliance with the Group's policies and the risk appetite parameters set out and approved by the Board.

Second line of defence: Risk function
The Group's risk function provides independent oversight and challenge through testing the effectiveness of business line risk management, as well as providing Group wide risk reporting. It recommends risk strategy and the Group's risk appetite to the Board. It also acts as a trusted advisor to the business and its expertise facilitates the effective design and embedding of policy and compliance.

Third line of defence: Internal Audit
The Group's Internal Audit function provides independent and objective assessment of the risk management activities of both the business lines and the risk function. Internal Audit reports on the effectiveness of the Group's risk management activities to the Board and senior management.

Governance of risk

The Group's committees monitor and challenge risk exposures against approved risk appetite. Each committee within the governance structure is responsible for ensuring the risk and control environment is established within its area of authority. This enables day-to-day decisions to be made, with clear reporting lines established through the Executive and Board Risk committees, and ultimately to the Board. Further information on governance is set out in the Corporate governance statement on page 42.

Principal risk and uncertainties

The Group monitors a number of risks to its business and takes action to mitigate their impact on the Group's strategic and financial performance. The principal risks and uncertainties faced by the Group are summarised on the following page. Further details of these risks are set out in the Risk report on page 86.

In addition to those risks and uncertainties and to the headwinds highlighted in the Chief Executive Officer's outlook on page 11, the Group faces other challenges, including the potential uncertainty resulting from political and regulatory uncertainties, both in the UK and globally.

"Responsible and transparent risk management."

Principal risks dashboard

For more information:
Page 87 — Risk report

For more information:
Page 88 — Risk report

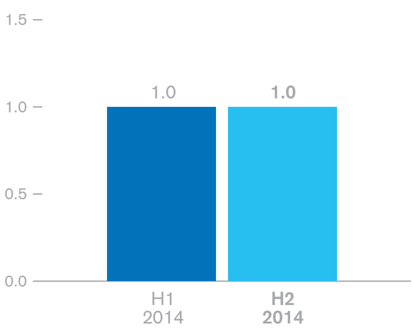
For more information:
Page 90 — Risk report

Conduct

The risk that the Group fails to deliver fair customer outcomes and achieve a positive experience for its customers.

What this means to TSB
Having the right people, doing the right things in the right way for our customers and ensuring that the Group continually assesses that we are achieving this aim.

Reportable banking complaints* (per 1,000 customers)



Banking complaints have remained stable at 1.0 per 1,000 accounts through 2014 as TSB works to improve customer service.

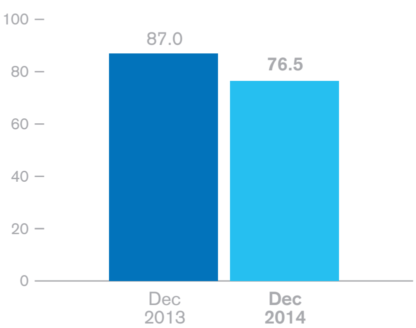
* See explanatory note 3 on page 10.

Funding and liquidity

Funding risk is the risk that the Group does not have sufficiently stable and diverse sources of funding or its funding structure is not efficient. Liquidity risk is the risk that the Group has insufficient financial resources to meet commitments as they fall due, or can only secure them at an excessive cost.

What this means to TSB
The Group's banking model is based on using its customer deposits to fund lending activities and seeks to hold sufficient liquid assets, with a limited appetite for reliance on wholesale funding.

Franchise loan to deposit ratio (%)



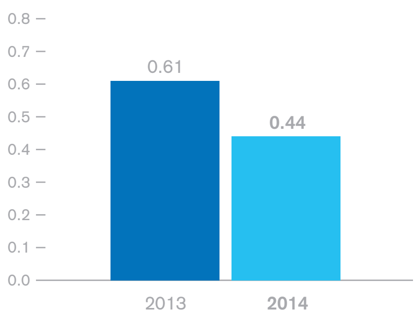
The Franchise loan to deposit ratio reflects a very robust funding position. The ratio decreased during 2014, due to the growth in customer deposits and lower loan balances.

Credit

The risk that a borrower with us fails to repay their loan or any other lending product on time.

What this means to TSB
The Group provides affordable lending to its customers using robust credit processes and controls.

Asset quality ratio (%)



In line with expectations impairment losses have decreased reflecting improved economic conditions, including rising house prices and reduced unemployment.

For more information:
Page 95 — Risk report

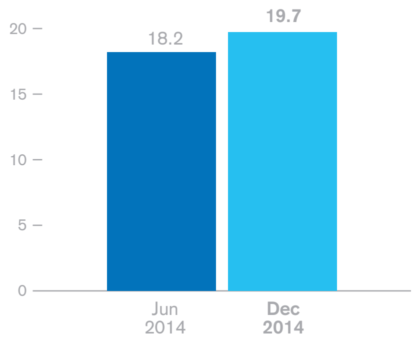
Capital

The risk of the Group having insufficient quantity or quality of capital to meet current or future requirements.

What this means to TSB

The Group maintains a strong capital base which meets both its regulatory requirements and supports the growth of the business, even under stressed conditions.

Pro forma CET1 ratio (fully loaded) (%)



The Group has a strong and improving capital position which will support its growth strategy.

For more information:
Page 97 — Risk report

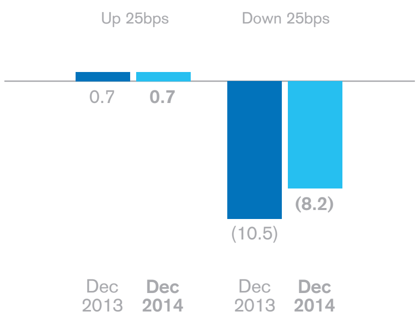
Market

The risk of a reduction in income, value or reserves caused by changes in the prices of financial instruments.

What this means to TSB

The Group aims to preserve its margins through the management of any market risk positions, including through the use of interest rate derivatives, that arise in the natural course of business.

NII sensitivity (illustrative impact of a 25bps change in interest rates) (£m)



The Group remains exposed to margin compression in the event of lower interest rates.

For more information:
Page 98 — Risk report

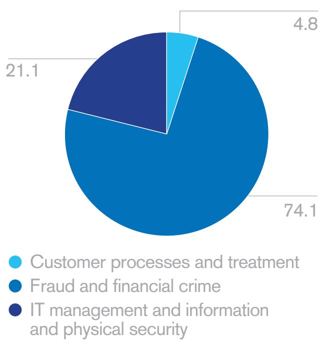
Operational

The risk of loss resulting from inadequate or failed internal processes, people or systems or from external events.

What this means to TSB

The Group faces risks from customer processes, IT systems, business continuity, fraud and financial crime, running digital services, information security and data loss, and ongoing compliance with a growing complex legal and regulatory agenda.

Operational risk events by value of loss (%)



Operational risk events are recorded on an individual basis where the operational loss is £5,000 or more and fraud losses are £20,000 or more. For 2014, events with aggregate losses of £1.2 million were recorded.

The Board monitors total operational losses as a percentage of income. This measure remained within the Group's risk appetite of 2.5% for the year.

"Solid delivery in line with expectation."

Darren Pope, Chief Financial Officer

The Group established a number of long term strategic targets at the time of its listing in June 2014. Our performance in 2014 remains consistent with those expectations.

Significant developments

2014 has been a year of significant achievements and developments at TSB. The Group's financial position and, in particular its strong capital and funding position, provides a sound platform from which to deliver the growth strategy over the coming years.

During 2013 a significant number of customers and their accounts were added to the Group's existing business following their transfer from other LBG entities in preparation for the Group's listing. In May 2013, 3.5 million customers transferred together with their deposit balances of £17.3 billion and loan balances of £2.1 billion. A further £13.0 billion of mortgage balances transferred to the Group in July 2013. This, along with the transfer of a number of branches and associated business infrastructure, transformed the Group's size and capabilities.

During 2014, the Group continued to build on this transformation with the following key developments:

Corporate structuring and associated transactions

During the course of 2014, the Group made the necessary changes to its corporate structure establishing TSB as a strong, independent competitor in the UK banking market.

These included:

- **Transferring colleagues to the Group**
  On 31 March 2014, TSB Partners were transferred to TSB from LBG under the terms of the Transfer of Undertakings (Protection of Employment) (TUPE) Regulations 2006. At this point, those who were members of LBG defined benefit pension schemes became deferred members of those schemes and our defined benefit pension scheme deficit was transferred to Lloyds Bank plc. No settlement payment was required and consequently the Group recorded a one-off gain of £63.7 million.

- **Establishing a Group holding company**
  On 25 April 2014, TSB Banking Group plc became the holding company of the TSB Group following a share for share exchange in which it acquired 100% of the issued share capital of TSB Bank plc from Lloyds Bank plc.

- **Capitalising the Group for growth**
  On 1 May 2014, TSB Banking Group plc issued £385.0 million of Tier 2 dated subordinated liabilities (for proceeds of £383.0 million) and, on 19 May 2014, issued 445 million ordinary shares for proceeds of £200.0 million. Both issues of capital were wholly subscribed for by Lloyds Bank plc.

- **Listing the Group**
  On 25 June 2014, TSB Banking Group plc achieved a premium listing on the London Stock Exchange, with a free-float of 38.5%. The free-float increased to approximately 50% on 26 September 2014 following a further partial sell-down by LBG.

Formalising arrangements and agreements with LBG

As part of the listing process, a number of agreements were signed with LBG to ensure that the Group is able to operate effectively and independently. These agreements are outlined in more detail on page 135 within our related party disclosures.

Factors affecting the Group's medium term profitability

In establishing TSB as a strong competitor in the UK banking market, and in response to a review by the Office of Fair Trading of the effect on competition of the divestment of TSB from LBG, two significant developments took place in 2014 that were designed to enhance the Group's medium term profit earning capacity:

- **Mortgage Enhancement**
  With effect from 28 February 2014 the economic benefit of a £3.4 billion portfolio of mortgage loans was assigned to the Group by LBG. This is designed to enhance the Group's profit before tax (PBT) by a cumulative £230 million over approximately five years and, during 2014, increased the Group's PBT by £71.7 million. This portfolio is subject to a call option exercisable by LBG, after the £230 million profit target has been achieved including at least £30 million in 2017.

- **Services arrangements with LBG**
  On 1 January 2014, the Group transitioned from operating within the LBG shared service model to a standalone business cost structure. IT services and certain operational activities are however still being provided by LBG under a TSA. The TSA runs until the end of 2016 when it will be replaced by the LTSA which is expected to increase the Group's cost base by more than £100 million p.a. from 2017.

Context for interpreting financial performance

These developments provide important context for understanding the current and future trends in the Group's financial performance. In particular:

- The ten months of earnings from the Mortgage Enhancement portfolio generated 53.6% of the Group's 2014 management basis PBT, a share that is expected to decline over the next three years; and

- The process to establish the Group's baseline standalone cost structure is now largely complete, but will see a significant step increase when the Group transitions to the LTSA from 2017.

The future impact of these two factors will be material. Adjusting the Group's 2014 management basis profit of £133.7 million to exclude the £71.7 million of earnings from the Mortgage Enhancement portfolio and taking into account the more than £100 million increase in costs from the future transition to the LTSA would have left the Group loss making. The growth strategy, combined with the normalisation of UK interest rates and the Group's continued focus on cost control, are together intended to deliver a 10% return on equity within five years following the Group's listing. The net result of these developments during 2013 and 2014 is the formation of a UK bank with a very sound financial standing that is well positioned to deliver its growth strategy.

Financial highlights

Summary balance sheet	2014 £ million	2013(1) £ million	Change %
Loans and advances to customers	**21,641.4**	20,099.1	7.7
Other assets	**5,530.0**	4,855.3	13.9
Total assets	**27,171.4**	**24,954.4**	**8.9**
Customer deposits	**24,624.9**	23,100.4	6.6
Other liabilities	**912.1**	547.3	66.7
Shareholders' equity	**1,634.4**	1,306.7	25.1
Total equity and liabilities	**27,171.4**	**24,954.4**	**8.9**

	2014	2013(1)	Change
Franchise loan to deposit ratio	**76.5%**	87.0%	(10.5)pp
Net asset book value per share (pence)	**327p**	261p	66p
Common Equity Tier 1 Capital ratio (fully loaded)	**23.0%**	19.0%	4.0pp
Pro forma Common Equity Tier 1 Capital ratio(2)	**19.7%**		
Leverage ratio (fully loaded)	**5.8%**	4.7%	1.1pp

Summary income statement	H1 2014 £ million	H2 2014 £ million	2014 £ million	2013(1) £ million	Change %
Net interest income	390.6	396.5	**787.1**	473.8	66.1
Other income	72.6	67.7	**140.3**	113.4	23.7
Total income	463.2	464.2	**927.4**	**587.2**	**57.9**
Operating expenses	(333.5)	(362.6)	**(696.1)**	(376.2)	(85.0)
Impairment	(51.1)	(46.5)	**(97.6)**	(80.3)	(21.5)
Profit before taxation (management basis)	78.6	55.1	**133.7**	**130.7**	**2.3**
Profit/(loss) on derivatives and hedge accounting	0.2	(3.3)	**(3.1)**	(39.3)	
Derivative fair value unwind	(14.0)	(10.1)	**(24.1)**	(6.6)	
Defined benefit pension scheme settlement gain	63.7	–	**63.7**	–	
Statutory profit before taxation	128.5	41.7	**170.2**	**84.8**	**100.7**
Taxation	(26.7)	(9.0)	**(35.7)**	100.2	
Statutory profit for the period	101.8	32.7	**134.5**	**185.0**	**(27.3)**

	H1 2014 %	H2 2014 %	2014 %	2013(1) %	Change
Group banking net interest margin(3)	3.58	3.55	**3.56**	3.59	(3)bps
Franchise banking net interest margin(3)	3.62	3.63	**3.62**	3.59	3bps
Group management basis cost:income ratio	72.0	78.1	**75.1**	64.1	(11.0)pp
Group asset quality ratio(4)	0.47	0.42	**0.44**	0.61	17bps

(1) Restated – see note 35.
(2) Pro forma is calculated on a full Internal Ratings Based (IRB) basis – see page 95.
(3) Management net interest income divided by average loans and advances to customers, gross of impairment provisions.
(4) Impairment charge on loans and advances to customers divided by average loans and advances to customers, gross of impairment allowance.

Key performance indicators

The Board monitors a set of KPIs that inform on progress against strategy. The financial outputs monitored are:

Franchise loan to deposit ratio
76.5%

Pro forma Common Equity Tier 1 Capital ratio (fully loaded)
19.7%

Leverage ratio (fully loaded)
5.8%

Franchise banking net interest margin
3.62%

Group asset quality ratio
0.44%

Financial performance

Basis of presentation
In order to present a more useful view of business performance, the Group's results are presented on a management basis which excludes volatility arising from derivatives and a non-recurring settlement gain in 2014 arising from the Group's withdrawal from defined benefit pension schemes. Further explanation of the approach taken to presenting the Group's management results can be found on page 28.

Balance sheet, funding and capital
Group customer deposits grew by 6.6%, driven in particular by the successful 'Classic Plus' bank account launch.

Group customer loans and advances increased by 7.7% following the £3.4 billion Mortgage Enhancement transaction. However, TSB Franchise lending continued to reduce, as expected, down 6.3% primarily due to lower mortgage balances. This reflected the effect of the Group's temporary inability to access the mortgage intermediary market for new business while the £7.2 billion back book of mortgages that was originally written through the intermediary market continued to repay and refinance. As a consequence, the Franchise loan to deposit ratio reduced from 87.0% to 76.5% during 2014.

In May 2014 the Group established a standalone liquid asset portfolio which at 31 December 2014 totalled £4.5 billion, of which £4.2 billion was held on deposit with the Bank of England and £0.3 billion was invested in a portfolio of UK gilts. Prior to the establishment of the standalone liquid asset portfolio, the Group was a member of the LBG UK Defined Liquidity Group and all liquid assets were held on deposit with LBG.

The Group's capital ratios strengthened in the year, with the Common Equity Tier 1 (CET1) ratio increasing from 19.0% to 23.0%. This reflects the issue of equity and profits retained during the year, partially offset by higher risk weighted assets primarily driven by a change to the operational risk capital calculation and the transfer of the Mortgage Enhancement portfolio.

The strong funding, liquidity and capital positions are intended to accommodate delivery of the Group's growth strategy.

Income statement and profitability
The Group's income statement performance in 2014 reflects the significant developments noted on page 17.

As a consequence, comparison of the Group's 2014 performance with that of 2013 is of limited benefit. A more meaningful comparison of the second half of 2014 to the first half of 2014 is therefore also presented in this Business review.

2014 compared to 2013
PBT on a management basis increased by £3.0 million to £133.7 million in 2014. Higher income, driven by a full year of earnings from customers and balances transferred during 2013 and the Mortgage Enhancement transaction was largely offset by the planned increase in operating costs as the Group established its standalone operating model. On a statutory basis, the Group's return on assets was 0.49%.

H2 2014 compared to H1 2014
PBT on a management basis decreased in the second half by £23.5 million to £55.1 million compared to the £78.6 million earned in the first half of 2014. This was primarily driven by an increase in the Group's costs as investment spend was skewed to the second half of the year, with the IPO being the Group's focus during H1. Income remained broadly unchanged in H2 compared to H1 as lower income from declining Franchise lending balances was offset by the recognition of a full half year of income from the Mortgage Enhancement portfolio. Impairment losses decreased by £4.6 million from H1 to H2 given the continuing relatively benign UK economic environment.

Darren Pope
Chief Financial Officer

Sources of funding

Money deposited by our customers into their bank and savings accounts provide the majority of the funds we use to support lending to customers. We also raise a small proportion of funds from other sources that diversify our funding profile and our shareholders also provide some funding in the form of equity in the business.

For more information:
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Page 106 — Financial statements

A substantial proportion of the Group's funding is made up of customer bank accounts and savings balances, which although repayable on demand have historically provided a stable source of long term funding. During 2014, funding resources increased by 9.3% to £26,674.8 million. As shown in note 1 to the consolidated financial statements, growth in bank account balances of £1,072.5 million is the largest contributor to customer deposit balance growth. This follows the successful launch of the 'Classic Plus' bank account in March 2014 which contributed to the Group opening 8.4% of all new and switching personal bank accounts in the UK over the last 12 months. Savings balances increased by 2.7% to £17,056.0 million reflecting the strength of the Group's deposit gathering capability. This growth was despite reductions in savings payable rates during the year.

In addition, during the year, the Group took initial steps to diversify further its funding sources. A securitisation funding programme (Cape Funding) was established in May 2014 under which the Group is able to borrow up to £2.5 billion from Lloyds Bank plc. The facility is capped at the lower of the balance of the Mortgage Enhancement portfolio and £2.5 billion and is therefore expected to decline as the Mortgage Enhancement portfolio reduces. As at 31 December 2014, only £10.0 million of this facility had been drawn. Further funding was raised from subordinated liabilities issued to LBG in May 2014.

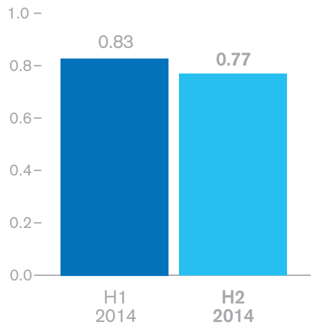
Cost of funding

The cost of customer deposits decreased by 6bps in H2 2014 to 0.77% compared with 0.83% in H1 2014, reflecting the phased reduction in interest payable rates on the savings portfolio. Average savings deposit costs decreased from 0.93% to 0.82%. This decrease was partially offset by the increase in the average cost of bank accounts given the 5% rate offered on 'Classic Plus' accounts. The overall reduction in the average cost of customer deposits was partially offset by higher non-customer funding costs reflecting the issuance of subordinated debt as part of the Group's recapitalisation in May 2014. Average bank account deposit rates increased from 0.57% to 0.65%.

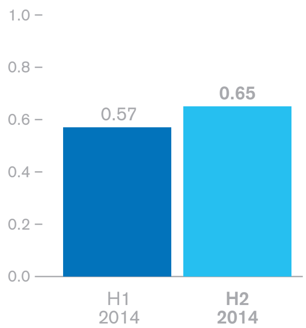
	2014 £ million	2013 £ million	Change %
Customer deposits	**24,624.9**	23,100.4	6.6
Non-customer funding			
Debt securities in issue	**10.0**	1.4	
Subordinated liabilities	**405.5**	–	
Shareholders' equity	**1,634.4**	1,306.7	25.1
Total funding resources	**26,674.8**	**24,408.5**	**9.3**

Customer deposits (£ million)

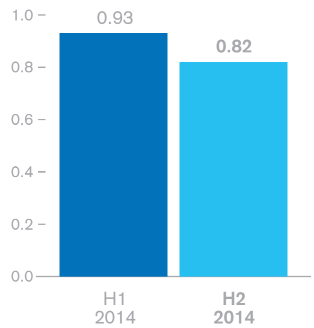
Average cost of customer deposits (%)



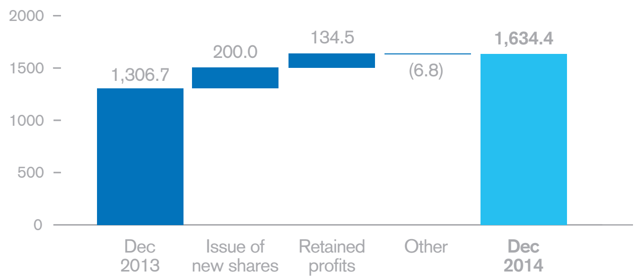
Average cost of bank account deposits (%)



Average cost of savings deposits (%)



Movements in shareholders' equity (£ million)



"Since the launch of our 'Classic Plus' bank account in March 2014, approximately 9% of new personal bank accounts opened in the UK were with TSB.

Loans

For more information:
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Funds deposited with the Group are primarily used to support lending to customers. The Group lends money to customers using different products, including mortgages, credit cards, personal loans and overdrafts. A portion of the funds deposited with the Group are held in reserve – we call that our liquidity portfolio, which enables the Group to meet unexpected future funding requirements.

Loans and advances to customers

Loans and advances to customers increased by 7.7% compared to December 2013, primarily reflecting the transfer to the Group of the Mortgage Enhancement portfolio on 28 February 2014. Excluding this, Franchise loan balances, net of impairment provisions, decreased by £1,259.8 million or 6.3%. This reflects a continuation of the trend in 2013 where repayments on the mortgage portfolio, originated through both direct and intermediary channels, continued to exceed new loan origination which was limited to sales from direct channels only. Despite the overall reduction in the intermediary balance, the direct balance remained stable and we saw our market share of direct new business grow from 1.6% to 2.2% during the year.

Unsecured retail lending and business banking loan balances, net of impairments, reduced by 4.9%. This was primarily due to the redirection of approximately 2,000 business banking customers to LBG as the Group was unable to provide the more complex products and services those customers required. Retail unsecured balances, net of impairment provisions, decreased by 0.9%, remaining broadly stable in spite of increased competition within this product segment.

Liquidity portfolio

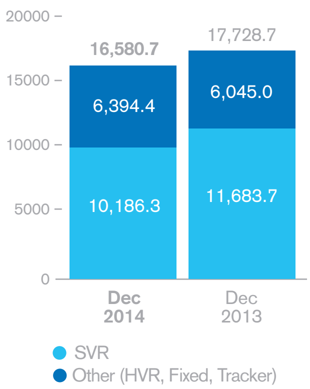
As previously mentioned, in May 2014, the Group exited the LBG UK Defined Liquidity Group and established a standalone liquid asset portfolio. At 31 December 2014, this was primarily held on deposit with the Bank of England with the portfolio being diversified from October 2014 through the purchase of a tranche of gilts.

Interest rates earned on loans

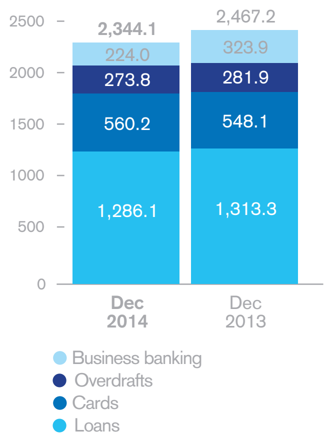
In H2 2014, the average rate earned on Franchise loans reduced from 3.90% to 3.87% as competition continued to weigh on new business and refinance rates. The average rate earned on Franchise mortgages reduced from 2.75% to 2.72%. Lower rates were earned on the non-SVR portion of the portfolio reflecting lower funding costs and increased competition in the market. Yields on unsecured retail lending decreased from 13.04% to 12.72% reflecting pressure on unsecured margins in a highly competitive market.

	2014 £ million	2013 £ million	Change %
Loans and advances to customers			
Franchise	**18,839.3**	20,099.1	**(6.3)**
Mortgage Enhancement	**2,802.1**	–	
	21,641.4	**20,099.1**	**7.7**
Primary liquidity assets			
Balances at central banks	**4,169.3**	–	
Gilts – available-for-sale	**339.7**	–	
Deposits with LBG	**–**	4,124.7	
	4,509.0	**4,124.7**	**9.3**

Franchise mortgages* (£ million)

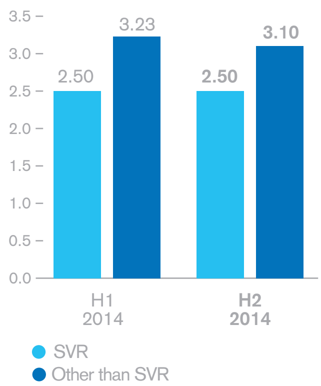


Unsecured retail lending and business banking* (£ million)

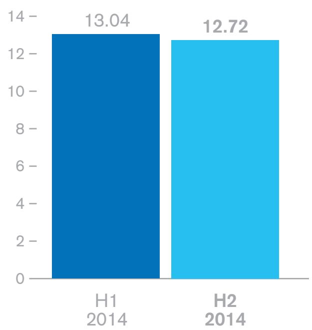


* Balances are shown gross of impairment provisions.

Average rate on Franchise mortgages (%)



Average rate on unsecured retail lending (%)



“In 2014 we lent more than £296 million to first time home buyers; we expect this to grow now our mortgages are available through brokers.

Income

For more information:
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We earn income in the form of interest that we receive on the loans we make to customers and we pay interest to savings and bank account customers on the money they deposit with us. We also earn other income from fees we charge for the provision of banking services and commissions from the sale of certain third party products such as general insurance.

2014 compared to 2013

Net interest income in 2014 increased by 66.1% to £787.1 million, primarily reflecting the full year effects of the 2013 customer transfers as outlined on page 17 and net interest income earned on the Mortgage Enhancement portfolio since its transfer to the Group on 28 February 2014. Franchise banking net interest margin remained broadly stable at 3.62% for the year to 31 December 2014.

Other income increased by 23.7% to £140.3 million and reflects earnings for the full year on the 3.5 million customers transferred to the Group in May 2013.

H2 2014 compared to H1 2014

Net interest income in the second half of 2014 increased by 1.5% to £396.5 million compared to the first half, primarily as the second half included a full six months of earnings on the Mortgage Enhancement portfolio. Franchise net interest income was marginally lower in the second half reflecting lower loan balances. Franchise banking net interest margin remained broadly stable as lower lending rates and the cost of subordinated debt issued in May 2014 were offset by lower funding rates and the mix effect of a proportionately smaller mortgage book. Lower interest rates, and particularly lower five year swap rates, only had a marginal impact on net interest income during H2 2014. However, as the Group continues to re-invest maturing five year swaps at prevailing rates, this will become a more significant factor through 2015 if current low interest rate expectations persist.

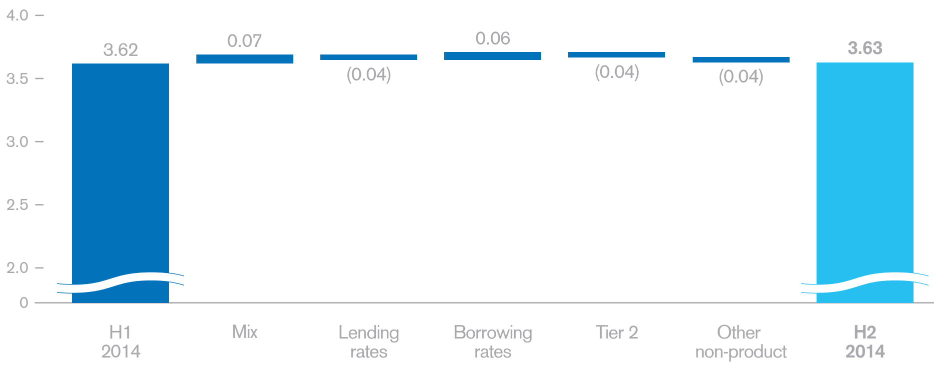
Other income in the second half of 2014 was £67.7 million, 6.7% lower than the first half. While other income in the Franchise segment was broadly stable, the Mortgage Enhancement segment reflected the recognition of a full half year of servicing fees and fees in respect of the Group's Cape Funding securitisation funding programme which commenced in June 2014.

Total income (management basis)

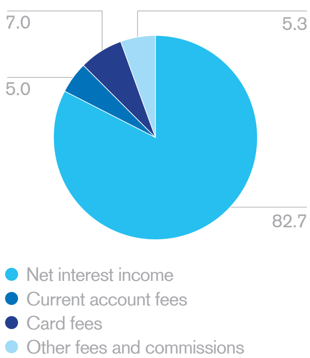
	H1 2014 £ million	H2 2014 £ million	2014 £ million	2013 £ million	Change %
Franchise	356.5	350.8	**707.3**	473.8	49.3
Mortgage Enhancement	34.1	45.7	**79.8**	–	
Net interest income	390.6	396.5	**787.1**	**473.8**	**66.1**
Other income	72.6	67.7	**140.3**	113.4	23.7
Total income (management basis)	463.2	464.2	**927.4**	**587.2**	**57.9**

	H1 2014 %	H2 2014 %	2014 %	2013 %	Change bps
Group banking net interest margin	3.58	3.55	**3.56**	3.59	(3)bps
Franchise banking net interest margin	3.62	3.63	**3.62**	3.59	3bps
Mortgage Enhancement banking net interest margin	3.16	3.07	**3.11**	–	

Franchise banking net interest margin (%)



Franchise total income (management basis) (%)



“Our income growth reflects the transformation of the Group’s balance sheet in 2013. TSB now provides great banking to more than 4.5 million customers.

Charges

For more information:
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Running a bank with 4.5 million customers comes with overheads. Charges we incur include the costs of paying our 8,700 TSB Partners, running our IT systems and branches, developing new products and services, meeting regulatory requirements and paying for advertising and marketing. Occasionally, our customers' circumstances change and they are unable to repay the money they borrow from us causing us to incur impairment losses. Finally, the Group pays tax to HMRC on the profits we earn.

(i) Operating expenses

2014 compared to 2013

Operating expenses increased by 85.0% to £696.1 million and reflect the transition on 1 January 2014 from operating within the LBG shared service model (with associated economies of scale) to our standalone operating model. Consequently, recharges from LBG ceased and were replaced with charges under the TSA for IT services and increased direct costs. These changes were reflected in higher employment cost, up £203.2 million (from a full year of the Group's enlarged branch and operational infrastructure and the establishment of the Group's support functions) and higher directly incurred marketing spend, up £67.7 million. The annual Financial Services Compensation Scheme (FSCS) levy increased by £12.1 million reflecting our larger balance sheet.

H2 2014 compared to H1 2014

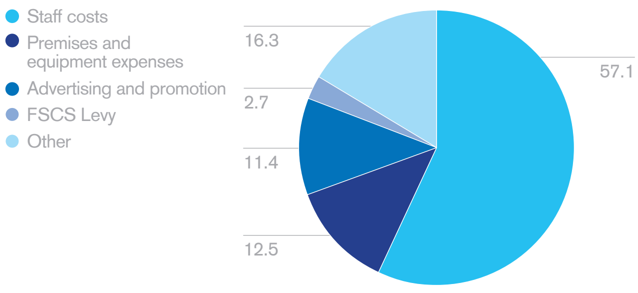
Operating expenses in the second half of 2014 increased by 8.7% compared to the first half. However, excluding the cost of the full year FSCS levy recognised in April 2014, the increase was 15.1%. This primarily reflects investment spend that was disproportionately weighted to the fourth quarter of 2014 (as we focused in H1 2014 on completing the Group's listing) and increased headcount as the Group continued to develop its intermediary mortgage distribution capability and completed the formation of the central functions required of an independent listed Group. TSA costs reduced in the second half of 2014 as the Group exited a number of the underlying TSA arrangements after establishing standalone capability in these areas and benefited from a £5 million discount.

Operating expenses

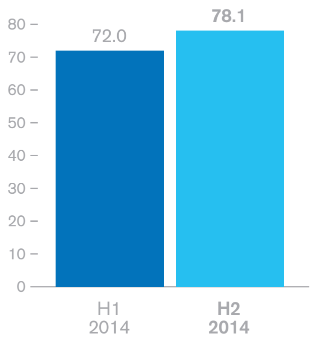
	H1 2014 £ million	H2 2014 £ million	2014 £ million	2013* £ million	Change %
Direct costs					
Staff costs	163.0	178.8	**341.8**	138.6	(146.6)
Premises and equipment expenses	36.7	37.8	**74.5**	44.3	(68.2)
Advertising and promotion	26.7	41.8	**68.5**	0.8	
FSCS levy	17.3	(1.3)	**16.0**	3.9	
Other	36.7	60.8	**97.5**	29.0	
	280.4	317.9	**598.3**	**216.6**	**(176.2)**
Transitional Services Agreement costs	53.1	44.7	**97.8**	–	
Recharges from other Lloyds Banking Group companies	–	–	**–**	159.6	
Total operating expenses (management basis)	333.5	362.6	**696.1**	**376.2**	**(85.0)**
Cost:income ratio (management basis)	72.0%	78.1%	**75.1%**	64.1%	(11.0)pp

* Restated – see note 35.

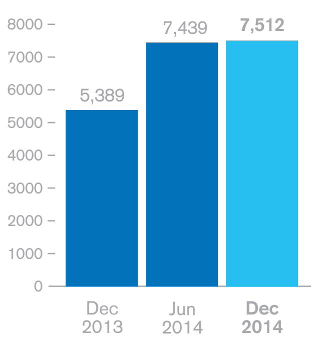
Direct costs 2014 (%)



Cost:income ratio (%)



Number of Partners (FTE)



(ii) Taxation

The tax charge of £35.7 million (2013: tax credit £100.2 million) represents an effective tax rate of 21.0% which is broadly consistent with the average UK corporation tax rate of 21.5% in 2014. The tax credit in 2013 was due to the recognition of £121.6 million of deferred tax assets arising from the transfer of business to the Group.

(iii) Impairment charge

2014 compared to 2013

The impairment charge increased by 21.5% to £97.6 million. The year on year comparison is of limited benefit given the significant balance of loans transferred to the Group during 2013. The asset quality ratio however decreased reflecting the improved economic conditions during 2014.

H2 2014 compared to H1 2014

The impairment charge in the second half of 2014 decreased by 9.0% to £46.5 million compared to the first half, primarily driven by a lower charge for the business banking and unsecured portfolios. The decrease in the business banking charge reflects the reduced size of the portfolio combined with lower arrears and write-offs. Within the unsecured portfolio, continued improvement in new lending quality and the positive effects of a stronger macroeconomic environment (particularly lower unemployment) helped to lower the charge in the second half of 2014 to £46.8 million from £48.2 million in the first half. During the second half the loss emergence period on unsecured lending was extended from two to three months to reflect changes in the time it takes customers to reach impairment, which increased the impairment charge by £5.5 million.

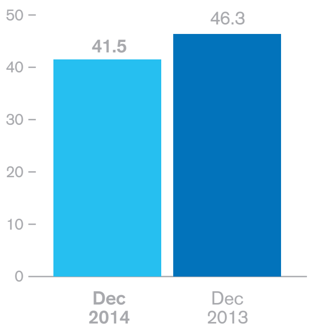
Impairment charge

	H1 2014 £ million	H2 2014 £ million	2014 £ million	2013 £ million	Change %
Mortgages	(0.6)	(0.2)	**(0.8)**	2.9	
Personal unsecured	48.2	46.8	**95.0**	72.7	
Business banking	2.9	(0.1)	**2.8**	4.7	
Total Franchise	50.5	46.5	**97.0**	**80.3**	**(20.8)**
Mortgage Enhancement	0.6	–	**0.6**	–	
Total impairment charge	51.1	46.5	**97.6**	**80.3**	**(21.5)**

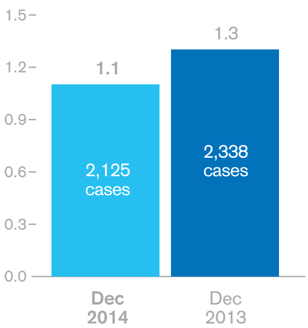
	H1 2014 %	H2 2014 %	2014 %	2013 %	Change bps
Asset quality ratio*					
Mortgages	(0.01)	–	**–**	0.03	3
Personal unsecured	4.50	4.31	**4.40**	4.63	23
Business banking	1.88	(0.07)	**1.02**	1.65	63
Total Franchise	0.51	0.48	**0.50**	**0.61**	**11**
Mortgage Enhancement	0.05	–	**0.02**	–	(2)
Total	0.47	0.42	**0.44**	**0.61**	**17**

* See explanatory note 4 on page 18.

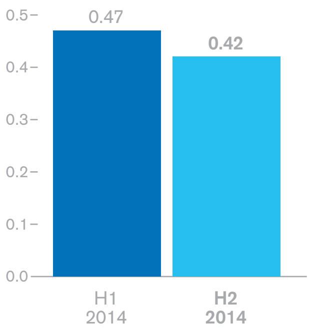
Average mortgages loan to value (%)



Mortgages greater than 3 months in arrears (%)



Asset quality ratio (%)



Profits and returns to shareholders

The Board reviews the Group's performance regularly on both a management and statutory basis and decides whether profits are put aside for future investment in the business, for protection against the uncertainties the Group faces, or returned to shareholders.

For more information:
Page 7 — Business model
Page 122 — Financial statements

(i) Management basis

In order to present a more useful basis of the Group's underlying business performance the Group excludes certain one-off and volatile items from its management results. The key adjustments are as follows:

Loss on derivatives and hedge accounting

From 1 January 2014, the Group established qualifying hedge accounting relationships designed to minimise accounting volatility. These are available as the Group adopts the accounting policy treatment available in the EU endorsed version of International Accounting Standard (IAS) 39 *Financial Instruments: Recognition and Measurement*, which is not available in the version issued by the IASB. The loss on derivatives and hedge accounting of £3.1 million primarily reflects the volatility arising from certain derivatives not designated in hedge accounting relationships including a portfolio of swaps with LBG used to economically hedge the basis risk of the Mortgage Enhancement portfolio. Prior to 1 January 2014, the Group did not designate any of its derivatives in hedge relationships for accounting purposes and therefore the decrease in their fair value of £39.3 million was reflected in the Group's income statement in 2013.

Derivative fair value unwind

As the interest rate swaps entered into with LBG on 1 November 2013 were designed to reflect the continuity of LBG's economic hedging approach within the Group, the terms differed from market rates at that date. Consequently, the interest rate swaps had a net positive fair value of £53.0 million on the date they were established. This amount, net of the amount recognised in 2013, unwinds through the Group's income statement over the remaining life of the interest rate swaps. During 2014, £24.1 million (2013: £6.6 million) of the fair value movement in the Group's derivatives was attributable to this factor. For statutory reporting purposes this amount is part of the change in fair value of derivatives presented in other income and is excluded from management profit as it does not appropriately reflect the Group's economic hedging approach.

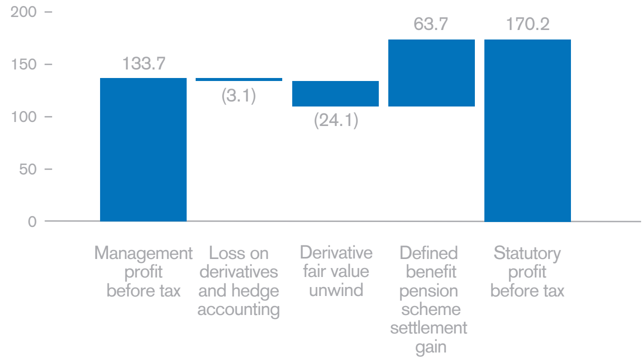
Defined benefit pension scheme settlement gain

As explained on page 118 the Group recorded a gain of £63.7 million reflecting the derecognition of the defined benefit pension scheme deficit. From 1 April 2014, the Group has no further liabilities in respect of defined benefit pension schemes.

	2014 £ million	2013* £ million	Change %
Management profit before taxation	**133.7**	130.7	2.3
Loss on derivatives and hedge accounting	**(3.1)**	(39.3)	
Derivative fair value unwind	**(24.1)**	(6.6)	
Defined benefit pension scheme settlement gain	**63.7**	–	
Statutory profit before taxation	**170.2**	**84.8**	**100.7**

* Restated – see note 35.

Reconciliation of the management basis to statutory results (£ million)



Reconciliation of the management basis profit to the statutory results

Year ended 31 December 2014	Management basis £ million	Gain/(Loss) on derivatives and hedge accounting £ million	Derivative fair value unwind £ million	Defined benefit pension scheme settlement gain £ million	Statutory results £ million
Net interest income	787.1	(28.9)	–	–	758.2
Other income	140.3	25.8	(24.1)	–	142.0
Total income	**927.4**	**(3.1)**	**(24.1)**	**–**	**900.2**
Operating expenses	(696.1)	–	–	63.7	(632.4)
Impairment	(97.6)	–	–	–	(97.6)
Profit before taxation	**133.7**	**(3.1)**	**(24.1)**	**63.7**	**170.2**
Taxation	(28.6)	0.7	5.2	(13.0)	(35.7)
Profit after taxation	**105.1**	**(2.4)**	**(18.9)**	**50.7**	**134.5**

Year ended 31 December 2013*	Management basis £ million	Gain/(Loss) on derivatives and hedge accounting £ million	Derivative fair value unwind £ million	Deferred tax impact from business transfers £ million	Statutory results* £ million
Net interest income	473.8	(10.0)	–	–	463.8
Other income	113.4	(29.3)	(6.6)	–	77.5
Total income	**587.2**	**(39.3)**	**(6.6)**	**–**	**541.3**
Operating expenses	(376.2)	–	–	–	(376.2)
Impairment	(80.3)	–	–	–	(80.3)
Profit before taxation	**130.7**	**(39.3)**	**(6.6)**	**–**	**84.8**
Taxation	(32.0)	9.1	1.5	121.6	100.2
Profit after taxation	**98.7**	**(30.2)**	**(5.1)**	**121.6**	**185.0**

* Restated – see note 35.

Profits and returns to shareholders (continued)

(ii) Segmental analysis
The Group's Executive Committee and Board review the results of the Group and consider performance across two segments:

– TSB Franchise segment; and

– Mortgage Enhancement segment.

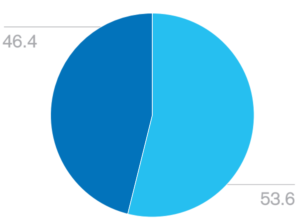
The Mortgage Enhancement segment was created to reflect the transfer of the economic benefit of a £3.4 billion portfolio of mortgages to the Group from LBG with effect from 28 February 2014. During 2014, the Mortgage Enhancement segment generated PBT of £71.7 million representing 53.6% of the Group's total PBT.

H2 2014 compared to H1 2014
Franchise PBT decreased by 68.1% to £15.0 million in H2 2014 compared to H1 2014. This was primarily due to higher costs, reflecting the build of the corporate support functions and mortgage intermediary capability, and lower income earned on the lower Franchise loan balances.

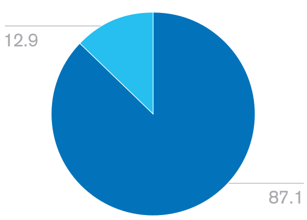
Mortgage Enhancement PBT increased by 26.9% to £40.1 million as the second half of 2014 included a full six months of earnings on the transferred mortgage portfolio, partially offset by lower mortgage balances.

Conclusion
As explained in the Chairman's letter on page 3, following a review of the Group's 2014 performance, the Board continues to prioritise the preservation of capital to support the Group's growth strategy over currently paying dividends. Consistent with expectations established at the time of its IPO, the Group does not currently expect to declare a dividend before 2018.

2014 Management PBT (%)



Loans and advances to customers at December 2014 (%)



Year ended 31 December 2014	Franchise £ million	Mortgage Enhancement £ million	Total £ million
Net interest income	**707.3**	**79.8**	**787.1**
Other income/(expense)	**147.8**	**(7.5)**	**140.3**
Total income	**855.1**	**72.3**	**927.4**
Operating expenses	**(696.1)**	**–**	**(696.1)**
Impairment	**(97.0)**	**(0.6)**	**(97.6)**
Profit before taxation (management basis)	**62.0**	**71.7**	**133.7**

H2 2014	£ million	£ million	£ million
Net interest income	350.8	45.7	396.5
Other income/(expense)	73.3	(5.6)	67.7
Total income	424.1	40.1	464.2
Operating expenses	(362.6)	–	(362.6)
Impairment	(46.5)	–	(46.5)
Profit before taxation (management basis)	15.0	40.1	55.1

H1 2014	£ million	£ million	£ million
Net interest income	356.5	34.1	390.6
Other income/(expense)	74.5	(1.9)	72.6
Total income	431.0	32.2	463.2
Operating expenses	(333.5)	–	(333.5)
Impairment	(50.5)	(0.6)	(51.1)
Profit before taxation (management basis)	47.0	31.6	78.6

Key balance sheet items at 31 December 2014			
Loans and advances to customers	**18,839.3**	**2,802.1**	**21,641.4**
Customer deposits	**24,624.9**	**–**	**24,624.9**

Key balance sheet items at 30 June 2014			
Loans and advances to customers	19,381.8	3,111.6	22,493.4
Customer deposits	23,700.4	–	23,700.4

Key balance sheet items at 31 December 2013			
Loans and advances to customers	20,099.1	–	20,099.1
Customer deposits	23,100.4	–	23,100.4

A responsible business

Being responsible is a core focus at TSB. The Group is mindful of the impact its actions and decisions can have on customers and local communities across Britain, as well as on its Partners. Whether in its business offering, relationships with the local communities served, or the partnership model, the Group will always strive to deliver the best for all stakeholders.

At TSB, five values underpin Partner behaviour. These are being Responsible, Transparent, Collaborative, Straightforward, and Pioneering. These values are central to how the Group operates and from 2015 the Partner performance process will assess Partner behaviour against the values.

In 2014 the Group started a full review of its ethics policy and position on human rights. While the Group does not have a formal human rights policy, new guidance linked to the Group's values, behaviours framework and conduct strategy is being developed for completion in 2015.

Integral to the Group's strategy and risk management is an intention to be a different sort of bank, one which feels 'neighbourly with know how', and which acts with integrity. In doing so, the Group aspires to be a helpful neighbour, a fair employer, and a responsible user of resources. The report that follows sets out commitments for 2015 and explains the progress made during 2014 to fulfil these aspirations.

Commitments for 2015

The Group is proud of its achievements in 2014 and for 2015 commits to being:

A helpful neighbour by:
- Decentralising charity activity to enable Partners to support local causes in their communities rather than a single bank wide charity of the year; and
- Providing additional funding to support Partner fundraising efforts to account for the end of the Matched Giving arrangement with Lloyds Bank and Bank of Scotland Foundations.

A fair employer by:
- Launching a new TSB Partner performance process, which aligns expected Partner behaviours with the Group's values;
- Embedding a new approach to remuneration which applies to all Partners; and
- Completing the work to update the Group's ethics, environmental and human rights position, governance and leadership structure.

A responsible user of resources by:
- Establishing an energy baseline and, where possible, resource utilisation targets to ensure the Group's growth strategy is delivered in a responsible, sustainable and efficient manner; and
- Implementing smart meters across the Group's property estate to improve energy management and reporting.

A helpful neighbour

As a business, the Group takes pride in behaving as a helpful neighbour. Support for charities during a year of significant development for the business is testament to Partners' commitment to make a difference in their local communities.

Charitable giving
In total Partners raised over £441,000 for charitable causes in 2014.

Alzheimer's Society and Alzheimer Scotland remained the Group's Charities of the Year in 2014, having originally been selected in 2013. In 2014, Partners raised £190,000 for these charities, bringing the total for the partnership to £363,000 over the two years. These funds will help run dementia support programmes in local communities across Britain, including:

– Dementia Cafés, which provide a safe, comfortable and supportive environment for people with dementia and their carers to socialise;

– Dementia support workers, who are pivotal in helping people with dementia to maintain their independence, improve their sense of well-being and take control of their own lives; and

– Singing for the Brain, also known as Musical Minds and Singing Memories in Scotland initiatives, which enable people with dementia to communicate and socialise through music and song.

In addition to supporting the Group's Charities of the Year, many Partners also responded to local need raising a further £99,000 for other charitable causes which were important to them and their communities.

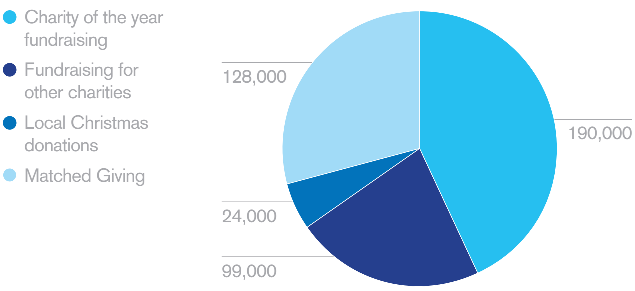
Funds raised by Partners were enhanced by a further £128,000 by the Lloyds Bank and Bank of Scotland Foundations 'Matched Giving' schemes in 2014.

In December 2014, £24,000 was donated by branches across the country to support the community at Christmas. Children's centres, food banks, homeless shelters and other local causes benefited.

Community engagement
Raising funds for charitable causes is just one of the ways the Group supports local communities. In 2014, many Partners also chose to give some of their working time to take part in volunteering activity supported by the Group.

Each year Partners are encouraged to spend a working day supporting their local community. As well as helping many organisations improve their physical environment, they worked with their local schools, used business skills to mentor young people, and ran employability workshops to help local people find work.

Total charitable donations in 2014 (£)



“Before Musical Minds, I was spending a lot of time in the house...

Musical Minds, one of the services to benefit from funding from the Group, enables people with dementia to communicate and socialise through music and song.

“...I would often listen to CDs but sometimes, it felt like being in a box and one of the carers suggested that I get in touch with Alzheimer Scotland who organise Musical Minds. Now I feel like I am a member of a VIP club. It has opened up new horizons for me. I have made so many friends and can just be myself. Wednesdays, when we rehearse, has become my favourite day of the week.”

Dennis, Musical Minds participant

A fair employer

The Group is focused on creating an inclusive culture where every Partner, regardless of gender, ethnicity, disability, sexual orientation, age or personal situation, should be able to fulfil their potential and flourish.

Disability
The Group aims to be an inclusive organisation in which people with disabilities are treated fairly and on equal terms for career development and progression. The Group's People with Disabilities policy is designed to inform colleagues with disabilities of the support the Group will put in place for them and to inform all Partners how to access that support. The Group will make every effort to retain Partners who develop a disability via the provision of reasonable adjustments, including, if necessary, redeployment to a suitable alternative vacancy.

This policy, along with a range of supporting initiatives, helps the Group to achieve this important goal. The Group runs a guaranteed interview scheme that internal candidates with a disability can opt to use and plans to expand that scheme to include external candidates in 2015. Line managers are given the confidence to support Partners with a disability through the availability of online guidance and the completion of annual disability awareness training. The Group is committed to becoming a disability confident employer and is a member of the Business Disability Forum.

Inclusion network
A key enabler in creating an inclusive culture was the launch in 2014 of the Group's diversity network, 'Inclusion'. This aims to help every Partner achieve their potential, focusing on three key themes: personal progression, work-life balance, and an inclusive culture. Executive sponsorship of each of the key audiences of gender, ethnic diversity, LGBT, disability, and 'New to TSB' further embeds the Group's approach in this area.

Gender diversity
Gender balance of Partners is a key priority to ensure that the Group recruits from the widest resource pool and appoints the best person for each role. The gender split of the Board is 27% female, and the Executive Committee is 42% female.

	Gender	Number	%
Board	Male	8	73
	Female	3	27
Bank Executive Committee	Male	7	58
	Female	5	42
Senior Managers*	Male	286	64
	Female	164	36
Managers	Male	958	51
	Female	932	49
All Partners	Male	2,776	32
	Female	5,862	68

* Senior Managers includes members of the Bank Executive Committee except those who are members of the Board.

A flexible, supportive workplace
Support is provided to Partners to help make TSB a great place to work. The Group has policies that enable Partners to use flexible working, including working compressed hours, flexible hours and job sharing to meet personal commitments.

A culture of lifelong learning is being embedded within the organisation. Every Partner is encouraged to have a personal development plan which they review regularly with their line manager. The 'TSB Academy' guides Partners through all of the learning and development that is available. In 2014, a mentoring scheme was launched to encourage informal learning at all levels of experience.

A range of services are also in place to support the wellbeing of Partners. An Employee Assistance Programme gives all Partners free access to confidential counselling and professional advice and an Occupational Health service allows line managers to refer Partners for medical assessments, to ensure support is available to facilitate Partner recovery. During 2014, action was taken to raise the profile of the Group's wellbeing services, including road-shows, briefings and the launch of a new Wellbeing website.

Engaging and collaborative
During 2014 the Group made every colleague a Partner in the business by awarding them £100 of TSB shares and giving every Partner a sense of shared ownership. The partnership model encourages all Partners to play an active role in shaping the Group's business and strategy and is key to delivering consistently great customer service.

'The Link', a forum of Partners across all levels, was established to gather and build on Partner feedback and enables meaningful dialogue between Partners and the Executive leadership. There are five regional Link Groups covering Britain, which together contain 101 Partners drawn from every part of our business. The outputs from every meeting are presented to the Executive Committee to help inform the Group's activity and strategic outlook.

Partner feedback is also received through an annual engagement survey. In our most recent survey, 75% of Partners responded. Confidence in the Group's leadership remains high at 82% while 90% of our Partners said they know and understand the TSB values and live those values when at work.

The Group encourages engagement with Partners and their representatives based on transparency and a commitment to trust and respect in the workplace. To do this, the Group is reviewing its union relationships based on the TSB values and aims to give choice to Partners by recognising three unions. These relationships, coupled with The Link and Interlink, an online forum accessible to all, provide Partners with a real voice at the heart of the business.

Collaboration is also encouraged through the recognition and celebration of Partner contribution. This was demonstrated in 2014 with the launch of a new 'Say Thank You' scheme which gives Partners the opportunity to recognise the contribution of Partners who role model the Group's values.

“Being a part of The Link was one of the highlights of my year, as the opportunity to debate topics affecting both the Group and TSB Partners was something that doesn’t come around often!

Jess O’Dwyer, TSB Partner

A responsible user of resources

In 2014, the Group demonstrated its commitment to the responsible use of resources through investment and initiatives in a number of key areas including improving:

- Energy efficiency by investing over £1 million across seven corporate offices;
- Access to management data by investing £280,000 in upgrading the retail branch network to smart utilities metering;
- Waste management, where 92% of waste is diverted from landfill;
- Paper management through sourcing all paper from suppliers who manufacture from FSC certified sources, and encouraging customers to go paperless; and
- Water management by carefully monitoring usage and repairing reported leaks in less than four hours.

The Group has joined The Energy Savings Opportunity Scheme (ESOS), a Government initiative which requires all eligible businesses to complete a total energy audit by December 2015. Over the next five years, the Group will work towards entry into phase three of the Carbon Reduction Commitment Energy Efficiency Scheme.

A detailed review of the Group's first year of reported greenhouse gas emissions can be viewed in the Directors' report on page 81. As this is the first year of reporting for the Group, there is no base year for comparison and no stated emissions targets against which to report. However, in 2015 the Group expects to establish an energy baseline and, where possible, resource utilisation targets against which it can report in 2016.

While the Group's strategy is one of growth, it is committed to continued stewardship of natural resources and will aim to adopt best practice to minimise the impact of business growth on its resource utilisation.

By order of the Board

Susan Crichton
Company Secretary
24 February 2015

Governance

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"Delivering local banking for Britain."

1. Will Samuel
Chairman

Skills and background
Will was appointed as Non-executive Chairman on 7 March 2014 bringing a wealth of experience of the banking sector and regulatory environment. He has held senior leadership roles at Schroders plc and Schroder Salomon Smith Barney before joining Lazard & Co firstly as Vice Chairman and then Senior Advisor. Will was appointed as Senior Advisor to the Financial Services Authority (FSA) in 2012 and subsequently Senior Advisor to the Prudential Regulation Authority (PRA) before stepping down on appointment to TSB. Former Non-executive Director positions include Chairman of HP Bulmer plc, Deputy Chairman of Inchcape plc and Non-executive Director of the Edinburgh Investment Trust plc.

Current external appointments
– Chairman of Howden Joinery Group plc
– Chairman of Ecclesiastical Insurance Group plc

Committee Membership
Nomination Committee (Chair)

2. Philip Augar
Independent Non-executive Director

Skills and background
Philip joined the Board as an Independent Non-executive Director on 16 May 2014. He is a Member of KPMG's Public Interest Committee and has held a variety of Non-executive positions including Board Member at the Home Office and the Department for Education and adviser on the banking crisis to the Scottish Parliament. He is also a member of the advisory board of New City Agenda. During his 20 year career in the City, he led NatWest's global equity and fixed income division and was Group Managing Director at Schroders with responsibility for the securities business. He has written several books and many articles on the City and related issues.

Current external appointments
– KPMG's Public Interest Committee
– Advisory board, New City Agenda

Committee Membership
– Risk Committee
– Remuneration Committee
– Nomination Committee

3. Norval Bryson
Non-executive Director

Skills and background
Norval joined the Board as a Non-executive Director on 31 January 2014. He is an actuary and currently Deputy Chairman of Scottish Widows Group Limited, a Trustee of the Church of Scotland Investors Trust and Deputy Chairman of St Columba's Hospice in Edinburgh. He was previously a Director at Lloyds TSB Scotland and also previously worked at the Scottish Provident Institution where he held various senior leadership positions including Deputy Group Managing Director and Group Finance Director.

Current external appointments
– Deputy Chairman of Scottish Widows Group Limited
– Trustee of the Church of Scotland Investors Trust
– Deputy Chairman of St Columba's Hospice in Edinburgh
– Chairman, University of St Andrews Staff and Life Assurance Scheme
– Chairman, Scottish Widows Retirement Benefits Scheme

4. Professor Dame Sandra Dawson
Independent Non-executive Director, Senior Independent Director

Skills and background
Dame Sandra joined the Board on 16 May 2014. She brings a wealth of experience and knowledge gained through a broad range of activities, including research, education and financial services in commercial, public and charitable bodies. Former Non-executive Directorships include Barclays Bank plc, JP Morgan Fleming Claverhouse Investment Trust plc, the Financial Services Authority and Oxfam.

Dame Sandra was KPMG Professor of Management Studies at Cambridge Judge Business School from 1995 to 2013, Director of the School from 1995 to 2006 and Master of Sidney Sussex College Cambridge from 1999 to 2009. She was previously at Imperial College, University of London ultimately as Professor of Organisational Behaviour.

Current external appointments
– Non-executive Director, Winton Capital Group
– Non-executive Director and Remuneration Committee Chair, DRS Data and Research Services plc
– Trustee/Non-executive Director, Institute for Government, Social Science Research Council USA and American University of Shariah
– Member of the UK-India Round Table

Committee Membership
– Remuneration Committee (Chair)
– Nomination Committee

5. Alexandra Kinney Pritchard (Sandy Kinney)
Independent Non-executive Director

Skills and background
Sandy was appointed to the Board on 16 May 2014. She has had a distinguished career across the financial services industry. Prior to joining TSB she has been a Non-executive Director at Irish Life and Permanent TSB, Skipton Building Society and the FSCS. Sandy is an accountant and was previously a Senior Partner at PricewaterhouseCoopers LLP (Head of European Strategic Performance Improvement).

Current external appointments
– Non-executive Director, Findel plc
– Non-executive Director, MBNA Limited

Committee Membership
– Risk Committee (Chair)
– Audit Committee

6. Mark Fisher
Non-executive Director

Skills and background
Mark was appointed as a Non-executive Director on 27 June 2014 and was formerly Chairman of TSB Bank plc until 13 February 2014. He is the LBG nominee director. He was LBG Director of Group Operations where his responsibilities included running the Verde programme, the programme establishing TSB as an independent business. He was also responsible for Group Integration and Group Simplification as well as being the Group's Executive Sponsor for disability.

Prior to joining LBG, Mark was Chief Executive Officer of ABN AMRO and was appointed as Chairman of the Managing Board in November 2007. He also held leadership positions at RBS and NatWest.

Current external appointments
– None

7. Godfrey Robson CB
Non-executive Director

Skills and background
Godfrey was appointed to the Board on 31 January 2014. He was previously a Non-executive Director of Lloyds TSB Scotland where he was Chairman of its combined Audit and Risk Committee. Latterly he chaired the IPO Committee of the new Bank.

His main career was in the Civil Service, notably as Head of Economic and Industrial Affairs for Scotland. He is former Chairman of Frontline Consultants, was founder and first Chairman of the Golden Jubilee Hospital Glasgow and has also been a Director of the Invest in Britain Bureau and a Trustee of Caledonia Youth.

Current external appointments
– Senior Policy Advisor to the International Centre for Alcohol Policy

8. Stuart Sinclair
Independent Non-executive Director

Skills and background
Stuart was appointed to the Board on 16 May 2014. During his career he has gained significant experience in financial services in the UK and overseas having held senior leadership positions in several financial services companies including as Chairman of GE Capital Bank (UK), Chief Executive Officer of Tesco Personal Finance, Director of Virgin Direct and Director of Retail Banking at Royal Bank of Scotland.

Current external appointments
- Senior Independent Non-executive Director at Swinton Insurance
- Senior Independent Non-executive Director, QBE Europe
- Non-executive Director, Provident Financial plc
- Non-executive Director, Vitality UK
- Council Member, Royal Institute of International Affairs (Chatham House).

Committee Membership
- Audit Committee
- Risk Committee
- Nomination Committee

9. Polly Williams
Independent Non-executive Director

Skills and background
Polly was appointed to the Board on 16 May 2014. She is a chartered accountant and former Partner at KPMG LLP. She resigned from her partnership in 2003 and has since held a number of Non-executive Directorship roles, including at Worldspreads Group plc, APS Financial Limited and Z Group plc.

Current external appointments
- Chairman, National Counties Building Society
- Non-executive Director, Daiwa Capital Markets Europe Ltd
- Non-executive Director, Scotiabank Ireland Limited
- Trustee of the Guide Dogs for the Blind Association.

Committee Membership
- Audit Committee (Chair)
- Risk Committee
- Remuneration Committee

10. Paul Pester
Chief Executive Officer

Skills and background
Paul was appointed as an Executive Director of the Company on 31 January 2014. Having joined LBG in 2010 he was appointed Chief Executive Officer of the Verde programme in 2011 through which he led the development and establishment of the new TSB within LBG. In 2013, Paul was appointed as Chief Executive Officer of TSB Bank plc and led the launch of the bank, its separation from LBG and listing on the London Stock Exchange.

Prior to this Paul spent six years as the Group Chief Executive Officer at Virgin Money and two years working at Santander UK where he led the acquisition of Bradford & Bingley and the subsequent integration of Abbey, Alliance & Leicester and Bradford & Bingley to create a single UK business. His early career was spent in management consultancy, principally at McKinsey & Company.

11. Darren Pope
Chief Financial Officer

Skills and background
Darren was appointed as an Executive Director of the Company on 31 January 2014. He joined Lloyds TSB in 2005 as Finance Director for the mortgage division where he was responsible for one of Europe's largest mortgage books on the acquisition of HBOS. It was from here that Darren was appointed to Project Verde where he led all aspects of the programme before moving into the Chief Financial Officer role in 2011.

Darren started his career at Prudential plc where he led the development of the Prudential Bank which subsequently became Egg. As one of the founders of Egg, Darren served as the internet credit card and savings provider's UK Finance Director following its 2000 IPO.

"Delivering local banking for Britain."

1. Neeta Atkar
Chief Risk Officer

Neeta is the executive responsible for the Risk Function and provides leadership with respect to the Group's risk management arrangements.

Skills and background
Prior to moving to TSB, Neeta joined Lloyds TSB in 2007 and undertook a range of risk roles both within the retail bank and at group level. She joined the Verde programme in 2011 as its Risk Director.

Neeta started her career at the Bank of England. During her ten years there, she undertook a variety of roles, including responsibility for supervising banks, roles in the Bank's own banking department and policy roles. She moved to the FSA on its creation.

Neeta left the FSA in 2000 to join one of the big four consultancy firms where she worked with a number of financial services clients on a wide range of regulatory, governance and credit risk projects. Thereafter, Neeta worked at Abbey National and later moved into the insurance industry by joining Royal & Sun Alliance in 2004.

2. Susan Crichton
General Counsel and Company Secretary

Susan leads the Group's Legal team in providing a broad range of legal and regulatory advice, legal risk management and counsel to all areas of the business, together with secretarial and governance support to the Board and its committees.

Skills and background
Susan is a solicitor with over 25 years of in-house experience within the financial services industry. She joined TSB in January 2014 as General Counsel and Company Secretary from the Post Office, where she held the role of General Counsel and was instrumental in separating the Post Office from Royal Mail, prior to its IPO in 2013.

Before that, Susan worked at Old Mutual/Skandia where her role focussed on risk and corporate governance.

She was General Counsel (Europe, Middle East and Africa) for GE Money for nine years, responsible for legal, compliance and government relations in the region.

3. Ian Firth
Treasurer

Ian is responsible for the management of the Group's balance sheet. Ian leads TSB's Treasury function and is responsible for management of the capital, funding, liquidity and market risk that arises in the balance sheet.

Skills and background
Ian was appointed Treasurer of TSB in 2012, following 12 years of wholesale banking experience at LBG, most recently as Managing Director of Treasury & Trading. Ian's career started at Barclays where, over a period of 20 years, his roles included Head of Markets Division Asia, Treasurer of BZW Japan, and Global Head of Funding.

4. Nigel Gilbert
Chief Marketing and Communications Officer

Nigel is responsible for internal and external communications, the ongoing development of the Bank's brand strategy and for shaping the reputation and perception of the Bank with customers, shareholders, regulators, the government, media, and external community groups.

Skills and background
Nigel joined TSB in December 2013 from Virgin, where he held the position of Virgin Media's first Chief Marketing Officer before moving on to become Key Projects Director for Virgin Management. Prior to Virgin, Nigel was Group Marketing Director with Lloyds TSB where he led the reinvigoration of the Lloyds TSB brand with the iconic customer proposition 'For the Journey'.

Whilst at Lloyds, Nigel secured the first official sponsorship of the London 2012 Olympic Games and was voted Marketer of the Year by the Financial Services Forum.

5. Rosemary Hilary
Chief Audit Officer

Rosemary is the executive responsible for Internal Audit and provides an independent audit service to the Group Audit and Risk Committees and Board. She is responsible for assessing significant risks and the design and operation of key controls in order to improve the Group's risk management, control and governance processes.

Skills and background
Rosemary has a wealth of experience gained from her career in audit, risk and financial services regulation. Rosemary joined TSB in October 2013. Before that, she held a number of senior regulatory roles at the FSA and then the FCA: Head of Internal Audit; Head of Risk Review; Head of Authorisations; and ten years as a front-line supervisor. Prior to that, Rosemary was at the Bank of England where she worked as a banking supervisor and also developed an oversight function in the Bank's dealing room.

Before joining the Bank of England, Rosemary worked for Girobank where she ran the Treasury Back Office function; this followed a graduate traineeship at Sun Alliance Insurance.

Current external appointments
- Trustee of the Board of Shelter and member of the Audit, Risk and Finance and Remuneration Committees
- Member of the MBA Advisory Board at Cass Business School

6. Rachel Lock
Human Resources Director

Rachel leads the Human Resources function across the Group, providing support to the Board, Remuneration Committee and Partners through the development and implementation of the Bank's people and remuneration strategy, framework and policies.

Skills and background
Rachel joined the TSB team in 2012 and has led the creation of the Group's HR function. Before joining TSB, Rachel was HR Director for LBG's Corporate Functions. Rachel first joined Lloyds Bank in 1986 and worked through the ranks holding a number of different Business and HR positions.

7. Ashley Machin
Chief Digital Officer

Ashley is the executive responsible for the ongoing development and integration of TSB's digital strategy.

Skills and background
Ashley joined TSB in October 2014 from LBG where, among a number of other roles, he was Managing Director of Group Digital. In this role, Ashley led the biggest internet bank integration in Europe, with the merger of HBOS and Lloyds TSB, and also paved the way for LBG to become the first bank to make mobile payments possible. Ashley has also been a member of the Digital Advisory Board for the Government for the last two years.

8. Peter Navin
Branch and Business Banking Director

Peter is the executive responsible for the leadership of the Branch, Business Banking and Intermediary Mortgage businesses. He leads the development of strategies that respond to changing customer demands.

Skills and background
Peter started his career as an international economist with ICI in the chemicals and pharmaceutical sector, before joining the (original) TSB in 1989. Here he held a number of roles including Director of Strategy for retail banking and insurance before moving into IT and operations. Within Lloyds TSB, Peter was Corporate Banking Director having previously been Product and Marketing Director for the same division.

Peter was appointed to the Scottish Executive Committee of LBG in 2009. He was also appointed Executive Director of Lloyds TSB Scotland plc in the same year and was made Chief Executive shortly afterwards, a position he held until June 2013. During this time, the business was prepared for its future role within TSB. Peter was appointed to his current role in 2011.

9. Jatin Patel
Product Director

Jatin leads the Bank's Products team with responsibility for directing the development and implementation of strategies for the Bank's range of products and ensuring that they reflect core risk management, regulatory and customer requirements.

Skills and background
Jatin joined the Bank at the beginning of 2013 and assumed the role of Product Director in July 2014. Prior to joining TSB he was the Current Accounts Director at Lloyds TSB, and prior to that held a number of roles in the Lloyds TSB Current Account business gaining a broad experience. Jatin also has experience of working in Group Strategy and Corporate Development and worked for a number of years in strategy consulting.

10. Helen Rose
Chief Operating Officer

Helen is the executive responsible for Customer Operations across the Bank, providing leadership and strategic direction to the Bank's Operations and IT functions including Change and Telephony.

Skills and background
Helen joined Lloyds TSB in 2005 as Finance Director for the Community Bank. She subsequently joined the Retail Board and was responsible for leading the integration of the Retail Divisions of Lloyds TSB and HBOS. She joined Verde in 2011 as Chief Operating Officer to lead the development and build of TSB. Following completion of the build programme, Helen took on responsibility for operations, payments, IT, customer relations, property, branch, telephony and ATM support teams.

Prior to joining Lloyds TSB, Helen spent 15 years in the retail sector where she held a variety of senior finance roles at Dixons, Forte and Safeway. Helen is a Fellow of the Institute of Chartered Accountants having qualified at Coopers and Lybrand.

11. Paul Pester
Chief Executive Officer

12. Darren Pope
Chief Financial Officer

Corporate governance statement

Chairman's introduction

At TSB, all our stakeholders are important to us. The design and operation of a robust governance structure appropriate for a group of TSB's scale and ambition is critical to meeting their needs.

As I mentioned in my Chairman's letter on page 3, in positioning the Group to achieve this objective the Board was enlarged ahead of its listing in June 2014. Its members were selected to provide an appropriate balance of skills, experience, independence and knowledge of the Group and the UK retail banking market.

As a Board, we endorse and subscribe to the brand and competitive positioning developed by the Executive, including the five values by which all TSB's Partners seek to behave; these values are to be Responsible, Transparent, Collaborative, Straightforward and Pioneering.

This values led approach is very much aligned to the Board's collective commitment to operating to the highest standards of corporate governance. We comply with both the letter and spirit of the UK Corporate Governance Code, representing your interests as the Group delivers its strategy.

Will Samuel
Chairman

Compliance statement

At 31 December 2014 TSB Banking Group plc (the Company) was fully compliant with the provisions of the UK Corporate Governance Code 2012 (the Code) which is available at www.frc.org.uk. The Company achieved premium listing on the London Stock Exchange on 25 June 2014. The corporate governance statement and the reports of the Audit, Remuneration, Risk and Nomination Committees explain how the provisions and principles of the FCA Listing Rules, Disclosure and Transparency Rules (DTRs) and the Code have been applied in the period from listing to 31 December 2014.

Change in the structure of the Group and preparation for plc status

The Company was incorporated as a wholly owned subsidiary of Lloyds Bank plc on 31 January 2014. On 25 April 2014, the Company acquired the entire issued share capital of TSB Bank plc from Lloyds Bank plc for a consideration of 50,000,000 ordinary shares of 1p each. The effect of this reorganisation was to insert the Company as the new immediate parent company of TSB Bank plc. Other significant transactions undertaken to prepare the Company for Admission are described in the significant developments section of the Business review on page 17.

In preparation for the Company's listing, it was recognised that although the internal governance processes were fit for purpose, additional work was required to enhance the Company for listed status. As a result, a number of workstreams were put in place to ensure that the Company's operations as a listed company complied with relevant regulation and guidance. Work included creating and embedding the necessary policies and procedures to meet the various corporate governance and regulatory requirements applicable to the Company.

The corporate governance framework

The corporate governance framework encompasses the Company, TSB Bank plc (the Bank) and any other subsidiaries of the Company from time to time. In addition, each Director serves as a Director on the Board of TSB Bank plc which is also chaired by Will Samuel. The Board of the Company (the Board) as a whole is collectively responsible to shareholders for promoting the long term success of the Company by directing the Company's affairs. The corporate governance framework is designed to assist the Board, the Board of the Bank and the Chief Executive Officer in discharging their duties by ensuring an appropriate scheme of delegation. This is achieved through:

- Board Authorities which set out the basis for delegation of authorities from the Board and the Bank Board to Board Committees and to the Chief Executive Officer; and

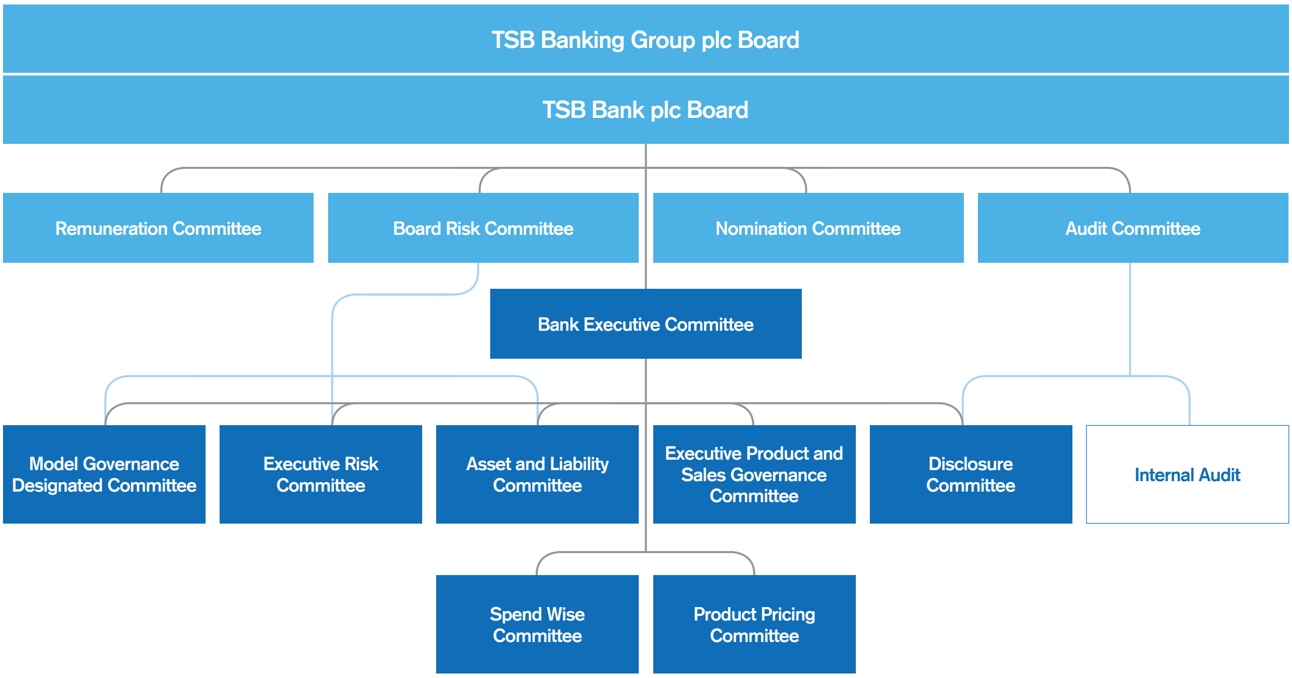
- Delegated Executive Authorities through which the Chief Executive Officer delegates aspects of his own authority to the Senior Executives and which sets out the support provided to him by the Executive Committees.

The corporate governance structure is supported by the internal governance framework as outlined on page 47.

An important principle, applied throughout the Company's governance framework, is that the delegation of executive authority is to the individual office holders (who may in turn delegate aspects of their authority to others). Executive committees may be established to support the individuals in exercising their delegated authorities but the committees do not separately hold any delegated authority in their own right.

The Corporate governance framework will be reviewed at least annually by the Board to ensure that governance arrangements are and remain effective.

The diagram below sets out the internal governance framework of Board and Executive Committees.



The role and responsibility of the Board

The Board's full responsibilities are set out in the matters reserved for the Board which are summarised below.

(i) Strategy

- Approving the Group's strategy and long term objectives and ensuring that rigorous and robust processes are in place to monitor organisational delivery of the agreed strategy within risk appetite and in accordance with all applicable laws and regulations;
- Determining Board structure, size and composition for the Company and TSB Bank plc, succession planning for members of the Company and Bank boards and committees, determining the roles of Chairman, Senior Independent Director, Non-executive Directors, Chief Executive Officer and Executive Directors;
- Approving the high level framework of Board delegations;
- Approving the share dealing code for Directors and other Persons Discharging Managerial Responsibilities (PDMR);
- Approving the governance policy and noting funding, liquidity, Pillar III disclosure and accounting policies; and
- Approving Group contracts with a lifetime cost exceeding £10 million, existing contracts where the cost exceeds £20 million, and approving sale and purchase of assets and raising capital approval of all contracts outside of the normal course of business.

(ii) Risk

- Determining risk appetite, which defines the amount of risk that the Board is prepared to take in pursuit of the Group's business objectives, including in periods of business and operational stress. Risk appetite is set and approved at least annually; and
- Reviewing the effectiveness of the Company's and Bank's risk management and internal control systems.

(iii) Shareholder communications

- Approving the interim results, financial statements and annual report and accounts;
- Approving the Group's dividend policy; and
- Approving the resolutions and associated documentation for shareholders at a general meeting.

Role of Directors

There is a clear division of responsibility between the Chairman and Chief Executive Officer, approved by the Board.

(i) Chairman

The Chairman is responsible for leadership of the Board and Bank Board and is pivotal in creating the conditions for overall Board and individual Director effectiveness. The Chairman's key accountabilities are as follows:

- Building an effective and complementary Board;
- Running the Board and setting its agenda;

Corporate governance statement (continued)

– Ensuring the Board members receive accurate, timely and clear information;

– Managing the Board and encouraging a culture of openness and debate;

– Ensuring effective communication with and chairing general meetings of shareholders;

– Encouraging active engagement by all Board members;

– Demonstrating effective leadership;

– Upholding the highest standards of integrity, probity and corporate governance; and

– Promoting effective relationships and open communication.

(ii) Chief Executive Officer
The Chief Executive Officer is responsible for running the business and has the following key responsibilities and accountabilities:

– Leading the formulation of the Group's strategy;

– Co-ordinating activities to implement strategy and for managing the business in accordance with the Group's risk appetite and business plan approved by the Board;

– Making decisions in all matters affecting the operations, performance and strategy of the business, with the exception of those matters reserved to the Board or specifically delegated by the Board to its committees;

– Setting the tone at the top in relation to culture, ethos and corporate social responsibility;

– Establishing, maintaining and implementing the risk management and funding and liquidity frameworks in line with Board approved appetite for risk; and

– The continuing review of the organisational structure of the Group and making recommendations for changes to optimise the use and adequacy of resources.

Other than matters expressly reserved to the Chief Executive Officer, authority can be delegated to the respective Functional Heads (Bank Executive Committee members), jointly or severally.

(iii) Non-executive Directors
Non-executive Directors have the same legal responsibilities as other Directors. However the role of the Non-executive Director has the following key elements:

– Providing constructive challenge to management and helping to develop strategy;

– Scrutinising the performance of management in meeting agreed goals and objectives and monitoring the reporting of performance;

– Satisfying themselves on the integrity of financial information and that financial controls and risk management systems are robust and defensible; and

– Determining appropriate levels of remuneration for Executive Directors and having a prime role in appointing and where necessary removing Executive Directors and in succession planning.

(iv) Senior Independent Director
The Senior Independent Director's role is defined as follows:

– Acting as a sounding board for the Chairman and to serve as an intermediary for the other Directors when necessary;

– Being available to shareholders if they have concerns which cannot otherwise be resolved;

– Chairing meetings in the absence of the Chairman;

– Reviewing the Chairman's performance; and

– Acting as an intermediary for Non-executive Directors where required to help them to challenge and contribute effectively.

Board membership and composition
Certain responsibilities of the Board and Bank Board are delegated to the Nomination, Audit, Risk and Remuneration Committees of the Board to assist the Board and Bank Board in carrying out their functions and to ensure independent oversight of internal control and risk management. The Committee terms of reference are available on the Group's website at www.tsb.co.uk.

As at the date of this report the Board has 11 members and is comprised as follows:

Non-executive Chairman	Will Samuel (independent on appointment)
Executive Directors	
Chief Executive Officer	Paul Pester
Chief Financial Officer	Darren Pope
Independent Non-executive Directors	Philip Augar
	Professor Dame Sandra Dawson (Senior Independent Director)
	Sandy Kinney
	Stuart Sinclair
	Polly Williams
Non-executive Directors	Norval Bryson
	Mark Fisher
	Godfrey Robson CB

Full biographical details including their skills and experience are shown on pages 38 to 39.

Board Committees

In June 2014 the Board established a Risk Committee (chaired by Sandy Kinney) to oversee the management of the risks the Group faces and an Audit Committee (chaired by Polly Williams) to oversee financial reporting and internal control. The Board also established a Nomination Committee (chaired by Will Samuel) to lead the process for appointments to the Board, as well as a Remuneration Committee (chaired by Dame Sandra Dawson), which has created and brought into operation the new approach to remuneration that supports the ongoing delivery of sustainable performance.

The Audit, Nomination, Remuneration and Risk Committees have each prepared reports which include a full discussion on their role, structure and composition.

Meeting attendance

The table below sets out the attendance of Directors at Board meetings and the attendance of Committee members at the relevant Committee meetings during the year.

Name of Director	Board meetings attended	Audit Committee meetings attended	Risk Committee meetings attended	Nomination Committee meetings attended	Remuneration Committee meetings attended
Number of meetings held	**11**	**5**	**4**	**–**	**7**
Will Samuel(2)	11 out of 11	–	–	–	–
Paul Pester(1)	11 out of 11	–	–	–	–
Darren Pope(1)	11 out of 11	–	–	–	–
Philip Augar(3)(6)	7 out of 9	–	4 out of 4	–	6 out of 7
Norval Bryson(1)(5)(6)	9 out of 11	–	3 out of 4	–	6 out of 7
Dame Sandra Dawson(3)	9 out of 9	–	–	–	7 out of 7
Mark Fisher(4)(5)(6)	5 out of 6	–	3 out of 4	–	–
Sandy Kinney(3)(6)	8 out of 9	4 out of 5	4 out of 4	–	–
Godfrey Robson(1)(5)	11 out of 11	5 out of 5	–	–	–
Stuart Sinclair(3)(6)	7 out of 9	4 out of 5	4 out of 4	–	–
Polly Williams(3)(6)	8 out of 9	5 out of 5	3 out of 4	–	7 out of 7

(1) Appointed to the Board on 31 January 2014
(2) Appointed to the Board on 7 March 2014
(3) Appointed to the Board on 16 May 2014
(4) Appointed to the Board on 27 June 2014
(5) Norval Bryson is paid a fee for attending the Risk and Remuneration Committees, Godfrey Robson is paid a fee for attending the Audit Committee and Mark Fisher is paid a fee for attending the Risk Committee. Accordingly their attendance at these committee meetings is disclosed in the table above, although they are not members of these committees. Their attendance and participation at these meetings for a transitional period enhances the discussion and ensures their experience and knowledge of the Group assists the committees in discharging their duties effectively.
(6) Directors not able to attend meetings due to longstanding prior commitments or illness, provided comments to the relevant Chair on matters to be discussed at the relevant meeting.

Board development programme

Each of the Non-executive Directors appointed to the Board during 2014, including the Chairman, completed a rigorous induction programme, the exception to this being Godfrey Robson and Norval Bryson, who were existing Directors of TSB Bank plc. The induction programme covered a wide range of areas including strategy and markets, capital and liquidity, conduct matters, the control environment and UK and EU regulatory architecture and infrastructure. All Directors took part in further training to prepare them for their roles as Directors of a listed company. Additional role specific training was also provided to those Non-executive Directors who have additional responsibilities and accountability within the Board structure, (i.e. the Chairman and chairs of the respective committees). Finally, Non-executive Directors were given the opportunity to request additional training in order that they could become fully comfortable with their role within the Board and to ensure that they were able to contribute to the operation of the Board and success of the Company in the fullest manner possible.

On an ongoing basis, deep dive sessions are regularly held to allow Non-executive Directors to explore key strategic and risk issues outside of the time constraints of a formal board meeting. A number of such sessions, run by relevant members of the Bank Executive Committee, were held during 2014 and covered topics including possible product launches and changes and the review of liquidity stress scenarios. The Chairman, as required by the Code, maintains an oversight of the training and development requirements of the Board, supported by the Company Secretarial and Risk functions. This support includes a quarterly review by the Risk function of mandatory training for the Group's Partners and the applicability of extending a number of these sessions to one or more of the Directors, as considered appropriate.

Corporate governance statement (continued)

Board effectiveness review and evaluation

An independent Board effectiveness programme is currently being undertaken led by Elisabeth Marx of Stonehaven International. As the Board is newly established the programme is designed to help the Board maximise its effective collaboration and constructive challenge and to support the Non-executive and Executive Directors in fulfilling their roles on a unitary board. An update as to the outputs of this programme will be included in the 2015 Annual Report. Stonehaven International has no other connection with the Company.

Independence

The Board has considered whether there are any relationships or circumstances which could, or appear to, affect the Directors' judgement. No Independent Non-executive Director, or member of their immediate family, has ever had a material relationship with the Group nor receives additional remuneration apart from Directors' fees, nor participates in the Group's share plans or pension schemes. Godfrey Robson (former Director of Lloyds TSB Scotland plc), Norval Bryson (Deputy Chairman of Scottish Widows Group Limited and former Director of Lloyds TSB Scotland plc) and Mark Fisher (LBG nominee Director and former Chairman of TSB Bank plc) are not considered to be independent. No Directors serve as Directors of any companies or affiliates in which any other Director is a Director. Lloyds TSB Scotland plc changed its name to TSB Bank plc on 9 September 2013.

Management of conflicts of interest

Each Director has a duty under the Companies Act 2006 to avoid a situation in which they have, or may have, a direct or indirect interest that conflicts, or might conflict, with the interests of the Company. This duty is in addition to the existing duty that Directors owe to the Company to disclose to the Board any interest in a transaction or arrangement under consideration by the Company. If Directors become aware of any situation which may give rise to a conflict of interest they must inform the rest of the Board immediately and the Board is then permitted under the Articles of Association to authorise such conflict. This information is then recorded in the Company's register of conflicts together with the date on which authorisation was given. In addition, Directors are asked to certify, on an annual basis, that the information contained in the register is correct.

Save as set out below in relation to Norval Bryson, there are no potential conflicts of interest between any duties owed by the Directors or senior management to the Company and their private interests or other duties.

Norval Bryson is Deputy Chairman and a Non-executive Director of Scottish Widows Group Limited, the holding company of various life, pensions and insurance companies which are potential competitors of TSB in the life market. Norval Bryson is a director of Lloyds Bank General Insurance Limited, a subsidiary of Scottish Widows Group Limited, which underwrites the home insurance product distributed by TSB under the General Insurance Distribution Agreement.

Reappointment of Directors

The Board considers that all Directors continue to be effective, committed to their roles and have sufficient time available to perform their duties. In accordance with the Code all Directors will offer themselves to shareholders for re-election annually. All Directors, save for Godfrey Robson, will seek election or re-election at the Company's 2015 AGM.

Directors not seeking re-election at the 2015 AGM

Godfrey Robson will not seek re-election as a Non-executive Director at the Company's 2015 AGM and will step down from the Board at that time. Accordingly, Godfrey's office as a Non-executive Director of the Company will cease at the conclusion of the Company's 2015 AGM.

Company Secretary and independent professional advice

The Company Secretary, Susan Crichton, is responsible to the Board for ensuring compliance with corporate governance requirements. The Board has access to her individually and collectively. As well as the support of the Company Secretary, any Director may take independent professional advice at the Company's expense in the furtherance of their duties, where considered necessary.

Evaluation of internal controls procedures

The Board has carried out an assessment of the effectiveness of the Company's risk management and internal control systems. The Audit Committee report explains the process in more detail on page 52.

External auditor

PricewaterhouseCoopers LLP (PwC) have expressed their willingness to continue as the Company's auditor. As outlined in the Audit Committee report on page 53 resolutions proposing their reappointment for 2015 and to authorise the Directors to determine their remuneration will be proposed at the 2015 AGM, as recommended by the Audit Committee.

Principal accountant fees and services

An analysis of fees for professional services provided by PwC, the Company's independent Auditor is set out in note 16 to the Group's consolidated financial statements on page 117.

Liaison with shareholders

The Executive Directors meet regularly with investors to discuss the Company's business and financial performance. In her role as Chairman of the Remuneration Committee, Dame Sandra Dawson met with ten of TSB's largest shareholders to discuss the Group's remuneration policy as detailed in the Directors' remuneration report and other matters as they arose. In addition, Executive Directors receive a monthly update of share ownership and trading performance, briefing the Board of any material events and changes. The Company's website (www.tsb.co.uk) contains information of interest to both institutional investors and private shareholders.

Internal governance framework

An explanation of the Bank Executive Committee and its sub committees is set out below.

(i) Bank Executive Committee

Chaired by the Chief Executive Officer, the Bank Executive Committee is the Group's principal executive committee. The Bank Executive Committee collectively supports the Chief Executive Officer in developing and implementing the Group's strategy, monitoring business performance and agreeing any actions that are required to manage issues that affect the Group. Consideration is given to the interests of all stakeholders, including customers, shareholders and Partners.

All members of the Bank Executive Committee report to the Chief Executive Officer. In addition, the Chief Risk Officer has a reporting line to the Chair of the Board Risk Committee. To protect the independence of Internal Audit, the Chief Audit Officer's primary reporting line is to the Chair of the Audit Committee with a secondary line reporting to the Chief Executive Officer.

Bank Executive Committee Sub-Committees

(i) Executive Risk Committee

Chaired by the Chief Risk Officer, the Executive Risk Committee reviews and recommends overall risk appetite, including its allocation within the Group. This Committee provides oversight to assure the effective operation of governance, risk and control frameworks across the Group. The Executive Risk Committee also regularly reviews aggregate risk exposures, concentrations of risk and risk versus reward returns and ensures that appropriate action is taken where risk positions are considered inappropriate.

(ii) Model Governance Designated Committee

Chaired by the Chief Risk Officer, the Model Governance Designated Committee approves, monitors and reviews material risk models across the Group. This is also the Board's designated model governance committee.

(iii) Product Pricing Committee

The Product Pricing Committee is chaired by the Chief Financial Officer and is responsible for reviewing and approving pricing strategy and any decisions in relation to the pricing of the Group's products. The Committee provides oversight over the management of the relevant categories of risk, including conduct risk, associated with product pricing strategies.

(iv) Asset and Liability Committee

Chaired by the Chief Financial Officer, the Asset and Liability Committee reports to the Board Risk Committee and is responsible for the strategic management of the Group's balance sheet and the risk management framework for all treasury risks. These are principally market, liquidity, capital, counterparty credit risks and earnings volatility.

(v) Spend Wise Committee

Chaired by the Chief Operating Officer, the Spend Wise Committee is responsible for the Group's expenditure. The Committee ensures that the Group spends efficiently and reviews cost budgets and forecasts to ensure that they support the delivery of the Group's strategy. The Committee also considers requests for expenditure that are over certain limits or are outside of forecast and budgets before they are spent to ensure these requests represent value for money.

(vi) Disclosure Committee

Chaired by the Chief Financial Officer and overseen by the Audit Committee, the Disclosure Committee is responsible for identifying inside information and determining how and when the Group should disclose that information in accordance with the Listing Rules. The Committee also reviews and recommends to the Board or Audit Committee items for approval, including, but not limited to, the annual report and accounts, preliminary announcement of annual results, half-year report and interim management statements.

(vii) Executive Product and Sales Governance Committee

The Executive Product and Sales Governance Committee is chaired by the Chief Risk Officer and is responsible for ensuring effective execution of the five key stages of the product lifecycle, providing strategic and senior oversight over the Product and Sales Governance Policy to identify, measure, monitor and control risks associated with product and sales process activities.

By order of the Board

Susan Crichton
Company Secretary, 24 February 2015

Nomination Committee report

“The Board values diversity in the boardroom and believes that creating an inclusive and diverse culture supports the attraction and retention of talented people and enhances the success of the Group.

Chairman’s introduction

All the current Nomination Committee members are independent Non-executive Directors.

The Nomination Committee is authorised by the Board to keep the composition of the Board under review and to lead the process for appointments to the Board, Board Committees and the chairmanship of those Committees. It is also responsible for keeping the structure, size and composition of the Board under regular review, and for making recommendations to the Board with regard to any changes necessary. The Nomination Committee also considers succession planning for the Board, taking into account the skills and expertise that will be needed on the Board in the future.

The members of the Nomination Committee are as follows: Will Samuel (Chairman), Dame Sandra Dawson, Philip Augar and Stuart Sinclair. The Committee was appointed on 22 May 2014 and had its first meeting in January 2015.

Recruitment of Non-executive Directors
Korn Ferry Whitehead Mann (KFWM) was used to assist with the selection of Non-executive Directors prior to the IPO and before the Committee had been established. Since then, and up to the date of this report, no further Board appointments have been made. However, the Board is currently considering the appointment of a Non-executive Director with retail banking experience to enhance the Board’s skills in this area. KFWM is assisting with this. Other than this, KFWM has assisted with the recruitment and assessment of certain members of the Executive team.

Diversity
The Group is committed to fair and consistent treatment of all Partners regardless of their personal characteristics which include gender, ethnicity, religion, sexual orientation, transgender status, disability, nationality or age. The Board has adopted this approach to diversity and has regard to it when considering Board candidates who are always assessed against objective criteria and appointed on merit. This has helped us develop a diverse Board with a mix of perspectives where challenge is encouraged. We currently have 27% women on the Board; although this may change over time as the Board is refreshed and new appointments are made. In identifying candidates for future appointments, the Committee will consider the balance of skills, knowledge, experience and diversity required on the Board for a particular appointment.

The number of women in senior management positions and throughout the Group is set out in the Responsibility review on page 34.

The Chairman’s other significant interests
My other significant commitments are as detailed on page 38. There have been no changes to them during the period from appointment to 31 December 2014.

Will Samuel
Chairman

Audit Committee report

"As Chair of the Group's Audit Committee I am proud to report on the activities of the Committee in the Group's inaugural annual report and accounts since listing.

Chair's introduction

I have a very clear understanding of the importance placed on the role of the Committee and, through this report, I will ensure that I and the Committee are held to account and that its activities are reported in a straightforward and transparent manner.

Prior to listing on 25 June 2014, the Group had a single combined Board Audit and Risk Committee, chaired by Godfrey Robson. At the date the Group listed, separate Audit and Risk Committees were established and I was appointed Chair of the Audit Committee.

I am a chartered accountant and spent a number of years as an Audit Partner at KPMG. I chair the board of the National Counties Building Society and am a Non-executive Director of Daiwa Capital Markets Europe and Scotiabank Ireland Limited. At the same time as my appointment, the Board also appointed Sandy Kinney and Stuart Sinclair to the Committee who also bring considerable relevant experience and skills. The Committee members' biographies are set out on pages 38 and 39. Godfrey Robson continues to attend and contribute to meetings of the Committee to ensure that its operation benefits from his considerable experience of the Group. All Non-executive Directors, including the Chairman, of the Group have a standing invitation to attend meetings of the Committee.

The report that follows describes the Committee's responsibilities and its activities since its establishment. It describes the matters reviewed by the Committee in assessing the transparency and integrity of the Group's inaugural financial reporting as a listed Group. It explains the Committee's work in assessing the effectiveness of the Group's internal controls and risk management framework and the activities undertaken to monitor the establishment and priorities of the Group's Internal Audit function. In discharging its responsibilities during 2014, the Committee has sought to develop a transparent and open framework of review and challenge of management's key judgements. External audit provides a key role in this challenge process and the Committee has satisfied itself as to the effectiveness and independence of the Group's external auditor during 2014.

The Group's focus in 2014 was establishing TSB as a listed Group and the Committee's activities were consistent with that objective. I am satisfied with the progress made in 2014. With the Group now focused on delivering its growth strategy, the Committee's focus in 2015 will be to ensure that the internal control framework evolves whilst remaining both adequate and effective as the Group grows.

Polly Williams
Chair, Audit Committee

Audit Committee report (continued)

Membership and operation of the Committee

The Committee comprises three independent Non-executive Directors, each with recent, relevant experience in finance or banking. Membership includes at least one member of the Board Risk Committee.

Committee meetings are attended by members of the Executive including the Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, Chief Audit Officer, and General Counsel. The external auditor, PwC, attends each meeting of the Committee which includes a private session between the Committee members and the external auditor without the Executive.

I report to the Board after each Committee meeting on the main matters discussed so that all Directors are informed on the activity of the Committee. I am available to all Directors for discussion of any matters in more detail and maintain regular dialogue outside Committee meetings with the Executive, particularly the Chief Executive Officer, Chief Financial Officer and Chief Audit Officer, and also with the lead and engagement partners of the external auditor.

The Committee met five times in 2014 following the Group's listing and has allocated its time to reflect the priorities of the Group in its initial post listing period as follows.

Audit Committee responsibilities and activity in 2014

The Committee is responsible for ensuring that a straightforward and transparent culture exists to ensure that the Group operates within the Board approved risk appetite for financial reporting, internal control, fraud and whistleblowing. Specifically, the Audit Committee is responsible for reviewing and reporting to the Board on:

- Financial statements and reporting;
- Internal controls and risk management systems;
- Whistleblowing and fraud;
- The Group's Internal Audit function; and
- The Group's relationship with its external auditors.

Financial statements and reporting

The Committee is responsible for review and challenge of the Group's interim and annual financial statements including the significant financial reporting estimates and judgements which they contain. During 2014, since its establishment, the Committee has considered the following matters:

(i) The consistency and appropriateness of, and any changes to, significant accounting policies

The Committee has considered and accepted management's review of the Group's accounting policies. This review included consideration of the nature of the Group's activities, industry wide practice and the obligation to adopt the accounting policies used in compiling the historical financial information in the Group's IPO price range prospectus.

The Committee considered and accepted separately management's proposals to adopt the principles of International Financial Reporting Interpretations Committee (IFRIC) 21 Levies in 2014 (see note 35 to the Group's consolidated financial statements on page 138).

(ii) The methods used to account for significant transactions

The Committee has reviewed and supported proposals from management on the accounting for the following significant transactions:

	Financial statement reference
Corporate reorganisation leading to the insertion of the new parent company	Basis of preparation (page 100)
Accounting for the Transitional Services Agreement	Note 16
Defined benefit pension schemes/implications of the TSB Partners' TUPE transfer	Note 17
Mortgage Enhancement and segmental reporting	Note 21
Hedge accounting income statement volatility associated with derivatives	Note 28

(iii) Whether the Group has made appropriate estimates and judgements

The Committee has reviewed the nature, basis for and the appropriateness of the estimates and judgements proposed by management in the Group's financial statements. Consideration has been given to these estimates and judgements at each of the Group's reporting dates in 2014. The table below summarises the position reflected in the Group's financial statements for the year ended 31 December 2014. After challenge, the Committee supported management's proposals in each of these cases.

Significant judgements and estimates	Audit Committee considerations	Financial statements reference
Impairment provisioning	At 31 December 2014, the Group's allowance for impairment losses was £86.1 million. Determining the adequacy of provisions against the Group's loan portfolio requires judgement in assessing the level of incurred losses in the Group's loan portfolio and future cash flows expected from impaired loans. During the year, the Committee received regular reports from management on provisioning including management's adjustments to modelled outcomes. These reports assessed the adequacy of historic provisions against subsequent recoveries, reviewed management's governance arrangements over provisioning adequacy and in particular the governance over impairment models and benchmarked the Group's metrics against other banks. At 31 December 2014, the Group's impairment provisions of £86.1 million included £20.5 million from management's adjustments to modelled outcomes. A key focus of the Committee during the year was an assessment of the level and rationale for such adjustments. The Committee received regular reports to support these adjustments, and reviewed management's plans to amend, where appropriate, the relevant models to minimise future adjustments. The Committee concluded that a robust governance framework existed to monitor provisioning adequacy and that the assumptions and judgements applied by management were appropriate.	Note 10 (page 112)
Customer remediation provision	Conduct issues are a key focus of the banking industry. The Group is protected from losses arising from historic customer misconduct under an indemnity provided by Lloyds Bank plc. However, technically the Group retains the primary liability for alleged misconduct to certain customers and accordingly a provision for customer remediation of £22.2 million has been recognised, together with an equivalent asset of £22.2 million in respect of indemnities provided by Lloyds Bank plc, primarily in respect of alleged mis-selling of added value current accounts, credit card protection, interest rate hedging products and in respect of an exposure to payment protection insurance products relating to mortgages. The Committee received a report from management setting out the approach undertaken to assess any liability for alleged conduct issues. This included assessing themes and volumes of customer complaints both internally and using available public information, discussions with regulators and broader commentary within the industry. The Committee was satisfied that the provisions, recovery under the indemnity and related disclosures in the financial statements were appropriate.	Note 33 (page 137)
Recoverability of deferred tax assets	At 31 December 2014, the Group's deferred tax assets included £106.4 million in respect of unutilised temporary differences arising in 2013 from the transfer of customer balances to the Group from LBG entities. Continued recognition of this asset requires judgement in assessing the availability of future taxable profits to absorb these temporary differences. The Committee received reports from management that concluded that sufficient taxable profits were forecast against which the full temporary difference is expected to be utilised. A variety of scenarios were considered by management in this assessment. The Committee agreed with management's judgement that based on the Group's forecast taxable profits, continued recognition in full of the deferred tax asset remained appropriate.	Note 20 (page 121)
Effective interest rate methodology	At 31 December 2014, the Group carried an asset of £16.6 million, for accounting purposes, in respect of the deferred recognition of bonus interest payable on certain savings products. Determining the carrying value of this asset requires management to estimate the expected repayment profile of the savings balances. The Committee received reports from management during the year summarising their approach to estimating the expected repayment profile of the savings balances which included consideration of the effect of new pricing on existing customer behaviour, developments in the industry, and an assessment of customers' future behaviour in the current low interest rate environment. The Committee was satisfied that the carrying value of the asset and the associated income recognition was appropriate.	Note 1 (page 106)
Fair value of financial instruments carried at amortised cost	Accounting standards require the Group to disclose the fair value of financial instruments that are carried on the balance sheet at amortised cost. As quoted prices are not available for the Group's amortised cost financial instruments, estimating their fair value requires judgement. The Committee received a report from management summarising the methodology adopted, including the key inputs and judgements required in estimating the fair values at 31 December 2014. The Committee concluded that the approach adopted and the fair values disclosed were appropriate.	Note 6 and 12 (pages 107 and 112)

Audit Committee report (continued)

(iv) The going concern statement
The Committee considered management's approach to, and the conclusions of, the assessment of the Group's ability to remain a going concern. The results of that assessment are set out in the Directors' report on page 82.

(v) Review of annual report
The Committee considered management's approach to, and governance arrangements over the preparation of this annual report and recommended to the Board that, taken as a whole the annual report was considered to be fair, balanced and understandable. The approach and results of that assessment are set out in the Directors' report on page 83.

Internal controls and risk management systems
The Committee is responsible for annually reviewing the adequacy and effectiveness of the Group's internal controls and risk management systems. The key elements for the management of risk within the business and the system for internal controls are set out within the risk management framework (see page 47). In conducting the review the Committee considered the following specific matters:

– A detailed review of the Group's governance and internal control framework;

– A review of the adequacy and effectiveness of the Group's internal financial control framework;

– Regular management information on the activity of Internal Audit; and

– The review of a Type 1 International Standard on Assurance Engagements (ISAE) 3402 controls report from LBG on the design effectiveness of those controls operated on the Group's behalf by LBG under the TSA.

Whistleblowing
The Committee oversees the adequacy of TSB's whistleblowing arrangements, ensuring that they are proportionate for the Group and enable Partners and contractors to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters. In 2014, the Committee considered a report on the whistleblowing arrangements within the Group and an overview of instances of whistleblowing. The report concluded that there is awareness of whistleblowing processes and procedures within the Group and that there were no matters that would suggest these are not operating effectively.
The report concluded that there were no areas of concern or trends identified and that appropriate action had been taken with the small number of cases reported.

Internal Audit
The Committee is responsible for monitoring the performance and effectiveness of Internal Audit. During 2014, the Committee carried out this responsibility by:

– Reviewing and approving the remit of Internal Audit, in line with the Chartered Institute of Internal Auditors July 2013 *Recommendations for Effective Internal Audit in the Financial Services Sector*;

– Reviewing and approving the 2014 Internal Audit plans and ensuring these had appropriate coverage of the business and were flexible and focused on the significant risk activities that the Group faced when continuing to build the bank in 2014;

– Approving the Internal Audit budget, including bringing in subject matter expertise where appropriate, to deliver the audit plan;

– Receiving regular reports on the significant recruitment undertaken during 2014 to achieve the agreed Internal Audit organisational design;

– Reviewing and approving the 2015 audit plan in line with the Group's strategy, ensuring that, as above, it has the flexibility to respond to important events as they arise;

– Reviewing the interaction between Internal Audit and the Risk function;

– Confirming that Internal Audit makes independent assessments of the Group's control framework but is fully informed by management's and the Risk function's reporting and views on risks and controls; and

– Receiving regular reports from the Chief Audit Officer on the range of Internal Audit activities undertaken in 2014 and monitoring activities resulting from Internal Audit reports.

Relationship with the external auditor
The Committee is responsible for the effectiveness of the Group's relationship with its external auditor and for assessing their independence and objectivity. During 2014 the Committee discharged this responsibility by:

– Agreeing the terms of the audit engagement letter;

– Reviewing and challenging the external auditor's audit strategy and their consideration of significant and elevated audit risks;

- Approving a policy governing the use of the external auditor for non-audit services to safeguard their objectivity and independence;
- Receiving reports from the external auditor covering management's estimates and judgements;
- Reviewing the outcomes of the Financial Reporting Council's Audit Quality Review inspection reports as they relate to PwC and their potential consequences for the Group's audit;
- Having regard to the risk of a perceived impact on independence arising from the engagement by LBG of PwC as reporting accountant for the Group's listing prospectus; and
- Considering the approach to obtaining independent assurance over outsourced controls.

In 2015 the Committee will continue to assess the Group's relationship with the external auditor and expects to augment the assessment process by formal enquiry of appropriate members of the Group's Board, Executive and senior management.

The Committee is mindful of its obligations to tender the Group's external audit, at a minimum, every ten years and will develop an audit tendering policy in 2015. While PwC has held the position of external auditor of TSB Bank plc since 1997, and of the Company since its incorporation, both as part of the wider LBG audit relationship, the Committee has taken into account the knowledge and experience that PwC have of the Group's business and the potential burden of tendering the audit so soon after listing. Consequently, the Committee has recommended to the Board that the re-appointment of PwC is put to shareholders for the audit of the 2015 financial statements along with a resolution for the Board to set the remuneration and terms of engagement of the Company's auditor. The Committee has also recommended that the audit will be subject to tender in 2017, appointment effective for the audit of the 2018 financial statements. Allan McGrath is the existing senior statutory auditor who is due to rotate off the engagement following the conclusion of the audit of the 2016 financial statements.

Priorities for 2015

During 2015, the Committee will ensure that the Committee's priorities are aligned with the delivery of the Group's growth strategy. The Committee's focus will increasingly turn to monitoring for the emergence of any strain on internal control and financial reporting processes that this growth may bring. The Committee will ensure that the Internal Audit plan and its access to resources remain appropriate, enabling assurance over the design and operation of the Group's governance, risk management and internal control frameworks. The Committee's focus will also ensure that appropriate judgement is applied on emerging financial reporting matters and will monitor the Group's preparations for changes to accounting for impairment of loans.

Board Risk Committee report

“ Effective risk management plays a central role in the execution of the Group’s strategy.

Chair’s introduction

I present this Risk report in the knowledge that we have made good progress in developing capabilities and processes to manage our risk profile within risk appetite and to support the delivery of our strategy.

I was appointed Chair of the Committee on 25 June 2014 when the Group listed. I have broad experience of the financial services industry. Previously, I was a senior partner and Head of European Strategic Performance Improvement at PwC and have since gained extensive non-executive bank board experience. I was a member of the board of the FSCS for six years and at Skipton Building Society for nine years, where I was the Chair of the Audit and Risk Committee. More recently, I completed three years on the board of the Irish bank, Permanent TSB. Currently I sit on the board of Findel plc, and MBNA Ltd. I am also a Fellow of the Chartered Institute of Management Accountants.

At the same time I was appointed Chair, the Board also appointed Polly Williams, Philip Augar and Stuart Sinclair to the Committee. The Committee members’ biographies are set out on pages 38 to 39.

The report that follows describes the Committee’s responsibilities and its activities since it was established. It explains the Committee’s work in assessing the balance between risk and reward and ensuring that the Group has a straightforward and responsible risk culture. It explains the matters reviewed by the Committee, including oversight of current and emerging risks faced by the Group, ‘deep dives’ to assess the management and mitigation of risk associated with strategic initiatives and its work to review the adequacy of the Group’s impairment provisions. The Committee also reviewed the activity of the Group’s risk oversight function, including an assessment of its effectiveness and approved its plans for 2015.

The Group’s focus in 2014 was establishing TSB as a listed Group. The Committee’s activities were consistent with that objective and I am satisfied with the progress made in 2014. With the Group now concentrating on the delivery of its growth strategy, the Committee will continue to focus on the Group’s risk appetite and emerging risks, the ongoing development of the risk management framework and the Group’s compliance with regulatory requirements.

Membership and operation of the Committee
The Board Risk Committee comprises of four independent Non-executive Directors, each with recent, relevant experience in risk and banking and includes at least one member of the Audit Committee.

As Chair of the Board Risk Committee, I provide verbal updates to the Board, supported by accompanying risk reports from the Chief Risk Officer. Further interaction with the Board is achieved through significant Non-executive Director membership of the Committee.

Board Risk Committee responsibilities and activity in 2014
The Committee is responsible for championing a straightforward and responsible risk culture and ensuring an appropriate balance between risk and reward. The Committee's priorities include the delivery of transparent and fair outcomes for customers, a safe and resilient financial profile and collaborative relationships with the Group's regulators and other stakeholders.

The core activity of the Committee includes the review and oversight of the Group's risk management framework (see page 47), its risk appetite, and compliance with regulatory requirements. The Committee met four times during 2014 subsequent to its establishment and its focus on these core elements was supported by the following activities:

(i) Regular review and approval of risk updates
The Committee undertook regular oversight of the Group's risk exposures and reviewed the development and approval of the Group's annual control self assessment. The Committee also reviewed the Group's capital and liquidity adequacy levels, scenario analysis and reverse stress testing. The Group's stress testing and scenario analysis programme is central to the analysis of the most material and emerging risks. The Committee undertook a review of the Internal Capital Adequacy Assessment Process (ICAAP) and Individual Liability Adequacy Assessment (ILAA) submissions including reviewing detailed scenario analysis, before their approval by the Board. The Committee also reviewed and approved the Group's recovery and resolution planning, impairment provision adequacy reviews, annual product reviews, and engagement and communication with regulators.

(ii) Risk reporting across all risk types
The Committee monitored and oversaw action plans to address the Group's top risks that were escalated for its consideration. This included the review of the Group's five year plan and the key risks associated with it, monitoring risk appetite metrics and limits and debating the consequences of the Group's key strategic and emerging risk profile.

(iii) Deep dives across different risk areas
In 2014, Committee members were provided with a focused review to deepen their understanding of specific risks and issues, with an assessment of appropriate activities to manage and mitigate their impact. These included 'deep dives' on the development of the Group's mortgage intermediary channel, the Group's relationship with LBG, implications of the Scottish independence referendum, and ongoing banking reform. The Committee also reviewed discussion papers from regulators and industry bodies on wider developments in the industry.

Priorities for 2015
During 2015 the Committee will continue to align its priorities to ensure effective delivery of the Group's growth strategy. The Committee's focus will also include the review of the Group's risk appetite and emerging risks, and the extent and categories of risk which the Board regards as acceptable for the Group. The Committee will also oversee the ongoing development, implementation and embedding of the Group's overall risk management framework and the Group's compliance with regulatory requirements.

Sandy Kinney
Chair, Board Risk Committee

Directors' remuneration report

"A new reward approach which is designed to be simple and fair and deliver shareholder value by putting customer service at the heart of everything we do.

Statement by Chair of the Remuneration Committee

I am pleased to present the Group's first Directors' remuneration report following our Admission to the London Stock Exchange in June 2014. This report sets out our Remuneration Policy and reward outcomes for 2014.

The IPO gave us an opportunity to create a new reward approach based on what customers told us, our values and alignment with our business strategy. We believe our TSB reward approach is different from the mainstream and right for this stage of our development.

The opportunity

The Group was created with a core purpose of bringing more competition to UK banking.

To inform our decisions on building the Group, we listened to feedback from customers about how they viewed the banking industry. Some 70% of responding customers said their perception of banking was negatively influenced by what they knew about bank pay and bonuses.

Our challenge was therefore to create an alternative remuneration approach that reflected the type of bank we aim to be and demonstrated we were listening to our customers, colleagues and shareholders. To aid our thinking we considered current remuneration models in the financial services sector, the wider marketplace and, in particular, in businesses where good customer service is key and the operating model is based on the concept of partnership. We now refer to those who work for TSB as Partners.

Our approach

We want our reward approach to be simple and fair, putting customer service at the heart of what we do. We believe we will best deliver shareholder value by focusing on sustainable business growth and rewarding behaviours that are consistent with our values.

For these reasons we have chosen the following principles to underpin our approach:

- Reward should be transparent, fair and market competitive. Our reward policies should be clear and consistent so that all our stakeholders can readily understand them. We believe this will help us to hire and retain Partners who share our vision, values and commitment to great customer service.

- Remuneration should reward sustained performance over time. The measures which underpin our remuneration schemes reward profitability, good customer service and the long term health of the Group. Final outcomes also take account of our assessment of how well risk, conduct and compliance issues are managed.

- The reward structure should be balanced. We have created what we believe is the right balance of fixed to variable remuneration, in-year to deferred remuneration and cash to share based remuneration. We believe the balance we have struck in these areas is right for the Group's business philosophy and stage of development whilst also complying with relevant regulation.

- Our reward practices should build a partnership culture embracing all Partners. We encourage share ownership for all Partners, offering various ways in which they can become TSB shareholders and Partners in the success of the business. All Partners were granted £100 of TSB shares on listing through the TSB Share Incentive Plan (SIP) and were designated Partners in the Group. New joiners post-listing are similarly granted £100 in TSB shares. Partners are required to retain these shares in order to be eligible to participate in the TSB Award.

The key elements of our new reward approach for our most senior Partners are as follows:

- We will not exceed an annual cap on total variable remuneration of one times fixed pay (basic salary plus other benefits) calculated in accordance with the PRA's remuneration code.

- Basic salary provides core remuneration taking into account relevant market benchmarks, complexity of the role and the individual's experience and performance.

- The TSB Award, which provides an 'on-target' annual award opportunity of 10% of basic salary and applies to every Partner in the Group, from the Chief Executive Officer to those on the front line. The 10% on-target core award fund could increase, in an exceptional year, to a maximum core award of 15% of basic salaries. In any given year the very best performers could receive up to twice the core award. The Committee will review and approve annually both the size of the TSB Award spend and the individual awards being proposed for the Executive Directors.

- The Sustainable Performance Award (SPA) is designed to support achievement of targets based on sustained business and personal performance. This award will be granted annually to a limited number of senior Partners and is funded, if sufficient profit is made, after the TSB Award and risk management gateways have been satisfied. For our Executive Directors the target annual grant will be at 62.5% of basic salary with a maximum 100% possible and a minimum of 0%. Final grants are always subject to the Committee's assessment of corporate and individual performance against pre-determined targets. The award will vest in tranches over a five year period subject to the achievement of sustainable corporate and individual performance conditions. For our Executive Directors 70% of the award will be delivered in TSB shares and 30% in cash.

- Market competitive benefits, principally pension contributions to a defined contribution scheme or, where appropriate, an equivalent cash payment; 4% of basic salary available to use in our flexible benefits offering; and an employer provided car or alternative cash car allowance.

- Executive Directors are also subject to shareholding guidelines which they are obliged to meet over time.

This structure is very different from that which our Executive Directors received while TSB was still part of LBG and represents a re-balance in our total compensation mix. For example, it significantly reduces the level of variable remuneration opportunity and generates a lower maximum earnings potential than they were eligible to receive under their LBG terms. To ensure our new remuneration package was appropriately positioned against the external market and against the legacy LBG arrangements, we reviewed the basic salaries of our Executive Directors initially on listing and subsequently in order to review the effectiveness of our approach. We will continue to look carefully at the appropriate levels of basic salary for our most senior Partners to ensure that we are able to deliver a competitive level of total remuneration.

The Executive Directors and the wider leadership team have supported this new approach and its alignment to our goals and values.

Shareholder consultation
Part of our commitment to transparency and fairness is to maintain an open and constructive dialogue with shareholders on remuneration issues. In the course of the IPO and the months that followed I and executive colleagues met many of our largest shareholders and advisory bodies to explain our approach and to listen to their views. We look forward to further shareholder feedback on our Directors' remuneration report and will continue to offer regular opportunities for dialogue on remuneration.

Directors' remuneration report (continued)

Rewarding performance in 2014
2014 was a unique year of change for TSB. It required strong leadership, engagement and commitment from all our Partners, including our Executive Directors and the other Bank Executive Committee members.

Prior to Admission our Executive Directors were employed under LBG terms and conditions. As such, they were eligible for a bonus under the legacy LBG bonus arrangement for this portion of the year, based on TSB performance prior to listing. We have sought to replicate the appropriate level of award for that period.

Under TSB's new approach the Committee has determined an on-target TSB Award of 10% of basic salary (pro rata and based on the post-listing period) should be awarded and a SPA grant of 90% of basic salary based on performance over the full year should be made in early 2015. The SPA will vest in annual tranches over five years only if sustainable performance targets are met.

The key 2014 reward outcomes for the Executive Directors were as follows:

	Legacy LBG bonus (1 January 2014 to listing)	TSB Award (listing to 31 December 2014)	SPA award grant* (1 January to 31 December 2014)
Paul Pester	**£377,000**	**£36,167**	**£630,000**
Darren Pope	**£181,250**	**£23,250**	**£405,000**

* SPA award will be granted in early 2015 and will only vest to the extent that performance is sustained as assessed on each of the five anniversaries of the award.

Further details of the Committee's assessment of 2014 performance outcomes are detailed on pages 70 to 74.

Future policy
In the period following listing, we undertook a review of Executive Directors' basic salaries against the external market. As we committed in the Prospectus the Chief Executive Officer's basic salary will remain at £700,000 and will not be reviewed before January 2016 when we expect to undertake a review of the Chief Executive Officer's remuneration.

After reviewing the Chief Financial Officer's basic salary against relevant market data and taking account of his excellent performance over the year the Committee decided to increase his basic salary from £450,000 to £535,000 with effect from 1 April 2015. This has moved his remuneration closer to the market median benchmark. It will be subject to further review next year.

Full details of our new Directors' remuneration policy are outlined in the Policy report on page 59 which, if approved by shareholders at our AGM in April 2015, is proposed to apply for at least one year following adoption.

The Committee is conscious that these are pioneering policies in an ever changing regulatory landscape. We pay particular attention to how our policies work in practice to understand whether there are any challenges or opportunities which need to be addressed. Should the Committee conclude that there are changes required we will incorporate any proposals when we seek shareholders' approval for them at AGMs in future years.

In conclusion, I commend the first TSB Remuneration Policy Report and annual Remuneration Report to you and trust they will earn your support.

Dame Sandra Dawson
Chair, Remuneration Committee

Policy report

This section of the report sets out our Directors' Remuneration Policy (the Policy). The aim of the Policy is to provide competitive remuneration that is aligned to the delivery of the Group's strategic goals, promotes its values and generates sustained business performance.

Shareholder approval will be sought for the Policy at the Group's 2015 AGM in accordance with section 439A of the Companies Act 2006, and, if adopted, will be effective from that date. The Remuneration Committee (the Committee) will consider the appropriateness of the Remuneration Policy annually to ensure that it continues to be aligned with the business strategy and enables the Group to both attract and retain talented individuals. The Policy is intended to cover at least one year following adoption. As this is a new policy, implemented against a background of regulatory change, it will be reviewed in application over the coming period. Should changes be required then we will revert to shareholders, consulting on any substantive revisions, and seek approval for any changes in the normal way.

1. TSB remuneration policy for Executive Directors

The Group's policy in respect of each component of remuneration for Executive Directors is set out below.

Basic salary	
Purpose and link to strategic objectives	To provide Executive Directors with core remuneration taking into account relevant market benchmarks, complexity of the role and the individual's experience and performance.
Operation	Basic salaries are usually reviewed annually, with any changes for Executive Directors normally becoming effective from 1 April. Basic salaries are reviewed taking into account a number of factors, including: – Performance of the Group and individual; and – Any changes in responsibilities, basic salary and total compensation levels for similar roles at companies of a similar size and complexity.
Maximum opportunity	There is no formal maximum to basic salary or basic salary increases. When considering any increase the Committee will take account of relevant factors, such as a change in the business, significant change to the role, development within the role or regulatory changes. The Committee will also take into account basic salary movements both in the wider market and elsewhere within TSB.
Performance metrics	Individual performance against role requirements and personal objectives will be one of the principal considerations in reviewing basic salary levels.
Pension	
Purpose and link to strategic objectives	To provide Executive Directors with post-retirement income.
Operation	Executive Directors are eligible to participate in the TSB Defined Contribution pension scheme. Executive Directors may receive a cash allowance of equivalent value in lieu of a pension contribution.
Maximum opportunity	Executive Directors may receive a pension contribution of 20% of basic salary.
Performance metrics	No performance conditions are applied.
Benefits	
Purpose and link to strategic objectives	To provide benefits comparable to those available for similar roles in similar companies.
Operation	Executive Directors receive benefits including a car allowance, funds to participate in the Group's flexible benefits scheme (which may be taken as a cash allowance), private medical insurance and life assurance. Executive Directors are also eligible to participate in any all-employee share plans operated by the Group on the same basis as other eligible Partners. Additional benefits may be provided in specific circumstances e.g. relocation allowances.
Maximum opportunity	There is no formal cap on the value of benefits. However, the total cost of benefits is set taking into account a number of factors including an assessment of overall spend against relevant market data. The Committee reserves the right to exercise discretion and make changes to benefits provided when required.
Performance metrics	No performance conditions are applied.

Directors' remuneration report (continued)

1. TSB remuneration policy for Executive Directors (continued)

Short Term Incentive – TSB Award	
Purpose and link to strategic objectives	To reward the achievement of annual business and personal performance targets, aligning any award with strategic business goals. To align all Partners behind common goals and a common plan to assist in building a partnership culture.
Operation	Executive Directors are eligible to participate in our short term incentive plan (the TSB Award). To be considered for an award, corporate and individual performance gateways must be satisfied. The TSB Award is subject to the Committee assuring itself that there is sufficient Management Profit to justify the award. The award level is determined by the Committee based upon actual performance against targets set at the beginning of the performance year. The core award is the same percentage of basic salary for all eligible Partners. For Executive Directors the award will be paid partly in cash and partly in shares. The share portion will be delivered under the 2014 Share Plan (as adopted at listing) and may be subject to a holding period as required by the regulations. For Executive Directors, a portion of the TSB Award may be deferred to meet regulatory requirements. Dividend equivalents may be awarded on the share portion of the award until the end of the holding period. Malus and clawback provisions apply for Executive Directors' TSB Awards which may be reduced or not delivered where there has been: (i) Material misstatement of audited financial returns; and/or (ii) Reasonable evidence of employee misconduct or material error; and/or (iii) A material failure of risk management, and/or (iv) A material downturn in financial performance. Following the delivery of TSB Awards amounts may be subject to clawback where any of (i) – (iii) above occur. These provisions will apply for seven years from the grant of an award (or any longer period required by applicable regulations).
Maximum opportunity	The TSB core award may vary between 0% and 15% of basic salaries. At 'on-target' performance the award will produce a core award of 10% of basic salaries. Exceptional individual performers (which may include Executive Directors) may receive an award higher than the core award. For all Partners, including Executive Directors, the maximum potential individual TSB Award is two times the core award in any given year. In a year when the core award is 15% the maximum individual award for an Executive Director would be 30% of basic salary (see note below). Similarly, a zero award can be applied if warranted. Awards are made in a combination of shares and cash. The shares awarded will be subject to the Executive Directors' shareholding requirement.
Performance metrics	The overall TSB Award level is based on the Committee's assessment of performance against pre-determined measures. These measures currently include (but are not limited to) customer outcomes, financial resilience and strategic delivery. For any Award to be granted, threshold corporate and individual performance gateways must be passed. At a Group level there will also be risk, capital and sustainable financial performance gateways. At an individual level there must have been at least satisfactory performance. All performance outcomes are subject to Committee discretion. The Committee will wish to assure itself that outcomes are reflective of underlying, sustainable business performance and the effective management of the Group's risk profile in line with the Group's desired risk appetite.

In the Prospectus TSB announced that the TSB "target award level will not exceed 10% of basic salary, with the maximum award level not exceeding 15% of basic salary". With the extension of the TSB Award to all Partners in 2015 the Policy described above will be applied in future. The Committee believes that it is consistent with the underlying principle of a single award plan for all Partners that Executive Directors should be eligible for an award on the same basis as every other Partner in the Group while remaining subject to the 1:1 cap.

1. TSB remuneration policy for Executive Directors (continued)

Sustainable Performance Award	
Purpose and link to strategic objectives	To reward sustained business performance over time and to closely align senior Partners' interests with those of other stakeholders.
Operation	Executive Directors and other senior Partners are eligible to participate in the SPA. The SPA is funded subject to there being sufficient remaining profit to warrant the award after funding for the TSB Award has been made to the wider Partner group. Awards are made in the form of cash and shares. For Executive Directors 70% of the award will be delivered in shares which are subject to a holding period as required by the regulations. Dividend equivalents may be awarded on the share portion of the award until the end of the holding period. The award pool for a particular performance year is determined by reference to corporate performance assessed against measures set at the start of the performance year. The Committee may apply its discretion in determining the final award pool, taking into account underlying performance, risk considerations and appropriate profit distribution. Individual awards are determined based on individual performance. Awards vest in tranches over a five year period post grant subject to sustained corporate and individual performance measures being met. If a tranche does not vest in whole or in part, any unvested amount from that tranche is forfeit. SPA awards may be reduced or cancelled prior to vesting where there has been: (i) Material misstatement of audited financial results; and/or (ii) Reasonable evidence of employee misconduct or material error, and/ or (iii) A material failure of risk management, and/or (iv) A material downturn in financial performance. Following the vesting of SPA Awards amounts may be subject to clawback where any of (i) – (iii) above occur. These provisions will apply for seven years from the grant of an award (or any longer period required by applicable regulations).
Maximum opportunity	The SPA award will have an on-target initial award value of 62.5% of basic salary and a maximum award value of 100% of basic salary in respect of any one year.
Performance metrics	Performance targets, used to determine the award pool size, will be a balanced scorecard of measures. These measures currently include (but are not limited to) customer service outcomes, financial resilience, strategic delivery and assessment of personal performance. Achievement against these targets is measured over a one year period prior to grant and a final decision on grant levels will be made by the Committee. Vesting is subject to corporate and individual performance release conditions over the vesting period, including: **Corporate:** Meeting sustainable financial performance targets achieved within risk appetite and without any material regulatory or compliance failures. **Individual:** Appropriate personal conduct including risk management and, adherence to regulatory and compliance requirements. The Committee may exercise discretion to reduce the proportion of the award that vests if targets have not been wholly achieved.

Performance measures – TSB Award and SPA Award

The performance measures for the TSB Award and SPA have been chosen to support the delivery of the Group's strategy, providing a balance between rewarding Partners for meeting financial and non-financial targets for the year and ensuring appropriate risk, compliance, conduct and customer outcomes.

The precise targets are set by the Remuneration Committee each year to ensure Executive Directors are focused on the Group's key objectives. In doing so, the Remuneration Committee takes into account a number of internal and external reference points, including the Group's business plan.

Directors' remuneration report (continued)

1. TSB remuneration policy for Executive Directors (continued)

Legacy matters

As disclosed in the Prospectus, the Executive Directors hold legacy awards granted by LBG prior to listing. These awards will subsist or will be replaced by broadly equivalent awards made by TSB such that no individual should either be disadvantaged or gain significantly as a result of listing.

Most legacy awards remain under the governance of LBG and its Remuneration Committee*. The legacy awards over which the TSB Remuneration Committee does have oversight are as follows:

LBG 2013 LTIP and 2014 LTIP	If LBG ceases to hold a majority of shares in the Group the LBG LTIP awards may lapse on a time pro-rated basis with the participants becoming good leavers under the LBG LTIP. To reflect the impact that the pro-rating will have on employees' awards, the Committee intends to grant awards over TSB shares (Substitution Awards) under the TSB 2014 Share Plan, adopted on listing. The value of the TSB shares used for these Substitution Awards will reflect the value forfeited on becoming a good leaver from LBG (before the application of performance conditions). The Substitution Awards will vest on the same original vesting dates as the LBG awards that they replace. On vesting both the LBG good leaver awards and the Substitution Awards will be subject to their respective performance conditions. Vesting of the Substitution Awards will be subject to the achievement of a balanced scorecard of TSB performance measures, replicating the LBG arrangement. It should be noted that the Substitution Awards described in this section do not count towards the calculation of the 1:1 cap since they will replace a forfeited award from LBG. This treatment is in accordance with the PRA's Remuneration Code.
LBG legacy bonus	Executive Directors participated in the LBG annual bonus scheme for the period up to listing. The maximum opportunities under this scheme for the Chief Executive Officer and Chief Financial Officer were 130% and 100% of basic salary respectively. To honour these pre-existing commitments, the Committee determined that awards should be made to the Executive Directors, reflecting legacy entitlements under this plan, pro-rated to reflect the period of time up to listing and with awards based on TSB performance against a balanced scorecard of metrics agreed at the start of the performance year. To replicate the LBG policy at least 40% of these awards will be deferred into shares in TSB and released over a three year period beginning with the first anniversary of award. Deferred share awards are subject to malus and clawback as well as forfeiture rules similar to those applied by LBG. As a legacy award the Executive Directors will not be required to retain these shares towards their overall shareholding requirement.

* Legacy awards that remain subject to LBG Remuneration Committee governance and oversight are as follows:

– **LBG Deferred Bonus Awards.** Legacy deferred amounts relating to bonuses awarded by LBG prior to 2014 will be released to participants by LBG on exactly the same terms as were set at the time of award, prior to listing, including the same release dates and ability for LBG to enforce malus/clawback if deemed appropriate.

– **Verde Completion Awards.** LBG determined that the Executive Directors would be eligible to receive a Verde Completion Award following listing, subject to the individual's satisfactory performance up to listing, the achievement of key corporate milestones and the individual's continued employment on the payment date. The maximum payments that may be made by LBG to Paul Pester and Darren Pope are £405,000 and £247,550 respectively. Any payments will be made as soon as reasonably practicable after the first anniversary of listing. These payments are subject to meeting certain targets and remain subject to performance adjustment at the discretion of the LBG Remuneration Committee.

– **2012 LTIP.** The performance period for this award ended on 31 December 2014. As LBG still retained a majority shareholding in TSB at that time, the awards will vest on exactly the same basis as for LBG participants.

– **2013 LTIP and 2014 LTIP 'good leaver' portions.** If LBG ceases to hold a majority of shares in TSB the LBG 2013 and 2014 LTIP awards may lapse on a time pro-rated basis with the participants becoming 'good leavers' under that plan. The portion of awards that subsist under the 'good leaver' treatment, will vest on exactly the same basis as for LBG participants, subject to the time pro-ration referred to above.

For the avoidance of doubt, the Committee reserves the right to make any remuneration payments and payments for loss of office notwithstanding that they are not in line with the policy set out above, where the terms of that payment were agreed (i) before the policy came into effect or (ii) at a time when the relevant individual was not a Director of the Company and, in the opinion of the Committee, the payment was not in consideration for the individual becoming a Director of the Company. For these purposes 'payments' includes awards of variable remuneration and, in relation to an award or option over shares, the terms of the payment agreed at the time the award is granted.

Adjustments and Corporate events: Awards may be adjusted in the event of a variation of the Company's share capital, demerger, delisting, special dividend, rights issue or other event that in the opinion of the Committee, may affect the current or future value of the Company's shares. Performance conditions applicable to the SPA awards may be amended if an event occurs which causes the Committee to consider that an amended condition would be more appropriate and not materially less difficult to satisfy.

In the event of a takeover of the Company, awards will normally vest at the time of the takeover to the extent the Committee determines, taking into account any relevant performance conditions and, unless the Committee determines otherwise, the period of time between the grant date and the date of the takeover. Alternatively, awards may be exchanged for equivalent awards in the acquiring company. In the event the Company is wound up or may be affected by a demerger, delisting, special dividend or other event, which may, in the Committee's opinion affect the current or future value of the Company's shares, awards may be allowed to vest on the same basis as a takeover.

2. Non-executive Directors' Fees

The Group's policy in respect of Non-executive Directors' fees is set out below.

Purpose and link to strategy	To attract and retain high performing Non-executive Directors with the relevant skills, knowledge and experience.
Operation	Non-executive Directors receive a basic annual fee and additional fees for additional Committee responsibilities. Fees are reviewed regularly and adjusted when required. The Chairman's fee is reviewed regularly by the Committee. The Chairman and Chief Executive Officer are responsible for determining all other Non-executive Director fees. In setting Non-executive Directors' fees account is taken of the responsibilities of the role and time commitment required, the fee levels in organisations of a similar size within the financial services sector and any fee increases will be considered in the context of pay increases for Executive Directors and the wider Partner population. Expenses incurred in the performance of non-executive duties may be reimbursed or paid for directly by the Company as appropriate, including any tax due on the expenses. The Chairman is provided with secretarial support and may have the use of a driver* if required. Non-executive Directors are not eligible to participate in TSB's in-year or long term schemes, or the all-employee share plans. Non-executive Directors are not entitled to any payment for loss of office. Notice of the termination of their appointment by the Non-executive Director is one month to the Company. Notice from the Company is in accordance with TSB's Articles of Association.
Opportunity	Fees are set at a level which is considered appropriate without paying more than is necessary to attract and retain the calibre of individual required by the Company. Additional fees are paid for performing additional Committee responsibilities, for example: – Senior Independent Director; – Committee Chairman; and – Committee membership. The current fee levels for Non-executive Directors are outlined in the annual Report on Remuneration.

* The Chairman did not benefit from the provision of a driver in 2014.

3. Remuneration arrangements throughout the Group

The Policy for Executive Directors is aligned with the remuneration philosophy and principles that underpin remuneration across the Group. The remuneration structure has been designed to be easy to understand, transparent and to foster a partnership culture.

It is important that the remuneration approach reflects the Group's core values and business strategy. As such, it is based on the principles set out below:

Principle	Policy
Transparent and inclusive reward structures	Reward approach will be kept consistent for all Partners.
Reward directly linked to the achievement of sustainable performance	Ensuring alignment with shareholders by carefully balancing a focus on profitability, customer service and strategic delivery and including conduct, risk and compliance gateways and malus/clawback provisions.
Ensure a balanced view of reward	Looking at all elements of reward, maintaining the 1:1 ratio between fixed and variable elements.
Overall expected value	Is fair and reasonable to reflect the size and scope of the roles and comparable to similar positions at other financial services companies.

As part of a comprehensive review of remuneration undertaken during 2014, the Group extended the TSB Award to all Partners from 1 January 2015. The TSB Award replaces all previous in-year awards, including sales incentive plans, and gives all Partners the same on-target award opportunity expressed as a percentage of basic salary. Basic salaries have been adjusted where necessary to reflect the lower variable element of pay. This adjustment has taken into account comparative market data to ensure that the overall reward potential remains competitive. The Group consulted with Trade Unions about plans to roll out the new arrangements to all its Partners. However, Partners were not consulted directly on the Directors' remuneration policy.

Directors' remuneration report (continued)

The on-target TSB Award is 10% of basic salary and the core award pool can range from 0% to 15% of basic salaries based on the Group's performance. The award will take account of the Group's ability to pay, as there must be sufficient profit to warrant the total cost of the award in each year. Partners must also meet an expected level of personal performance, as measured by the Group's Partner Performance process, to receive an award. The very best performers could receive up to two times the core award paid to other Partners in any one year. Similarly, a zero award can be applied if warranted. The funding of the TSB Award will be determined by the Committee taking into account the overall performance of the Group. This, in turn, determines the level of the core award.

Selected senior Partners will be eligible to participate in the SPA. Eligibility relates to senior responsibilities and currently extends to fewer than 150 individuals. Awards to all Partners will be made on the same criteria and using the same performance measures as the awards made to Executive Directors.

Awards will only be made if there is sufficient profit to meet the cost, after the cost of the TSB Award has been met. No Partner will receive a SPA in excess of 100% of basic salary in any one year and total variable pay will not exceed fixed pay (when calculated according to the Remuneration Code) in any one year.

At listing, all employees were given the title of Partner and granted £100 of shares in the Group, to reinforce the partnership concept and to build Partner share ownership. All new Partners will similarly be granted £100 in shares and Partners are required to retain these shares in order to be eligible to participate in the TSB Award.

4. Recruitment policy

4.1 Principles

In determining remuneration arrangements for new appointments to the Board (including internal promotions), the Committee applies the following principles:

- Any arrangements should be in the best interests of the Group and shareholders, delivering market competitive levels of remuneration without paying more than is necessary;
- All relevant factors should be taken into account, including the calibre of the individual, the nature of the role, market practice/ external benchmarking of levels of total remuneration, the individual's current remuneration package, the Group's Remuneration Policy, internal relativities and existing arrangements for other Directors; and
- The new appointee will have (or be transitioned onto) a remuneration package that is in line with the policy tables presented above. Specific provisions may be made; for example, where an Executive Director is required to work at a location which is not in proximity to his or her home additional benefits such as relocation costs and housing allowance may be provided.

The Committee retains discretion to make appropriate remuneration decisions outside the standard policy to meet exceptional individual circumstances. This might, for example, be if an interim Executive Director were to be required on a short term basis, or if exceptional circumstances dictate that the Chairman or a Non-executive Director takes on an executive role on a short term basis. Any such arrangements would be reported to shareholders in the normal way.

4.2 Buy-outs

To facilitate recruitment, the Committee may make an award to "buy out" rewards and any other compensation arrangements forfeited on leaving a previous employer. In doing so, the Committee will take account of any terms attached to forfeited arrangements, including any performance conditions attached to those awards, the likelihood of those conditions being met, the proportion of the vesting/performance period remaining and the form of the award (e.g. cash or shares). Buy-out awards will be made on a comparable basis to those forfeited and will not be more generous than the value of the forfeited award, both in quantum and vesting timetable. Any share awards would generally be made under the 2014 Share Plan adopted upon listing. The vesting of such awards will, in all cases, be dependent on satisfactory personal performance during the period in question, and will lapse if the individual resigns or is dismissed for gross misconduct.

In considering its approach, the Committee will give due regard to all relevant factors (including, but not limited to, quantum, the nature of remuneration and the jurisdiction from which the candidate was recruited).

4.3 Maximum level of variable pay

The maximum level of variable pay which may be awarded to new Executive Directors in respect of their appointment shall be limited to 100% of fixed pay, calculated in accordance with the applicable Remuneration Code provisions and excluding any awards made to compensate the Executive Director for rewards forfeited on leaving their previous employer.

4.4 Recruitment of Non-executive Directors

In the event of the appointment of a new Non-executive Director, remuneration arrangements will normally be in line with those detailed in the relevant table above. It is not anticipated that buy-out arrangements will apply, or that any variable awards will be made.

5. Executive Director share ownership guidelines

Under the Group's share ownership guidelines, Executive Directors are expected to build up, over time, a personal shareholding equivalent in value to 200% of basic salary for the Chief Executive Officer and 150% of basic salary for the Chief Financial Officer. Ordinary shareholding values will be based on historical investment value (or value on vesting if arising from incentive plans). Shares vesting (after the payment of tax) under such arrangements would, unless the Committee determines otherwise, normally have to be held until these requirements have been met. For the avoidance of doubt, any TSB shares acquired as a result of participation in an LBG Legacy arrangement will be excluded from this requirement. Thus, for example, shares acquired as part of the LBG Legacy Bonus provisions would be excluded from this requirement.

The Committee is aware that the most recent guidelines on share ownership suggest that a shareholding of 200% of basic salary should apply to all Executive Directors. In light of the current levels of Executive Director shareholding this issue will be further considered as individual holdings grow.

6. Executive Director service contracts

The key employment terms and other conditions for Executive Directors, as stipulated in the current Executive Directors' service contracts, are set out below.

Provision	Policy
Notice period	– 12 months' notice by the Company; and – Six months' notice by the Executive Director.
Termination payment	– The Group may, at any time in its absolute discretion, elect to terminate employment by paying to the Executive, in lieu of the notice period referred to above, the equivalent of the basic salary for the period. Any payments in lieu of notice may be paid in instalments and be subject to mitigation.
Remuneration and benefits	– The operation of all reward plans, including the TSB Award and Sustainable Performance Award is non-contractual; and – Contractual benefits for Executive Directors comprise Group pension contribution of 20%, which may be taken as cash, a car allowance (or a non-pensionable cash allowance), flex benefits to the value of 4% of basic salary, life cover (equal to four times basic salary), private medical cover and annual health screening.

7. Payment for loss of office

In the event that the employment of an Executive Director is terminated, any compensation payable will be determined in accordance with the terms of the service contract between the Company and the employee, as well as the rules of the relevant reward plans.

The following table summarises the leaver provisions of the reward plans under which Executive Directors may currently hold awards:

Plan	Good leaver categories	Treatment for good leaver	Treatment for any other leaver
TSB Award	– Ill-health, injury or disability – Retirement – Death in service – Sale of employing entity out of TSB – Redundancy – Other scenarios in the Committee's discretion	– Leavers during the performance period are eligible to participate subject to performance and unless the Committee determines otherwise taking into consideration time served. – Leavers after the end of the performance period will receive the award in full.	Not eligible for an award

Directors' remuneration report (continued)

Plan	Good leaver categories	Treatment for good leaver	Treatment for any other leaver
Sustainable Performance Award	– Ill-health, injury or disability – Death – Sale of employing entity out of TSB – Other scenarios at the Committee's discretion (except where participant is summarily dismissed)	– Unvested awards will vest on the normal vesting date, unless the Committee determines the award will vest earlier, in either case, taking into account the extent applicable performance conditions have been satisfied, and, unless the Committee determines otherwise, the period of time that has elapsed from grant to the date of the individual's cessation of office or employment. If an individual dies holding unvested awards, awards will normally vest as soon as practicable following the individual's death.	Awards lapse in full (whether or not vested)
LBG legacy deferred bonus (awarded by LBG pre 2014)	– Ill-health, injury or disability – Retirement – Redundancy – Death – Sale of employing entity out of LBG – Other scenarios at the LBG's Remuneration Committee's discretion (except where participant is summarily dismissed)	– Awards continue until the normal vesting date, unless LBG's Remuneration Committee determines the award will vest earlier. – If an individual dies holding awards, they will normally vest as soon as practicable following the individual's death.	Awards lapse in full
All employee share plans	Leaver treatment under these plans will be in accordance with HMRC rules.		
2014 LBG bonus	Leaver treatment will be on the same terms as the SPA.		
LBG 2013 and 2014 LTIP	As disclosed in the prospectus, the outstanding LBG LTIP awards made to participants by LBG prior to Admission continue to subsist. When LBG ceases to have control of TSB, the participants will be treated as 'good leavers' and their awards will therefore vest on the original vesting date but will be reduced based on the proportion of the performance period elapsed at the date of the cessation of control. These subsisting LBG LTIP awards are subject to the following leaver provisions. If prior to LBG ceasing to have control of TSB and the normal vesting date, a participant leaves TSB for reason of ill-health, injury, disability, retirement, the sale of their employing entity out of the Group, redundancy or for any other reason determined by the Committee, the individual will be treated as a 'good leaver'. In these 'good leaver' circumstances awards will either vest on the normal vesting date or on the individual cessation of office or employment (at the Committee's discretion) to the extent the performance conditions have been met and the performance period has elapsed. In any other circumstance the awards will lapse in full.		

8. Non-executive Directors

Non-executive Directors do not have service contracts, but hold letters of appointment. The initial term of appointment is usually three years. Two Non-executive Directors (Norval Bryson and Godfrey Robson) were appointed for an initial period to the first AGM. All Non-executive Directors are subject to annual re-election by shareholders at each AGM. The key employment terms of the current Non-executive Directors are set out below:

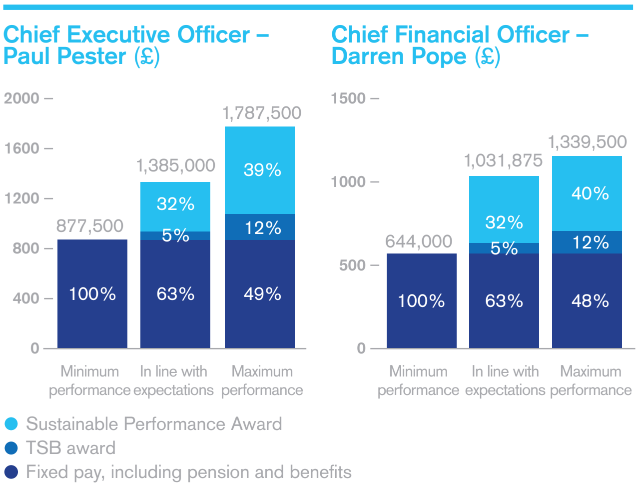
Provision	Policy
Notice period	– Non-executive Directors are required to provide one-month's notice.
Termination payment	– No payment in lieu of notice or other termination payments will be made.
Remuneration and benefits	– Reasonable expenses incurred in the performance of duties will be reimbursed or paid for directly by the Company as appropriate, including any tax due on the expenses. – Non-executive Directors may not participate in the Company's incentive plans.

Non-executive Directors appointed by LBG in accordance with the Relationship Agreement are subject to the same terms as other Non-executive Directors. Non-executive Directors' letters of appointment are available for inspection at the Company's registered office during normal business hours and will be available at the AGM.

9. Illustration of the remuneration policy

The Committee considers the level of remuneration that may be received under different performance outcomes to be reasonable in the context of the performance delivered and the value added for shareholders.

The charts provide illustrative values of the forward looking, full year remuneration package awarded to Executive Directors under three assumed performance scenarios. These charts are for illustrative purposes only and actual outcomes may differ from that shown. The charts do not factor in any share price appreciation or dividends/dividend equivalents that may be paid to participants nor do they reflect the impact of not meeting vesting conditions for the SPA.



Note: In reference to the Chief Executive Officer and the Chief Financial Officer tables (above) the calculation of pay and the 1:1 cap is determined according to the relevant regulatory requirements. The calculation of fixed pay includes basic salary, pension contribution, flex allowance and car allowance. Variable pay includes any TSB Award and any SPA award. However, because of the deferred nature of the SPA the initial award value is discounted in line with the regulations when calculating the cap. With the current structure of fixed pay the maximum TSB Award (30% of basic salary) combined with the maximum SPA (100% of basic salary) would not breach the 1:1 cap due to the permitted SPA discount. The above illustrations do not include the SPA discount. When this adjustment is made the total variable award (TSB Award plus SPA) falls below the total fixed pay at Maximum Performance.

Assumed performance	Assumptions used
Fixed pay	
All performance scenarios	– Consists of total fixed pay, including basic salary, benefits and pension – Basic salary – basic salary effective as at 1 January 2015 (and 1 April for the Chief Financial Officer) – Benefits – based on benefits expected to be paid in 2015 – Pension – 20% of basic salary
Variable pay	
Minimum performance	– No TSB Award – No SPA award
Performance in line with expectations	– TSB Award of 10% of basic salary – SPA award of 62.5% of basic salary which vests in five annual tranches subject to sustained performance
Maximum performance	– TSB Award of 30% of basic salary – SPA award of 100% of basic salary which vests in five annual tranches subject to sustained performance

10. Consideration of wider employee pay

The Committee takes into consideration the pay and conditions of our Partners across the Group when determining remuneration arrangements for Executive Directors. In particular, the Committee pays attention to the general level of basic salary increases and TSB Award outcomes within the wider population.

Information relating to wider workforce remuneration is provided in regular updates to the Committee including updates on reward communications.

Whilst the Committee does not directly consult with Partners as part of the process of determining executive pay, the vast majority of our Partners are shareholders and so are able to express their views in the same way as other shareholders.

11. Consideration of shareholder views

The Committee has borne in mind shareholder views and best practice guidelines during the year and has provided details (above) of consultation undertaken in formulating the Policy set out in this Report. The Committee continues to be mindful of shareholder views when evaluating and setting on-going remuneration strategy and consultation with shareholders will continue in future prior to any significant changes to the Remuneration Policy being proposed.

12. Minor amendments to the Remuneration Policy

The Committee may make minor changes to this Policy to aid in its operation or implementation without seeking shareholder approval for a revision to this Policy provided the changes do not materially advantage Directors.

Directors' remuneration report (continued)

Annual report on remuneration

This section of the report deals with the operation of the Group's remuneration policies in the course of 2014 and how the Committee intends to apply the Directors' remuneration policy in 2015.

On listing, the Committee decided to adopt a remuneration structure for Executive Directors comprising the TSB Award (with an on-target annual award of 10% of basic salary) and the SPA (with an on-target annual award of 62.5% of annual basic salary). The Committee believes that this combination significantly reduces the risk of incentivising short term gain at the expense of longer term sustainability. Executive Directors' variable pay awards in aggregate are limited to 100% of fixed pay (calculated in accordance with the applicable Remuneration Code provisions) which further reduces the risk of over incentivising short term gain.

However, overall compensation needs to remain competitive and the Committee therefore decided to increase the basic salary for the Chief Executive Officer and the Chief Financial Officer at listing, as a step towards reflecting the new remuneration structure and their additional responsibilities as Main Board Directors of a listed Company. Upon careful consideration and as a further step to ensuring a competitive total compensation package, a further increase will be implemented for the Chief Financial Officer from 1 April 2015 as set out in the section 'Implementation of remuneration policy in 2015'.

As part of this transition the TSB Award is based on service from the date of listing, whilst the Legacy LBG Award, although determined by the Committee and payable by TSB, is based on the variable pay structure and basic salary in place in 2014 prior to listing.

1. Single total figure of remuneration

The following tables set out the total remuneration for Executive Directors and Non-executive Directors for the whole of 2014 or from the date of appointment where later. For the period from the date of the Group's listing on 26 June 2014 to 31 December 2014, Executive Directors' remuneration was subject to TSB policies. Remuneration for the period 1 January 2014 to 25 June 2014 was subject to LBG policies and is provided in support of full disclosure. Further, TSB is required to make a statutory disclosure of a single total remuneration figure covering the period during which the Executive Directors provided qualifying services. This has been determined to be the period from 25 April 2014, the date that TSB Banking Group plc became the holding company for the TSB Group, to 31 December 2014.

Comparative figures for previous years are not included as they would relate entirely to service with LBG.

Non-executive Directors[1] (audited)

	Date of Appointment	Fees from Date of Appointment to 24 April	Benefits from Date of Appointment to 24 April[2]	Fees from later of Date of Appointment or 25 April to 31 December	Benefits from later of Date of Appointment or 25 April to 31 December	Total	Single Figure Total
Will Samuel	7 March 2014	£65,000	£105	£222,083	£669	£287,857	£222,752
Philip Augar	16 May 2014	–	–	£56,667	£315	£56,982	£56,982
Norval Bryson[3]	31 January 2014	£17,417	£5,332	£54,250	£17,846	£94,845	£72,096
Dame Sandra Dawson	16 May 2014	–	–	£73,333	£315	£73,648	£73,648
Mark Fisher[4]	27 June 2014	–	–	£39,722	£14,720	£54,442	£54,442
Sandy Kinney	16 May 2014	–	–	£63,333	£411	£63,744	£63,744
Godfrey Robson[3]	31 January 2014	£23,750	£11,928	£47,917	£26,246	£109,841	£74,163
Stuart Sinclair	16 May 2014	–	–	£56,667	£497	£57,164	£57,164
Polly Williams	16 May 2014	–	–	£70,000	£315	£70,315	£70,315

(1) Non-executive Directors do not participate in the TSB incentive schemes and therefore corresponding columns of the Single Figure table have not been included.
(2) Where Non-executive Directors' expenses incurred in the performance of their duties are subject to tax the amount is reported in the Benefits column.
(3) Norval Bryson and Godfrey Robson were Directors of LTSB Scotland. Their fees for the period prior to 25 April relate to duties in their respective roles.
(4) Mark Fisher is a Non-executive Director of TSB and as such is not eligible to participate in any TSB incentive schemes. Prior to his appointment as Non-executive Director of TSB he was employed by LBG and received awards under the LBG Long Term Incentive Plan, subject to the achievement of LBG performance measures. Prior to joining TSB, he entered into an arrangement with LBG whereby the vesting of a portion of his outstanding LBG awards under the LBG Long Term Incentive Plan would be subject to his acting as LBG's Appointee Director on the Board of TSB as well as achievement of the original LBG performance measures. As at the date of publication of this Report, TSB has not been informed by LBG of the proportion of the 2012 Long Term Incentive award that will vest. Assuming a maximum estimate of the vesting (i.e. 100% vesting), the proportion of the award that vests by reference to his appointment as Non-executive Director of TSB is estimated to be £728,293. The award will be wholly settled by LBG at no cost to TSB.

1. Single total figure of remuneration (continued)

Executive Directors (audited)

	LBG Policy		TSB Policy	Total	Single Figure Total
	1 January to 24 April	25 April to 25 June	26 June to 31 December	Remuneration 2014	25 April to 31 December
Paul Pester					
Basic Salary(1)	£190,000	£100,000	£361,588	£651,588	£461,588
Benefits(2)	£8,596	£4,283	£13,353	£26,232	£17,636
Legacy LBG Bonus(3)	£247,000	£130,000	–	£377,000	£130,000
TSB Award(3)	–	–	£36,167	£36,167	£36,167
LBG 2012 LTIP(4)	£517,034	£37,325	£116,256	£670,615	£153,581
Pension(5)	£38,000	£20,000	£72,318	£130,318	£92,318
Sub Total	£1,000,630	£291,608			
Total	**£1,292,238**		**£599,682**	**£1,891,920**	**£891,290**

	LBG Policy		TSB Policy	Total	Single Figure Total
	1 January to 24 April	25 April to 25 June	26 June to 31 December	Remuneration 2014	25 April to 31 December
Darren Pope					
Basic Salary(1)	£118,750	£62,500	£232,440	£413,690	£294,940
Benefits(2)	£15,503	£8,160	£25,294	£48,957	£33,454
Legacy LBG Bonus(3)	£118,750	£62,500	–	£181,250	£62,500
TSB Award(3)	–	–	£23,250	£23,250	£23,250
LBG 2012 LTIP(4)	£421,372	£30,418	£94,746	£546,536	£125,164
Pension(5)	£23,750	£12,500	£46,488	£82,738	£58,988
Sub Total	£698,125	£176,078			
Total	**£874,203**		**£422,218**	**£1,296,421**	**£598,296**

(1) Basic salary represents the amounts paid in respect of the relevant period.
(2) Benefits represent the taxable value of all benefits received in the relevant period. Executive Director benefits include car allowance and flexible benefits totalling 4% of salary.
(3) The annual bonus represents the amount paid in respect of performance over the 2014 calendar year. This is spilt into two parts:
– Legacy LBG bonus: As disclosed in the Prospectus the Executive Directors were entitled to receive annual bonus payments under the LBG annual bonus scheme in respect of the period from 1 January 2014 to the date of listing. Under these legacy arrangements, Paul Pester and Darren Pope received annual bonus payments of 100% of maximum, pro-rated. There will be no ongoing entitlements under the LBG annual bonus scheme; and
– TSB Award: This has been pro-rated to reflect the period since listing when the Group implemented its remuneration arrangements.

(4) The LBG 2012 long term incentive plan represents amounts earned where performance is measured over multiple years. Under the TSB remuneration arrangements, the first awards under the SPA will be granted in early 2015, based on performance achieved in 2014. Awards will vest in five tranches, subject to the achievement of corporate and individual release conditions over the next five years, and will be included in future years' single figures accordingly.

The amounts disclosed in the tables are in respect of legacy LBG arrangements. As disclosed in the Prospectus, Paul Pester and Darren Pope hold subsisting share awards under the LBG Long Term Incentive Plan (LTIP) 2006. As set out in the plan rules, these awards continued to exist under the LBG plan upon listing. For those legacy LTIP awards granted in 2012, the performance period ended on 31 December 2014 and will vest based solely on the performance of LBG over the full performance period. Details of performance measures and targets for these awards have not been disclosed in this report given they relate to a different entity and the commercial sensitivities arising.

As at the date of publication of this Report, TSB has not been informed by LBG of the proportion of the award that will vest. As such, the figures are based on a maximum estimate of the vesting value i.e. assuming 100% vesting of the awards and valued at an average LBG share price to 31 December 2014 (as prescribed by the regulations). The estimated value has been split between the different time periods based on qualifying services to each entity over the three year performance period.

The values will be revised in the 2015 Directors' Remuneration Report based on actual vesting levels and share price on the date of vesting.

(5) Pension represents the equivalent cash allowance the Chief Executive Officer and the Chief Financial Officer have elected to receive in lieu of pension contributions.

The 1:1 cap applies only to remuneration in respect of service from listing (26 June 2014). Prior to that date, under LBG policies, a 2:1 cap applied. The calculation of the 1:1 cap is determined according to the relevant regulatory requirements. The calculation of fixed pay includes basic salary, pension contribution, flex allowance and car allowance. Variable pay includes any TSB Award and any SPA award. Because of the deferred nature of the SPA the initial award value is discounted in line with the regulations when calculating the cap.

Directors' remuneration report (continued)

2. 2014 Awards

2.1 Legacy LBG Bonus (audited)

As set out above, the Executive Directors were eligible to receive an award under the Legacy LBG Bonus scheme in respect of the period prior to listing.

The legacy bonus arrangements were aligned to the opportunity and performance metrics communicated by LBG to the Chief Executive Officer and Chief Financial Officer of TSB for 2014 and prior to the separation of TSB from LBG.

The maximum opportunity under the scheme for the Chief Executive Officer and Chief Financial Officer was 130% and 100% respectively of pre-listing basic salary, time pro-rated for the relevant pre-listing period. The Committee assessed the corporate and individual performance during the pre-listing period against the TSB scorecard set at the beginning of the financial year to determine the level of award to be made to the Executive Directors. A summary of the measures against which the Legacy LBG Bonus was assessed is set out below. The Committee considers more granular details to be commercially sensitive.

2014 Legacy LBG Bonus – performance assessment

Primary corporate objectives	– Ensure that legal agreements are in place with LBG to enable the effective separation of the two banks – Complete a successful IPO of TSB – Increase the share of PCA flows – Meet market expectations for TSB performance
Key "transitional" objectives	– Negotiate the legal separation from LBG, including the Separation Agreement, Relationship Agreement and IT Agreement – Develop a standalone business plan and present to shareholders in the Prospectus and investor meetings – Complete a successful IPO of TSB
"Standard" Lloyds Banking Group balanced scorecard	– Achievement against a scorecard of metrics which are categorised into (i) customer, (ii) people, (iii) building the business, (iv) risk and (v) financial

Based on the Committee's assessment against these targets, it has been determined that the legacy LBG bonus award payable to the Chief Executive Officer and Chief Financial Officer respectively will be 130% and 100% as a proportion of basic salary for the period. Part of the bonus payable will be delivered in shares (60% for the Chief Executive Officer and 40% for the Chief Financial Officer) which will be released in equal tranches over three years. The remaining 40%/60% of the bonus will be released in 2015, split equally between shares and cash. All shares released to the Executive Directors will be required to be held for a minimum of an additional six months but will not count towards the TSB shareholding requirement.

2.2 TSB Award

During 2014, as part of the creation of TSB as a standalone bank, TSB designed a new reward framework based on our partnership model. As part of this, all TSB Partners will be eligible to receive an annual TSB Award, under which all Partners, including Executive Directors, will have the same on-target level of 10% of basic salary.

This plan has been extended to all Partners from the start of 2015. As a commitment to the forward looking strategy, the Executive Directors waived their entitlement to the legacy LBG annual bonus from listing to the end of 2014, in favour of the new TSB framework, including eligibility to receive a TSB Award.

The process for determining the TSB Award for all Partners (including Executive Directors) is as follows:

(i) Gateway tests – Assess whether profitability and risk management gateways have been satisfied at a Corporate Level.

(ii) Corporate performance assessment – Assess Corporate performance against pre-determined Key Performance Indicators (KPIs) to determine the core award size and overall funding for the year.

(iii) Individual performance assessment – Assess individual performance to ensure all individuals have met minimum individual performance criteria to be eligible for the award and identify any exceptional performance in the year which may warrant an enhanced Pioneer award (up to twice the core award).

2014 TSB Award out-turn

Gateway tests	The Committee reviewed the Group's performance against the profitability and risk management gateways: – Profitability gateway: The Committee is comfortable that there are sufficient profits to warrant the 2014 TSB Award and that the profits adequately reflect the Group's underlying performance. – Risk management gateway: The Committee reviewed and reflected upon the Group's risk management, as reported by the Chief Risk Officer (CRO). This included consideration of there having been no material regulatory or compliance issues, no serious breaches of the liquidity or capital risk appetite policies and a satisfactory control environment throughout 2014. – Against that background, the Committee determined that the Group had met both corporate gateway requirements.
Corporate performance assessment	**Customer Outcomes (50%) – At TSB, the customer is at the heart of the business strategy** – The Committee has assessed the Group's performance against key performance indicators measuring customer satisfaction (net promoter score (NPS)), the provision of advice to our customers and effectively and promptly dealing with any complaints. – At the 2014 year-end, the Group's NPS was positive and above the target. TSB maintained sales quality above the level expected for the period. The number of reportable complaints (excluding legacy issues about packaged bank accounts) stood at 1.0 complaint per 1,000 accounts for the year. – The Committee has therefore determined that TSB exceeded expectations under this category. **Financial Resilience (25%) – The ongoing financial success of the Group requires the Group to generate sustainable profits** – The Committee has assessed the Group's 2014 profits and their quality. – TSB exceeded the target profit through both income performance and effective cost management. – The Committee has therefore determined that TSB exceeded expectations under this category. **Strategic Delivery (25%) – Delivery of annual strategic targets is fundamental to the achievement of long term sustainable performance** – The Committee has assessed the PCA market share flow, the digital penetration of new PCA customers and gross asset flows. – TSB significantly outperformed the PCA market share flow target during 2014 and the proportion of new PCA customers using internet banking exceeded the target set by the Committee. Whilst TSB achieved a good performance in gross asset flows, we would like to have seen a higher market share in the branch network. – The Committee has considered progress against the strategic goals and, noted both the significant achievements beyond expectations in two indicators and that the third had not been met in full. Overall for the post-listing period, the Committee judged TSB to have achieved an on-target level for Strategic Delivery. The Committee reflected on the Group's corporate performance against each of these categories and determined that the TSB Award should prudently be funded at the on-target level of 10% of basic salary (pro-rated for the post-listing period) given that this is the first time the Award has been made and that it is applicable only to a part-year of performance.
Individual performance assessment	At an individual level, the Committee reviewed the Executive Directors' performance for the period between listing and 31 December 2014 in detail (see further details in SPA Award summary below). As part of this assessment, it confirmed that the Executive Directors had demonstrated satisfactory personal conduct (with no compliance or risk breaches) throughout 2014 and would be eligible to receive a core TSB Award in respect of 2014 at the on-target level of 10% of basic salary (pro-rated for the period post-listing). For the Chief Executive Officer this is an award of £36,167 and for the Chief Financial Officer £23,250. These amounts are to be delivered 40% in cash, 60% in shares (subject to a 6 month holding period). The shares delivered under this plan will count towards the Executive Director shareholding requirement.

Directors' remuneration report (continued)

2.3 SPA Award

The process for determining the grant level for SPA Awards for all participants (including Executive Directors) is as follows:

(i) Assess whether profitability and risk management gateways have been satisfied at a Corporate Level.

(ii) Assess corporate performance against pre-determined KPIs to determine the SPA pool size.

(iii) Assess individual performance to determine individual award levels.

SPA Awards are made following the publication of the Group's results (i.e. in early 2015) and will vest in five annual tranches. The first tranche will vest on the first anniversary of the award, subject to the achievement of sustainable performance release conditions including Capital and Liquidity and Regulatory and Compliance gateways as well as cumulative Return on Equity performance targets.

FY1	FY2	FY3	FY4	FY5	FY6	FY7
Q1	Q1	Q1	Q1	Q1	Q1	Q1
Grant based on performance against corporate and individual metrics in the year	Sustained performance					
Individuals invited to participate and informed of performance conditions	Conditional award made	Up to 20% vests subject to release conditions	Up to 20% vests subject to release conditions	Up to 20% vests subject to release conditions	Up to 20% vests subject to release conditions	Up to 20% vests subject to release conditions

2014 SPA grant level (audited)

Gateway tests

As with the TSB Award, the Committee reviewed the Group's performance against profitability and risk management gateways, as follows:

- Profitability gateway: The Committee is satisfied that, after the funding of the TSB Awards, there is sufficient profit to fund the 2014 SPA Award.
- Risk management gateway: The Committee reviewed and reflected upon the Group's risk management, as reported by the Chief Risk Officer. This report included no material regulatory or compliance issues, no serious breaches of the liquidity or capital risk appetite policies and a satisfactory control environment throughout 2014.

Against that background, the Committee determined that the Group had met both of the Corporate gateway requirements.

2014 SPA Award – Corporate performance assessment

Corporate performance assessment

The Committee reviewed the Group's performance against pre-determined criteria, taking into consideration performance as a whole, and achievements against the Board approved plan.

The performance categories are the same as the TSB Award because these are considered to be the core drivers of sustainable performance. However, the weighting given to each category and performance indicators vary under the SPA.

Each category has been given equal importance under the SPA in order to ensure a balanced focus on the core drivers of sustainable performance in the year for which the Award quantum is determined.

The performance against the corporate performance metrics, as summarised in the table below, was assessed over the complete financial year 2014 for the SPA whereas the TSB Award relates solely to the post-listing period.

Customer Outcomes (33.3%) – At TSB, the customer is at the heart of the business.

- The Committee has assessed the Group's performance in this category against key performance indicators measuring customer satisfaction (net promoter score (NPS)), the provision of advice to our customers and effectively and promptly dealing with any complaints.
- At the 2014 year-end, the Group's NPS was positive and well above the target. TSB had maintained the level of sales quality above the level expected by the Committee throughout 2014 and also ensured the number of complaints (excluding any legacy issues) which are not dealt with promptly stood at 1 complaint per 1,000 accounts.
- The Committee has therefore determined that TSB exceeded their expectations under this category.

Financial Resilience (33.3%) – The ongoing financial success of the Group requires the Group to generate sustainable profits whilst maintaining adequate control over costs.

- The Committee has assessed the 2014 profit and operating costs in order to determine the performance under the financial resilience category.
- TSB has exceeded the profit target and have operated at a lower than planned operational cost base.
- The Committee has therefore determined that TSB has exceeded expectation under this category.

Strategic Delivery (33.3%) – Delivery of annual strategic targets is fundamental to the achievement of long term sustainable performance of the Group.

- The Committee has assessed the PCA market share flow, the digital penetration of new PCA customers and gross asset flows.
- TSB significantly outperformed the PCA market share flow target during 2014 and the proportion of new PCA customers using internet banking exceeded the target set by the Committee. Whilst TSB achieved a good performance in gross asset flows we would like to have seen a higher market share in the branch network.
- The Committee has considered progress against the strategic goals and, noted both the significant achievements beyond expectations in two indicators and that the third had not been met in full. Overall for post-listing period the committee judged TSB to have achieved an on-target level Strategic Delivery.

The Committee considered the Group's performance in the round, for 2014 against each of these categories and determined that the SPA Award should be funded above the on target level at 90%. This reflected the Group exceeding expectations in eight of the nine key corporate metrics considered and its achievement of the completion of a successful IPO process. Whilst the Group achieved a good performance in gross asset flows we would have liked to have seen a higher market share in the branch network.

Taking into consideration the corporate performance for 2014 as a whole, including the very successful build of the Group and the completion of the IPO process, the award is appropriate compared with the level of the TSB Award which relates only to the post-listing period.

The Committee considers more granular details to be commercially sensitive.

Directors' remuneration report (continued)

2014 Individual performance assessment	The individual award quantum is determined based on the achievement of personal performance objectives during the year. Generally, for Executive Directors, achievement of 'on-target' corporate and 'on-target' individual performance would result in an award of 62.5% of basic salary and 'maximum' performance would result in an award of up to 100% of basic salary. A summary of the Executive Directors' individual assessments for 2014 is provided below.
	Chief Executive Officer
	The Committee has reviewed the Chief Executive Officer's performance during 2014 and considers that he has delivered very strong personal performance in 2014 on the basis of delivering the following outcomes: – Successfully leading TSB in the process of it becoming a standalone business; – Providing strong leadership and direction in successfully concluding negotiations to separate from LBG; – Outstanding leadership of the Group through a successful IPO process; – Building strong relationships with investors and clearly presenting a credible vision for TSB as a challenger bank; – Personally conveying to Partners a commitment to the TSB brand values and engaging Partners across the Group in the vision for TSB; – Successfully managing the Group and setting the strategic direction for the Group; – Building and leading a strong Bank Executive team to meet the demands of the UK listed environment; and – Championing the TSB local bank brand and partnership values which has been well received by stakeholders.
	Chief Financial Officer
	The Committee has reviewed the Chief Financial Officer's performance during 2014 and considers that he has made a key contribution towards the leadership of TSB on the basis of delivering the following outcomes: – Key contributions to the Group's separation from LBG including playing a vital role in the negotiation of the terms; – Outstanding performance during the IPO process including in the preparation of the Prospectus and meeting with investors to communicate the Group's financials; – Playing a key role as a member of the leadership team in shaping the future of the Group; – Successfully transitioned from a divisional Finance Director to the Chief Financial Officer of a listed Group including the announcement of H1 results; and – Implementing systems and process and creating a team with the necessary strength in depth in the finance function, and supporting the implementation of the Group's strategy.
	As shown above the Committee determined that the result against the personal objectives resulted in maximum achievement which when combined with the achievement of corporate goals, resulted in SPA Awards of 90% of basic salary for each of the Chief Executive Officer and Chief Financial Officer.

These awards will be made early in 2015, 70% in TSB shares and 30% in cash. The awards will be released in five annual tranches, with the first tranche to be released in 2016. Each tranche's release is subject to the achievement of sustainable performance conditions (set out below). Any shares delivered will be subject to a further six month holding period and will count towards the Executive Directors' personal shareholding guideline.

Each of the tranches is only released to the individual if the sustainable performance conditions have been met at each vesting date. These conditions are as follows:

(i) Capital and Liquidity: No significant breach of Board risk appetite in the year.

(ii) Regulatory and Compliance: No material regulatory issues and satisfactory internal control environment in the year.

(iii) Sustainable financial performance: Performance against pre-determined cumulative return on equity targets has been achieved.

A report on the achievement of the release conditions will be included in subsequent Annual Reports as each tranche becomes available for release.

3. Scheme interests awarded during the financial year

The table below summarises the scheme interests awarded by the Group to the Executive Directors during the 2014 financial year including the following:

– All-Partner £100 Award – All eligible Partners in service at listing, including Executive Directors, were granted shares to the value of £100 under the SIP and designated as Partners in TSB. The shares remain subject to the rules of the SIP and must ordinarily be held for at least three years before they can be sold. New entrants will similarly be granted £100 in shares. Partners are required to retain these shares in order to be eligible to participate in the TSB Award.

– Legacy share awards – Prior to listing, the Chief Executive Officer and Chief Financial Officer were granted a number of share awards under the LBG Long Term Incentive Plan 2006 and Deferred Bonus Plan. These legacy awards were made over LBG shares with any performance conditions relating to LBG. Mark Fisher, a Non-executive Director of TSB who is not eligible to participate in any TSB incentive schemes, was also granted LBG awards under these schemes in respect of his former employment as a senior executive in LBG. These legacy LBG awards are disclosed as required by the regulations.

Awards made by the Group over TSB shares (audited)

	Type of Award	Number of TSB shares	Face value at grant	Performance period
Paul Pester				
SIP Award – All Partner £100 share award[1]	Share award	38	£99	None
SIP Award – TSB Sharematch award[2]	Share award	165	£458	None
TSB Sharesave[3]	Discounted options	3,991	£8,999	None
TSB Award[4]	Share award	–	–	–
SPA Award[5]	Share award	–	–	–
Darren Pope				
SIP Award – All Partner £100 share award[1]	Share award	38	£99	None
SIP Award – TSB Sharematch award[2]	Share award	331	£919	None
TSB Sharesave[3]	Discounted options	3,991	£8,999	None
TSB Award[4]	Share award	–	–	–
SPA Award[5]	Share award	–	–	–

(1) All Partners in service at the date of listing, including Executive Directors, were awarded shares to the value of £100. The share price at the date of listing was 260p.
(2) Shares are awarded monthly and Partner contributions are matched on a 1:1 basis up to the first £30. The TSB Sharematch awards include partnership and matching share awards which are made monthly using the TSB share price on award date. These awards have been valued using the average TSB share price for 2014 (£2.7755). The matching shares are subject to forfeiture in the first three years.
(3) Eligible Partners, including Executive Directors, were eligible to participate in TSB Sharesave. Options were granted in 2014 at a 20% discount. The options price was £2.2548.
(4) No awards made in 2014. Share element of the 2014 TSB Award granted in early 2015 will be paid in shares (see page 70 for further details of the TSB Award).
(5) No awards made in 2014. The first award under the SPA will be made in early 2015 (see page 72 for further details of the SPA Award).

Legacy Awards made by LBG over LBG shares (audited)

	Type of Award	Number of LBG shares	Face value at grant	Performance period
Paul Pester				
LBG 2014 LTIP awards[1]	Conditional share award	760,668	£600,000	3 years to 31 Dec 2016
LBG 2013 Deferred Bonus Plan[2]	Conditional share award	468,297	£368,500	None
LBG SIP Awards – LBG Sharematch[3]	Share award	1,372	£1,077	None
Darren Pope				
LBG 2014 LTIP awards[1]	Conditional share award	475,417	£375,000	3 years to 31 Dec 2016
LBG 2013 Deferred Bonus Plan[2]	Conditional share award	251,115	£197,500	None
LBG SIP Awards – LBG Sharematch[3]	Share award	1,372	£1,077	None
Mark Fisher[4]				
LBG LTIP	Conditional share award	2,628,743	£2,019,138	3 years to 31 Dec 2016
LBG Deferred Bonus Plan	Conditional share award	1,191,106	£939,521	None

(1) Prior to the Group's listing, LBG made LTIP awards to select key management personnel including the Executive Directors of TSB. Awards were made in 2014 by reference to performance in 2013. The LBG 2014 LTIP was awarded at 100% of salary. The share price used to determine the number of shares under awards under the LBG 2014 LTIP awards was 78.878p. Under the LBG 2014 LTIP 0% of the awards will vest if a threshold level of performance is not achieved.
(2) Awards made to implement the LBG annual bonus deferral policy. Awards were made in 2014 by reference to performance in 2013. The share price used to determine the number of shares awarded under the LBG 2013 DBP awards was 78.2382p (June 2014 release) and 78.878p (deferred share awards post June). Deferred awards will be released over the period to September 2017.
(3) All LBG employees, including Executive Directors, were eligible to participate in LBG SIP. The plan was frozen to TSB Partners (including Executive Directors) at the date of listing, with the last award made on 9 July 2014. The LBG Sharematch awards include partnership and matching share awards which were made monthly, using the LBG share price on award date. These awards have been valued using the average LBG share price for 1 January to 9 July 2014 (78.49p).The matching shares are subject to forfeiture in the first three years.
(4) Mark Fisher is a Non-executive Director of TSB and is not eligible to participate in any TSB incentive schemes. The LBG awards shown above were granted in respect of his former employment as a senior executive in LBG and comprise LBG Long Term Incentives and LBG Deferred Bonus awards. These awards will be wholly settled by LBG at no cost to TSB. The Long Term Incentive awards will only vest to the extent that the original performance conditions set by LBG are met.

Directors' remuneration report (continued)

4. Payments to past Directors and payments for loss of office

There have been no payments made to past Directors or payments for loss of office in 2014.

5. Statement of Directors' shareholding and share interests (audited)

The table below shows Directors' shareholdings as at 31 December 2014:

		Total directors' interests as at		Breakdown of share plan interests as at 31 December 2014								
				TSB awards over TSB shares					LBG awards over LBG shares			
				Share Awards		Options			Share Awards		Options	
Director	Shareholding guideline as a % of salary (% achieved)	31 Dec 2014	31 Dec 2013	Unvested and subject to performance conditions	Unvested and not subject to performance conditions	Unvested and subject to performance	Unvested and not subject to performance	Vested but not exercised	Unvested and subject to performance	Unvested and not subject to performance	Vested but not exercised	Exercised in the year
	(1)	(2) (6)			(3)				(4) (5)	(4) (5)		
Paul Pester	200 (0.2)	1,115	–	–	203	–	3,991	–	2,332,281	327,166	22,156	–
Darren Pope	150 (0)	–	–	–	369	–	3,991	–	1,689,284	189,872	22,156	–
Will Samuel	–	42,470	–	–	–	–	–	–	–	–	–	–
Philip Augar	–	–	–	–	–	–	–	–	–	–	–	–
Norval Bryson	–	2,230	–	–	–	–	–	–	–	–	–	–
Dame Sandra Dawson	–	1,115	–	–	–	–	–	–	–	–	–	–
Mark Fisher	–	–	–	–	–	–	–	–	11,712,439	1,979,085	–	–
Sandy Kinney	–	–	–	–	–	–	–	–	–	–	–	–
Godfrey Robson	–	–	–	–	–	–	–	–	–	–	–	–
Stuart Sinclair	–	–	–	–	–	–	–	–	–	–	–	–
Polly Williams	–	–	–	–	–	–	–	–	–	–	–	–

(1) The Committee has confirmed that the Executive Directors have complied with TSB's share ownership policy during 2014. In line with corporate governance guidelines only shares owned outright and unvested share interests which are not subject to further performance conditions or continuous employment are included for the purpose of calculating the shareholding guidelines.

(2) All TSB shares owned outright by the Directors and/or connected persons. These shares were acquired as part of the TSB IPO.

(3) Shares awarded under the SIP – £100 share award made to all Partners and TSB Sharematch awards. The TSB Sharematch awards include partnership and matching share awards which are made monthly. The matching shares are subject to forfeiture in the first three years.

(4) Mark Fisher is a Non-executive Director of TSB and is not eligible to participate in any TSB incentive schemes. The LBG awards shown in the table were granted in respect of his former employment as a senior executive in LBG and comprise LBG Long Term Incentives and LBG Deferred Bonus awards. These awards will be wholly settled by LBG at no cost to TSB. The awards were made over multiple years of service at LBG and Long Term Incentive awards will only vest to the extent that the original performance conditions set by LBG are met.

(5) As disclosed in the prospectus Paul Pester and Darren Pope continue to hold subsisting awards under the following LBG schemes:

Scheme	Details of awards	Type of Award
LBG Long Term Incentive Plan 2006	These were granted in 2012, 2013 and 2014. As set out in the plan rules, these awards continued to exist under the LBG plan upon listing i.e. will vest at the same time as other participants in the plan and to the extent LBG meets its performance targets. On the date that TSB ceases to be a subsidiary of LBG, the participants will be treated as 'good leavers' and there will be a pro rata reduction in the number of shares based on the time in the performance period to the date of leaving. At that point, it is the Group's intention to make Substitution Awards to the equivalent value of the pro rata reduction in the LBG LTIP awards. The Substitution Awards will be made using TSB shares and vesting will be based on TSB performance.	Conditional shares
LBG Deferred Bonus Plan	As disclosed in the Prospectus Paul Pester and Darren Pope hold subsisting share awards under this Plan. These Awards will continue to operate under the LBG plan, including when the Group is no longer a subsidiary of LBG.	Conditional shares
LBG Sharesave	These options were granted in 2013. On the date that TSB ceases to be a subsidiary of LBG, the participants will be treated as 'good leavers' and will have six months to exercise Sharesave options.	Discounted options
LBG SIP	These shares were awarded prior to and during 2014. The LBG SIP was frozen following the IPO, with the last award made in July 2014. The LBG Sharematch awards include partnership and matching shares. The matching shares are subject to forfeiture in the first three years. On the date that TSB ceases to be a subsidiary of LBG, the participants will be treated as 'good leavers' and shares will be released from the SIP free of income tax and NI.	Market purchase shares

(6) With the exception of TSB Sharematch awards, details as at 20 February 2015 are the same as above. Paul Pester's holding has increased from 203 shares to 334 shares. Darren Pope's holding has increased from 369 shares to 500 shares.

6. Implementation of remuneration policy in 2015

This section provides an overview of how the Committee is proposing to implement our Remuneration Policy in 2015.

6.1 Basic salary, pension and benefits

In the period following listing, the Committee undertook a review of Executive Directors' salaries against the external market.

As was committed in the Prospectus the Chief Executive Officer's basic salary will remain at £700,000 and will not be reviewed before January 2016. In accordance with the Group's wider policy the Chief Executive Officer's pension contribution/allowance will remain as a fixed percentage of basic salary and the Flexible Benefits allowance has been adjusted to apply the standard percentage (4%) to the basic salary as at September 2014. This is in accordance with the policy applied to all Partners.

After reviewing the Chief Financial Officer's basic salary against external market data for comparable roles in companies of similar size to TSB and taking into account his excellent performance over the year (see page 74 for further details) the Committee decided to increase the Chief Financial Officer's annual basic salary from £450,000 to £535,000 with effect from 1 April 2015.

The Committee is conscious that this is a significant adjustment, in part a result of a conservative approach taken to the first stage adjustment made at listing. The Committee believes that the adjustment is consistent with the commitment to ensure that the overall remuneration package is properly aligned to market levels of reward and that the adjustment is appropriate. The Committee will continue to review the Executive Directors' remuneration annually, taking into account individual performance and contribution to the Group.

6.2 TSB Award

In 2015 the TSB Award was extended to include all Partners. The maximum annual TSB Award for all Partners, including Executive Directors will be two times the core award. Based on Group performance the core award can range from 0% to 15% in any year, resulting in a maximum individual award of 0% to 30% in the year (see policy table on page 60).

The corporate performance measures are the same for all Partners in order to strengthen the Group's inclusive partnership culture and will continue to measure performance against Customer Outcomes, Financial Resilience and Strategic Delivery.

The Committee considers that the exact TSB Award targets are commercially sensitive.

6.3 Sustainable Performance Award

The maximum SPA will remain at 100% of basic salary for the Executive Directors in 2015. Grant levels will continue to be based on Financial Resilience, Customer Outcomes, Strategic Delivery and personal performance. Vesting of the awards will be in five annual tranches and subject to corporate and individual release conditions.

As with the TSB Award, the Committee considers the exact SPA award targets to be commercially sensitive. However we commit to providing more context regarding performance against these targets and the resulting vesting amounts at the end of the relevant vesting period.

6.4 Non-executive Director remuneration

The table below shows the Non-executive Director fee structure for 2015. The fee levels shown below were set at listing and will be maintained for 2015. We expect to review Non-executive Director fee levels in the first quarter of 2016 and annually thereafter.

	2015 fees
Chairman of the Board fee	£325,000
Senior Independent Director fee	£20,000
Board member basic fee	£60,000
Additional fee for Audit/Remuneration/ Risk Committee Chair	£25,000
Additional fee for membership of each of Audit/Risk/Remuneration Committee	£10,000
Additional fee for membership of Nomination Committee*	£5,000

* The Chairman waives his entitlement to this fee.

7. Contextual disclosures

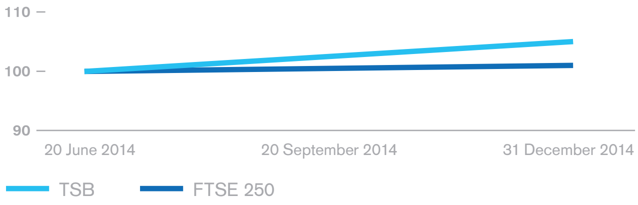
The following section sets out graphs and tables to provide additional context to shareholders on executive pay and corporate performance.

7.1 TSR performance and Chief Executive Officer remuneration outcomes

The performance graph overleaf illustrates the total shareholder return performance of TSB in the period since its listing compared with that of the companies comprising the FTSE 250 index. TSB is a constituent of this index and as such it has been selected as an appropriate comparator group. Given the relatively short period which has elapsed since listing, this data is currently of limited assistance to shareholders, but will build over time to give a view of comparative performance against the FTSE 250 index.

Directors' remuneration report (continued)

Historical TSR performance



7.2 Table of historic Chief Executive Officer data

	2014
Paul Pester	
Single figure of total remuneration	£1,891,920
Percentage of maximum TSB Award paid	66.6%
Percentage of maximum SPA vesting	0%

Percentage change in remuneration for the Chief Executive Officer

Comparative figures for previous years are not included as this relates entirely to service under the governance of LBG and therefore percentage changes are not provided.

As detailed in the statement from the Committee Chair, TSB's overall reward strategy has been designed to create a culture of partnership and as such the remuneration of the Chief Executive Officer is always considered in the context of remuneration for other Partners.

7.3 Relative importance of the spend on pay

The table below illustrates the current overall expenditure on pay relative to dividends paid. However, it should be noted that TSB has yet to pay any dividends and the information in this table is therefore currently of limited use.

The figures presented have been calculated on the following bases:

– **Overall expenditure on pay** – represents total staff costs from continuing operations for the full year.

– **Dividends** – dividends paid in respect of the year.

	Remuneration paid to all employees £ million	Dividend paid/share buybacks £ million
2014	**278.1**	**0**

7.4 Funding of shares and dilution limits

TSB will comply with overall dilution limits consistent with the guidelines provided by the Investment Association. These limits are 10% in any rolling ten year period for all plans and 5% in any rolling ten year period for executive share plans.

7.5 External appointments

Paul Pester is an Advisory Board Member of the Financial Services Forum for which he does not receive a fee. Darren Pope does not currently hold any external appointments.

8. Consideration by the Directors of matters relating to Directors' remuneration

The Company's Board entrusts the Committee with the responsibility for the remuneration policy in respect of Executive Directors, senior executives and Code Staff and ensuring its ongoing appropriateness and relevance. The Committee's full terms of reference are available on the company's website. The terms of reference, were approved by the Committee upon its formation and will be kept under regular review.

The section of this report addressing Corporate Governance provides details of the Committee members and their attendance at Remuneration Committee meetings.

As a matter of course Committee meetings are also attended by the Company Chairman, the Chief Executive Officer, the HR Director, the Chief Risk Officer, and the Director of Performance and Reward to provide input on their specialist areas as requested by the Committee. The Company Secretary acts as the secretary to the Committee. None of these additional attendees participates in any part of any meeting that discusses issues directly affecting their own remuneration.

In setting the remuneration for the Partners for which it has direct responsibility, the Committee takes into account the pay and conditions of the wider workforce as a matter of course.

The Committee appointed Deloitte LLP (Deloitte) to provide independent advice on remuneration matters following a presentation to the Committee members.

Deloitte is a member of the Remuneration Consultants Group and as such voluntarily operates under the code of conduct in relation to executive remuneration consulting. The Committee is satisfied that the advice it has received has been objective and independent. As advisor to the Committee, Deloitte has provided independent advice on matters under consideration by the Committee including in relation to compliance with regulations, advice on market trends and data and implementation of remuneration arrangements.

Deloitte's fees in respect of the advice provided to the Committee during 2014 were £82,000 and were charged on the basis of its standard terms of business. Deloitte also provided advice on remuneration to management during 2014, as well as providing advice on taxation and financial matters and other miscellaneous consulting and assurance services. In addition, management received external advice, including market data and legal counsel, from a number of other providers which is not considered to be material in assisting the Remuneration Committee in consideration of the Directors' remuneration.

As a matter of good practice the Committee will review the work of Deloitte during 2015 and formally consider the continuing appointment of Deloitte as adviser to the Committee.

Directors' report

Introduction
The Directors of TSB Banking Group plc (the Company) present their report for the period ended 31 December 2014, in accordance with section 415 of the Companies Act 2006. The UK Listing Authority's (UKLA) DTR and Listing Rules also require the Company to make certain disclosures, some of which have been included in other appropriate sections of the Annual Report and Accounts.

The information set out on pages 2 to 36 and, in particular, the following cross-referenced material, is incorporated into this Directors' report:

– Likely future developments in the Group's business (page 11); and

– The Board of Directors and the Corporate governance statement (pages 38 to 47).

Results and dividends
The consolidated balance sheet can be found on page 102 and the consolidated statement of comprehensive income is on page 103. In line with the Chairman's letter on page 3, the Directors do not currently propose to pay a dividend.

Directors
The Directors who served during the period under review or from the date of their appointment are:
Will Samuel
Philip Augar
Norval Bryson
Dame Sandra Dawson
Sandy Kinney
Mark Fisher
Godfrey Robson CB
Stuart Sinclair
Polly Williams
Paul Pester
Darren Pope

Their biographies (which include dates of appointment) appear on pages 38 and 39. All Directors will retire at the 2015 AGM and, save for Godfrey Robson as noted on page 46, will put themselves forward for election or re-election.

The Company's Articles of Association (the Articles) give the Directors power to appoint and replace Directors. Under the terms of reference of the Nomination Committee, any appointment must be recommended by it for approval by the Board of Directors. Directors can also be removed from office by ordinary resolution of which special notice has been given.

Power of Directors
The Directors are responsible for managing the business of the Company and may exercise all the powers of the Company so long as the Articles or applicable legislation do not stipulate that any such powers must be exercised by the members.

Directors' indemnities
The Directors have the benefit of a deed of indemnity which constitutes a 'qualifying third party indemnity provision'. This indemnification for Directors provided by the Company has been arranged in accordance with the Company's Articles and the Companies Act 2006. These deeds were in force prior to the Company's listing. The indemnities remain in force at the date of signing these financial statements and are available for inspection at the Company's registered office.

Directors' emoluments waiver
No Directors, save for the Chairman who waived his entitlement to the fee for membership of the Nomination Committee, have waived their emoluments during the period under review, nor have any Directors agreed to waive future emoluments.

As noted in the Directors' remuneration report on page 70 Paul Pester and Darren Pope waived their entitlement to the legacy LBG annual bonus from Admission to the end of 2014, in favour of the new TSB Award.

Directors' share interests
Details of the interests of the Directors and their connected persons in the share capital of the Company, including any interests under the long term incentive plan (LTIP), are set out in the Directors' remuneration report on page 76.

Share capital
At 20 February 2015 the total issued share capital with voting rights consisted of 500,000,000 ordinary shares of £0.01 each. No shares are held in Treasury.

Voting rights
The Company's Articles of Association provide that subject to any rights or restrictions attached to any shares, on a show of hands every member present in person or by proxy shall have one vote, and on a poll every member shall have one vote for every share of which he is a holder. On a poll, votes may be given either personally or by proxy or (in the case of a corporate member) by a duly authorised representative.

A shareholder entitled to attend and vote at a general meeting may appoint one or more proxies to attend and vote instead of him. A proxy need not be a shareholder of the Company. A member may also appoint more than one proxy if he so wishes, provided that each proxy is appointed to exercise the rights attached to different shares held by the member.

Under the Relationship Agreement, Lloyds Banking Group plc has also undertaken (subject to certain exceptions) that it will notify the Company in the event that it intends to vote against the Board's recommendation in respect of a resolution at a general meeting of the Company, and if it fails to do so will either not vote on the resolution, will vote with the Board's recommendation or will vote for and against the resolution proportionally with other shareholders.

Directors' report (continued)

In addition, the Relationship Agreement contains certain restrictions on the extent to which Lloyds Banking Group plc may requisition a general meeting, put forward resolutions or agenda items at an Annual General Meeting or require the circulation of a written statement to shareholders.

Restrictions on the transfer of shares

Other than as set out below, there are no specific restrictions on the transfer of shares in the Company, which is governed by the Articles of Association and prevailing legislation, nor is the Company aware of any agreements between holders of securities that may result in restrictions on the transfer of shares or that may result in restrictions on voting rights. The Directors who purchased shares on Admission are subject to a 365 day lock-up period during which they will not sell any ordinary shares they own in the Company.

Variation of rights

Subject to the Companies Act 2006 and in accordance with the Articles of Association rights attached to any class of shares may be varied with the consent in writing of the holders of three-quarters in nominal value of the issued shares of the class or with the sanction of a special resolution passed at a separate general meeting of the shareholders.

Major shareholders

Information provided to the Company pursuant to the UKLA's DTRs is published on a Regulatory Information Service and on the Company's website. As at 31 December 2014 and 20 February 2015, the Company had been notified under DTR5 of the following significant holdings of voting rights in its shares.

	As at 31 December 2014		As at 20 February 2015	
Name of shareholder	Number of shares	% of issued share capital	Number of shares	% of issued share capital
Lloyds Banking Group plc	250,005,309	50.001	250,005,309	50.001
Majedie Asset Management Limited	25,581,226	5.12	25,581,226	5.12
Jupiter Asset Management Limited	25,069,388	5.01	25,069,388	5.01
TIAA-CREF Investment Management, LLC/ Tradewinds Global Investors, LLC	15,285,041	3.06	15,285,041	3.06

Authority to allot shares

Prior to the Company's listing, at a general meeting held on 4 June 2014 the Company was granted the authority to allot shares up to an aggregate nominal value of £1,666,666 and, in addition, an authority to allot up to an aggregate nominal amount of £3,333,333 in connection to a rights issue. The Company also received authority to allot shares on a non pre-emptive basis up to a maximum aggregate nominal amount of £250,000. As at the date of this report, no shares have been issued under these authorities. These authorities will apply until the conclusion of the 2015 AGM unless revoked, varied or renewed prior to, or at, that meeting.

Authority to purchase own shares

Prior to the Company's listing, at the general meeting held on 4 June 2014 the Company was granted the authority to purchase no more than 10% of the nominal amount of the issued share capital of the Company. This authority was in place at the financial year end and will apply until the conclusion of the 2015 AGM unless revoked, varied or renewed prior to, or at, that meeting. The Company did not purchase any of its own shares during the period under review.

Relationship Agreement and Significant Agreements

Any person who exercises, or controls on their own or together with any person with whom they are acting in concert, 30% or more of the votes able to be cast on all or substantially all matters at general meetings of a company are known as 'controlling shareholders'. The Financial Conduct Authority's Listing Rules require companies with controlling shareholders to enter into a written and legally binding agreement which is intended to ensure that the controlling shareholder complies with certain independence provisions. The agreement must contain undertakings that:

– Transactions and arrangements with the controlling shareholder (and/or any of its associates) will be conducted at arm's length and on normal commercial terms;

– Neither the controlling shareholder nor any of its associates will take any action that would have the effect of preventing the listed company from complying with its obligations under the Listing Rules; and

– Neither the controlling shareholder nor any of its associates will propose or procure the proposal of a shareholder resolution which is intended or appears to be intended to circumvent the proper application of the Listing Rules.

The Board confirms that, in accordance with the Listing Rules, on 9 June 2014, the Company entered into such an agreement with Lloyds Banking Group plc (the 'Relationship Agreement'), which took effect on 25 June 2014. Lloyds Banking Group plc held approximately 50% of the Company's voting rights as at 31 December 2014.

The Board confirms that, since the Relationship Agreement took effect on 25 June 2014 until 31 December 2014:

– The Company has complied with the independence provisions included in the Relationship Agreement; and

– So far as the Company is aware, the independence provisions included in the Relationship Agreement have been complied with by Lloyds Banking Group plc and its associates.

Except for the Relationship Agreement, the Company is not party to any significant agreements that are subject to change of control provisions in the event of a takeover bid. In the event of a takeover bid whereby (i) the Company's ordinary shares cease to be admitted to listing on the Official List or (ii) LBG, together with its associates, ceases to own or control (directly or indirectly) 20% or more of the voting share capital of the Company, the Relationship Agreement will terminate.

Details of agreements of significance with the Company's controlling shareholder, Lloyds Banking Group plc, are set out in note 30 to the consolidated financial statements on page 133. In particular, on 9 June 2014 TSB and LBG formally entered into the TSA and LTSA for the provision of IT services and certain operational activities. The TSA runs until the end of 2016 when it will be replaced by the LTSA from 2017 for a term of up to seven and a half years.

Disclosures required under Listing Rule 9.8.4R

The following table is included to meet the requirements of Listing Rule 9.8.4R.

Information required	
Amount of interest capitalised by the Group in 2014 and any related tax relief.	There was no interest capitalised by the Group in 2014.
Publication of unaudited financial information.	There was no unaudited financial information published in 2014 within the meaning of LR9.8.4R(2).
Smaller related party transactions entered into before 16 May 2014.	There was no smaller related party transactions entered into up to and including 15 May 2014.
Allotment of equity securities for cash other than pursuant to an open offer or rights issue or any issue specifically authorised by shareholders.	During the year there was no allotment of equity securities for cash other than pursuant to an open offer or rights issue or any issue specifically authorised by shareholders.
Parent company participation in placing.	Not applicable.
Contracts of significance in which a Director is interested.	Not applicable.
Agreement under which a shareholder has agreed to waive dividends.	There are no arrangements in place whereby a shareholder has agreed to waive a dividend.

Employees

Further detail relating to employees (referred to as TSB Partners) can be found in the Responsibility review on page 34.

The disclosures in the Responsibility review include information relating to Partner engagement, certain information on the Company's policy concerning employment of disabled persons, information on gender diversity and its treatment of Partners.

Greenhouse gas emissions

The Group's greenhouse gas emissions for 2014 were 22,521 tonnes of carbon dioxide equivalent (CO_2e). As this is the first year of reporting for the Group, there is no base year for comparison and no stated emissions targets against which to report. In 2015 the Group expects to establish an energy baseline and, where possible, resource utilisation targets against which it can report in future years.

The report is based on emissions for UK operations under the Group's operational control. The Group follows UK Government's Environmental Reporting Guidelines 2013 and uses the latest conversion factors specified in the Department for Energy and Climate Change UK Government conversion factors for Company Reporting.

The Group is reporting scope 1 and scope 2 emissions. Scope 1 emissions cover direct emissions from Group sites and vehicles including heating and generator fuels, vehicle fuels in vehicles operated by the Group and refrigerant leakage. Scope 2 covers offsite emissions directly related to consumption at Group sites, namely electricity generation, excluding transmission and distribution losses. The Group has not reported scope 3 emissions such as business travel using privately owned vehicles, as it does not have access to this data.

	Amount consumed	Units	Emissions (tonnes CO_2e)
Scope 1 emissions source			
Gas	18,642,791	kWh	3,448
Vehicle fuel	2,253,369	Miles	687
Fuel oils	45,097	Litres	132
Refrigerants	134	kg	231
Scope 1 Sub total			**4,498**
Scope 2 emissions source			
Electricity	36,465,039	kWh	18,023
Total Group Emissions (Scope 1+2)			**22,521**

Directors' report (continued)

Actual consumption data accounts for 40% of reported scope 1 and 2 emissions. This covers energy at sites where the Group pays the energy bills; and covers the period from January to April 2014 for electricity and from January to August 2014 for gas; it also includes fuel consumption from UK company cars based on total mileage.

Estimated consumption accounts for the remaining 60% of emissions. This covers electricity and gas at all Group sites (i.e. where the Group pays the energy bills and all consumption where they are paid for by the landlord), refrigerants and gas oil for all sites. In respect of electricity, estimated consumption covers the period May to December 2014 and in respect of gas consumption, covers September to December 2014. Estimated electricity and gas consumption are calculated from the accrued values, which are a forecast of consumption, where complete actual billed consumption was not available. The numbers are calculated by extrapolating the consumption observed at each site in previous months.

The figures do not include consumption for sites where energy is used but not charged separately; i.e. where the landlord rents out space in a building and the utilities are included within the rent. This is due to lack of data to either calculate or estimate usage. Estimates are calculated from observed Group consumption intensity and published benchmarks where relevant.

To improve the accuracy of its reporting and energy management and reduce the use of estimated data in future reporting, in 2015 the Group will continue to roll out smart meters across the property estate.

Greenhouse gas emissions for 2014 were equivalent to 3.00 tonnes CO_2e per FTE, using FTE as at December 2014 and were 25.02 tonnes CO_2e per £ million of revenue (as measured by total income).

Amendment to the Company's Articles
Any amendments to the Articles may be made in accordance with the provisions of the Companies Act 2006 by a special resolution of the members of the Company.

Political donations and expenditure
No amounts were given for political purposes during the year.

Financial risk management and hedging policies
Details of the use of financial instruments, together with risk management disclosures can be found in note 28 to the consolidated financial statements on page 130. Further information on hedging accounting policies can be found on page 125.

Post balance sheet events
There are no significant events affecting the Group that have arisen between 31 December 2014 and the date of this report that require disclosure.

Research and development activities
During the ordinary course of business the Group develops new products and services.

Overseas branches
The Group does not have any branches outside of the United Kingdom.

Corporate headquarters and registered office
The Corporate headquarters and registered office address for TSB Banking Group plc is 20 Gresham Street, London EC2V 7JE. Telephone: +44 (0)20 7003 9000. Website: www.tsb.co.uk.

Disclosure of information to external auditor
In accordance with the provisions of the Companies Act 2006, the Directors serving at the date of approval of this report confirm that, so far as each Director is aware, there is no relevant audit information of which the Company's Auditor is unaware and each Director has taken all the steps that he or she ought to have taken as a director to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Going concern
The Directors recognise their responsibility to make an assessment of the Group's ability to continue as a going concern, for a period of at least twelve months from the date the financial statements are approved.

The assessment is based on the Group having sufficient liquidity and capital, and includes consideration of the funding and capital plans of the Group, the ILAA and the ICAAP submitted to the PRA. In light of the Group's capital resources (page 95) and funding resources (page 88) the Directors are satisfied that adequate funding and liquidity resources will be in place to allow the financial statements to continue being prepared on a going concern basis and are not aware of any material uncertainties that may cast significant doubt upon the Group's ability to continue as a going concern.

Fair, balanced and understandable
The Board has ultimate responsibility for reviewing and approving the annual report. The Directors confirm that they consider that the annual report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy. When arriving at this conclusion the Board was assisted by a number of processes including:

– The Annual Report is drafted and comprehensively reviewed by appropriate senior management with overall co-ordination by the Financial Controller;

– An extensive verification process is undertaken to ensure factual accuracy, with third party review by legal advisers; and

– The final draft is reviewed by the Audit Committee prior to consideration by the Board.

Annual General Meeting
The Company's AGM is to be held at the offices of CMS at Cannon Place, 78 Cannon Street, London, EC4N 6HL on Wednesday 22 April 2015 at 10.30am. Registered shareholders will be sent a Notice of AGM.

By order of the Board

Susan Crichton
Company Secretary, 24 February 2015

Registered in England and Wales Company Number 08871766

Statement of Directors' responsibilities

The Directors are responsible for preparing the strategic report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the Group and Company financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The financial statements are required by law to give a true and fair view of the state of affairs of the Group and of the profit or loss of the Group for that period. The Directors consider that, in preparing these financial statements, the Group has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider applicable have been followed.

The Directors have responsibility for ensuring that the Group keeps adequate accounting records which disclose with reasonable accuracy the financial position of the Group and which enable them to ensure that the financial statements comply with the Companies Act 2006 and, as regards the financial statements, Article 4 of the IAS Regulation. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions. Each of the Directors, whose names are listed on page 79 of this annual report, confirms that to the best of their knowledge:

- The financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group; and

- The strategic report includes a fair review of the development and performance of the business and the position of the Group, together with, in the Strategic report and the Risk report, a description of the principal risks and uncertainties they face.

On behalf of the Board

Will Samuel

Will Samuel
Chairman

Paul Pester
Chief Executive Officer

24 February 2015

Risk report

In this section

86	Summary of principal risks and uncertainties
87	Conduct risk
88	Funding and liquidity management
90	Credit risk
95	Capital management
97	Market risk
98	Operational risk

Summary of principal risks and uncertainties

The Group is exposed to a number of principal risks and strategic uncertainties that arise from the business activities that underpin its business model and strategy. In addition to the headwinds that are highlighted in the Chief Executive Officer's statement on page 11, the principal risks faced by the Group are summarised in the table below and further analysed in the report that follows.

	Principal risk	Mitigating actions
Conduct risk	The risk that the Group fails to deliver fair customer outcomes and achieve a positive experience for its customers.	– Ensuring customers' best interests are at the heart of everything the Group does. – Enhancing how its customer propositions are reviewed and assessed. – Refining how customer outcomes are understood. – Developing clear customer accountabilities for Partners including rewards with customer-centric metrics. – Identifying and understanding the root cause of where the Group falls short and putting it right.
Funding and liquidity risk	Funding risk is the risk that the Group does not have sufficiently stable and diverse sources of funding or its funding structure is not efficient. Liquidity risk is the risk that the Group has insufficient financial resources to meet commitments as they fall due, or can only secure them at an excessive cost.	– Maintaining a prudent liquid asset buffer of high quality unencumbered assets in excess of regulatory requirements. – Demonstrating an ability to meet prudent liquidity risk appetite metrics throughout the Group's planning horizon. – Stress testing of the Group's liquidity positions, conducted against a range of scenarios, to meet all UK liquidity regulatory requirements. – Maintaining a contingency funding plan to address possible liquidity shortfalls in emergency situations.
Credit risk	The risk that borrowers with the Group fail to repay their loans or any other lending product on time.	– The Group's credit policy incorporates prudent lending criteria aligned with Board-approved risk appetite. – Clearly defined levels of authority to ensure the Group lends appropriately and responsibly with a separation of origination and sanctioning activities. – Robust credit processes and controls, including well-established committees and independent credit risk assurance, to ensure distressed and impaired loans are identified, considered and controlled. – Stress tests undertaken as part of the business planning cycle with the aim of ensuring the Group is able to operate within its risk appetite, throughout the period of the plan.
Capital risk	The risk of the Group having insufficient capital, by quantity or quality, to meet current or future requirements.	– Monitoring of capital ratios to ensure they exceed regulatory capital requirements and internal Board approved risk appetite measures over the plan period. – Stress tests undertaken as part of the business planning cycle with the aim of ensuring the Group is able to operate within its risk appetite, throughout the period of the plan.
Market risk	The risk of a reduction in earnings, value or reserves caused by changes in the prices of financial instruments.	– Board approved risk appetite and governance framework. – Regular reporting of market risk exposure to the Group's Asset and Liabilities Committee and Risk Committee.
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.	– The Group employs a framework for managing its operational risk which includes preventative, detective and mitigating controls. – Under a detailed arm's length TSA, LBG continues to support the Group following its admission to the London Stock Exchange. This agreement provides for the supply of IT and associated banking services to the Group and its customers. Benefits include LBG continually updating and improving its IT system architecture and systems' resilience.

Conduct risk

For more information:
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The Group offers a range of retail and business banking products designed to support its customers' needs. Building long term customer relationships that are both straightforward and transparent, providing fair customer outcomes and excellent customer service is vital in delivering the Group's strategy.

In doing so, the Group sets out to provide great banking to more people, help more people borrow well and provide the kind of service that current and prospective customers want and deserve. The principles we apply to customers are also reflected in the conduct treatments the Group applies to other stakeholders and Partners.

As set out on page 86, to achieve this, the Group is:

- Ensuring customers' best interests are at the heart of everything the Group does;
- Enhancing how its customer propositions are reviewed and assessed;
- Refining how it reviews and responds to customer outcomes;
- Developing clear customer accountabilities for Partners with a remuneration framework which rewards the correct skills, attitudes and right behaviours; and
- Identifying and understanding the root cause of where the Group falls short and putting it right.

By holding to this approach, the Group believes it will deliver the 'basics' well, build sustainable value and differentiate itself from its competitors.

The Group's approach to further augment its conduct risk strategy can be simply translated as:

- Having the right people;
- Doing the right things;
- In the right way for customers; and
- Continually assessing whether this aim is being achieved.

Having the right people
The Group's partnership model is designed to recruit, retain and reward Partners who share and live TSB's values. The Group is investing in a substantial programme of Partner development and training to ensure that Partners behave in a way that is aligned to TSB's values and delivers the right customer outcomes. In 2015 every customer-facing Partner will participate in a tailor made service training programme.

Doing the right things
The Group continues to invest in a number of initiatives to improve and simplify its customer processes and products. For example, the Group is enhancing its digital channels, upgrading branches and has reduced the cost to customers who call us. The Group is also focusing on fewer and simpler products to best meet the needs of customers, such as its 'Classic Plus' current account and 'Fix and Flex' ten year mortgage product.

The right way for customers
The Group is transforming its branch operating model and developing its Partner reward and remuneration frameworks to focus on customer needs and sustainable performance. As mentioned above, the Group is investing in its digital services and is focused on delivering a great customer experience and fair outcomes via this channel. The Group also aims to support vulnerable customers by creating a specialist support team and providing additional training to Partners.

Continually assessing that we are achieving our aim
The Group actively identifies and seeks to understand the root cause of when it falls short and what it can do better. It uses a range of tools to ensure that it receives timely feedback from customers and Partners, both on new and existing products and processes. It continually assesses the views and opinions from a wide range of market commentators, with the aim of improving the Group's ability to provide fair outcomes to customers.

Whilst making good progress, the Group continues to receive reportable banking complaints in relation to legacy issues. Excluding these issues about Packaged Bank Accounts, the volume of reportable banking complaints remained broadly stable through the year at 1.0 per 1,000 accounts. Including legacy issues, reportable banking complaints rose from 1.1 in the first half to 1.2 in the second half of 2014. As explained in the consolidated financial statements (note 33), the Group is protected from losses arising from historic misconduct under an indemnity provided by Lloyds Bank plc.

The positive change in the Bank net promoter score underlines the improvements the Group has made in providing excellent service to customers.

Funding and liquidity management

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The Group's liquidity is actively monitored and managed through a series of Board approved limits and triggers.

These short and long term liquidity measures are reported on a regular basis both internally and externally to the regulators. The Group's funding and liquidity position is underpinned by a significant customer deposit base. A substantial proportion of the deposit base is made up of customer bank accounts and savings accounts which, although repayable on demand, have historically provided a stable source of funding and help to reduce the amount of liquidity that the Group is required to hold to comply with its regulatory obligations.

The Group currently has a minimal requirement for wholesale funding and holds surplus liquidity.

Group funding position

	2014 £ million	2013 £ million	Change %
Availability of funding			
Customer deposits	**24,624.9**	23,100.4	6.6
Wholesale funding			
Debt securities in issue	**10.0**	1.4	
Subordinated liabilities	**405.5**	–	
Total shareholders' equity	**1,634.4**	1,306.7	25.1
Total funding resources	**26,674.8**	**24,408.5**	**9.3**
Funding demand			
Loans and advances to customers	**21,641.4**	20,099.1	7.7
Loans and advances to banks(1)	**134.5**	–	
Cash balances	**227.0**	200.2	13.4
Funded assets	**22,002.9**	**20,299.3**	**8.4**
Balances at central banks	**4,169.3**	–	
Gilts – available-for-sale	**339.7**	–	
Loans and advances to banks	**–**	4,124.7	
Primary liquidity assets	**4,509.0**	**4,124.7**	**9.3**
Other assets(2)	**659.5**	530.4	24.3
Total assets	**27,171.4**	**24,954.4**	**8.9**
Other liabilities(3)	**(496.6)**	(545.9)	(9.0)
Funding requirement	**26,674.8**	**24,408.5**	**9.3**
	%	%	Change
Funding and liquidity key performance indicators			
Group loan to deposit ratio	**87.9**	87.0	0.9pp
Franchise loan to deposit ratio	**76.5**	87.0	(10.5)pp

(1) Loans and advances to banks at 31 December 2014 primarily comprise balances required by Cape Funding No. 1 plc.
(2) Other assets comprise derivative assets, items in course of collection, property, plant and equipment, deferred tax assets and other assets.
(3) Other liabilities comprise derivative liabilities, items in course of transmission to other banks, deposits from banks, current tax liabilities and other liabilities.

Wholesale funding

During 2014, the structure of the Group's balance sheet continued to develop to reflect the Group operating on a standalone liquidity basis. The Group sought to ensure its funding base was appropriately diversified and established access to alternative forms of funding through its first secured funding transaction, Cape Funding, a secured facility of £2,500 million established with LBG in May 2014. This facility has only been partially utilised in 2014 with an outstanding drawn balance of £10.0 million at 31 December 2014. The Group also issued subordinated liabilities in May 2014 for net proceeds of £383.0 million.

Analysis of 31 December 2014 total wholesale funding by residual maturity

	Less than one year £ million	One to two years £ million	Two to five years £ million	More than five years £ million	Total 31 Dec 2014 £ million	Total 31 Dec 2013 £ million
Securitisations	–	–	–	**10.0**	**10.0**	–
Subordinated liabilities(1)	–	–	–	**405.5**	**405.5**	–
Total wholesale funding(2)	–	–	–	**415.5**	**415.5**	–

(1) Subordinated liabilities include accrued interest and fair value hedge accounting adjustment (see note 4 to the Group's consolidated financial statements).
(2) All wholesale funding is denominated in sterling.

Encumbered assets

The Board monitors and manages total balance sheet encumbrance under a Board approved risk appetite measure. As referred to above, the Group established a securitisation funding structure (Cape Funding) which resulted in the encumbrance of certain loans and advances to customers in support of the transaction as follows:

Securitisations

	Assets encumbered £ million	Notes in issue £ million
Cape Funding No. 1 plc	**11.7**	**10.0**
As at 31 December 2014	**11.7**	**10.0**
As at 31 December 2013	–	–

In addition, the Group has the following assets that are considered to be encumbered:

- Cash collateral placed with counterparties of £53.6 million;
- Available-for-sale financial assets in the form of gilts sold subject to repurchase agreements of £32.9 million; and
- Loans and advances to banks of £132.6 million recognised by Cape Funding No. 1 plc.

Liquidity portfolio

In May 2014, the Group established a standalone liquid asset portfolio as part of its exit from the LBG UK Defined Liquidity Group. As at 31 December 2014 the portfolio comprised cash held on deposit with the Bank of England and a portfolio of UK gilts. Prior to this, all liquidity was held on deposit with LBG and was reported on the Group's balance sheet within loans and advances to banks.

The Group's liquidity portfolio comprises highly liquid unencumbered assets available and immediately accessible to meet potential cash outflows. The Group's liquidity position is managed as a single pool by the Group's Treasury function and is available for deployment at immediate notice, subject to complying with regulatory requirements, and is a key component of the Group's liquidity management process.

The Group also tracks performance against the upcoming Capital Requirements Directive (CRD) IV requirements to report a Liquidity Coverage Ratio (LCR) and a Net Stable Funding Ratio (NSFR). The Group is well positioned to meet both requirements when they become effective, currently expected to be October 2015 for LCR and 1 January 2018 for the NSFR.

Primary liquidity

	2014 £ million	2013 £ million
Central bank cash deposits	**4,169.3**	–
UK gilts	**339.7**	–
Loans and advances to banks	**–**	4,124.7
Total	**4,509.0**	4,124.7

Credit risk

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To help customers borrow well, the Group assesses each credit application based on individual circumstances at the time of application, reviewing whether or not customers can afford to repay any commitments and that they are applying for a product which meets their needs. Occasionally, customers' circumstances can change and they are unable to repay the money that they borrow from the Group. In these situations the Group will work with its customers to improve their position by offering various temporary treatment strategies and support.

Impaired loans and advances

Impaired loans decreased to £205.0 million, a 15.0% reduction since December 2013 and as a percentage of closing advances, reduced to 0.9% (2013: 1.2%). The reductions followed a sustained improvement in UK economic conditions during the year.

Impairment provisions as a percentage of impaired loans increased slightly to 42.0% as at 31 December 2014. The increased level of provision coverage for unsecured lending results from an extension to the loss emergence period in the second half of the year.

At 31 December 2014	Loans and advances to customers £ million	Impaired loans £ million	Impaired loans as a % of closing advances %	Impairment provisions* £ million	Impairment provisions as a % of impaired loans %
Mortgages					
Franchise	**16,580.7**	**127.3**	**0.8**	**19.3**	**15.2**
Mortgage Enhancement	**2,802.7**	**0.5**	**–**	**0.6**	**120.0**
Total mortgages	**19,383.4**	**127.8**	**0.7**	**19.9**	**15.6**
Personal unsecured	**2,120.1**	**71.5**	**3.4**	**63.2**	**88.4**
Business banking	**224.0**	**5.7**	**2.5**	**3.0**	**52.6**
Total gross lending	**21,727.5**	**205.0**	**0.9**	**86.1**	**42.0**
Impairment provisions	**(86.1)**				
Total	**21,641.4**				

At 31 December 2013	Loans and advances to customers £ million	Impaired loans £ million	Impaired loans as a % of closing advances %	Impairment provisions* £ million	Impairment provisions as a % of impaired loans %
Mortgages					
Franchise	17,728.7	138.7	0.8	24.0	17.3
Enhancement	–	–	–	–	–
Total mortgages	**17,728.7**	**138.7**	**0.8**	**24.0**	**17.3**
Personal unsecured	2,143.3	87.7	4.1	67.7	77.2
Business banking	323.9	14.9	4.6	5.1	34.2
Total gross lending	**20,195.9**	**241.3**	**1.2**	**96.8**	**40.1**
Impairment provisions	(96.8)				
Total	**20,099.1**				

* Impairment provisions include collective unimpaired provisions.

Mortgages portfolio

The Group's mortgage portfolio consists of Franchise mainstream home-owner mortgages, Franchise buy-to-let mortgages and the Mortgage Enhancement portfolio; it does not include specialist or sub-prime mortgage products. Loans and advances as at 31 December 2014 total £19,383.4 million (31 December 2013: £17,728.7 million), of which 85.5%, £16,580.7 million, are Franchise mortgages.

The Group is committed to helping local people find the right mortgage for their needs. During 2014, the Group advanced gross new mortgage lending of £1,474.1 million, of which £296.3 million was to first time buyers. The Group also lent £625.9 million to a mixture of new and existing customers moving to a new home. The percentage of Franchise mainstream new lending agreed on an interest only basis is less than 7% of total new lending.

The composition of the Franchise mortgage portfolio has remained stable during 2014, with buy-to-let mortgages representing 13.4% (2013: 13.3%) of the total Franchise loans and advances.

To allow the Group to reach more customers and help them to borrow well, it invested in its mortgage business through the successful implementation of the Mortgage Market Review (MMR) in the first half of 2014, and more recently with the launch of a new intermediary channel that will support its core growth aspirations.

Mortgages – composition by rate type

The composition of the Franchise portfolio by rate type has changed modestly during 2014. The Group ceased offering standard variable rate mortgages (SVR) as the standard reversionary rate from June 2010, replacing this product with the homeowner variable rate (HVR) mortgage. Consequently, the SVR book continues to decrease as customers repay or remortgage from this product. SVR mortgages now represent 61.4% of total Franchise mortgages, down from 65.9% at December 2013 with HVR increasing to 8.1% (2013: 5.2%).

The continuing low interest rate environment has resulted in an increase in the portfolio share of fixed rate mortgages to 19.3% (2013: 16.4%). The proportion of the portfolio represented by tracker mortgages has reduced as a result of lower demand in the current economic environment, and as customers revert to the HVR product at the end of their initial tracker term.

	Franchise		Mortgage Enhancement		Total	
	At 31 Dec 2014 £ million	At 31 Dec 2013 £ million	At 31 Dec 2014 £ million	At 31 Dec 2013 £ million	At 31 Dec 2014 £ million	At 31 Dec 2013 £ million
SVR	**10,186.3**	11,683.7	**–**	–	**10,186.3**	11,683.7
HVR	**1,347.9**	930.7	**1,630.5**	–	**2,978.4**	930.7
Fixed	**3,199.0**	2,899.2	**359.9**	–	**3,558.9**	2,899.2
Tracker	**1,847.5**	2,215.1	**812.3**	–	**2,659.8**	2,215.1
Total	**16,580.7**	**17,728.7**	**2,802.7**	**–**	**19,383.4**	**17,728.7**

Mortgages – composition by repayment type

Franchise mortgages on interest only decreased to 44.0% of total mortgages (31 December 2013: 45.8%) reflecting the Group's approach to new lending in this area. All applicants for new interest only lending are fully assessed to ensure that a suitable method of repayment is in place to repay their mortgage at maturity. For existing interest only customers, the Group has a contact programme in place designed to ensure they have a suitable mortgage repayment vehicle already in place, or have the opportunity to take steps to avoid a potential repayment shortfall.

	Franchise		Mortgage Enhancement		Total	
	At 31 Dec 2014 £ million	At 31 Dec 2013 £ million	At 31 Dec 2014 £ million	At 31 Dec 2013 £ million	At 31 Dec 2014 £ million	At 31 Dec 2013 £ million
Repayment	**9,292.1**	9,614.2	**1,503.5**	–	**10,795.6**	9,614.2
Interest only	**7,288.6**	8,114.5	**1,299.2**	–	**8,587.8**	8,114.5
Total	**16,580.7**	**17,728.7**	**2,802.7**	**–**	**19,383.4**	**17,728.7**

Mortgages – Franchise maturity profile

As at 31 December 2014, 9.0% of the Group's Franchise mortgages are due to mature within five years. 16.9% of interest only mortgages are due to mature within the next five years.

At 31 December 2014	Due within one year £ million	Due within one to five years £ million	Due after more than five years £ million	Total £ million
Repayment	**8.9**	**261.5**	**9,021.7**	**9,292.1**
Interest only	**222.3**	**1,007.3**	**6,059.0**	**7,288.6**
Total	**231.2**	**1,268.8**	**15,080.7**	**16,580.7**

At 31 December 2013	Due within one year £ million	Due within one to five years £ million	Due after more than five years £ million	Total £ million
Repayment	7.8	253.1	9,353.3	9,614.2
Interest only	242.5	1,003.5	6,868.5	8,114.5
Total	**250.3**	**1,256.6**	**16,221.8**	**17,728.7**

Credit risk (continued)

Mortgage loan to value analysis

Increasing house prices have led to improvement in the Group's loan to value (LTV) composition during 2014. Of the Group's Franchise portfolio, 76.9% of mortgages have a LTV of less than 70% (31 December 2013: 65.9%). The increase in house prices also benefited the percentage of Franchise mortgage accounts with a LTV of more than 100%, which has reduced to 1.0% (31 December 2013: 2.7%).

The average LTV for new mortgage accounts has increased slightly to 55.9%, from 55.3% in 2013. Stock LTV on the Franchise portfolio decreased to 41.7% (31 December 2013: 46.3%), as a result of the improvements to house prices. The Group employs several LTV criteria on its mortgage products and these limits also apply to the new intermediary business launched in January 2015.

At 31 December 2014	Franchise mainstream %	Franchise buy-to-let %	Franchise interest only %	Franchise total %	Mortgage Enhance-ment %	Total %
Less than 70%	**75.8**	**83.6**	**75.1**	**76.9**	**94.5**	**79.4**
70% to 80%	**13.8**	**9.9**	**11.4**	**13.3**	**5.4**	**12.2**
80% to 90%	**6.6**	**3.6**	**6.5**	**6.2**	**0.1**	**5.3**
90% to 100%	**2.6**	**2.6**	**4.8**	**2.6**	**–**	**2.2**
Greater than 100%	**1.2**	**0.3**	**2.2**	**1.0**	**–**	**0.9**
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Average loan to value(1)						
Stock	**41.0**	**46.3**	**43.7**	**41.7**	**40.3**	**41.5**
New mortgages	**55.7**	**57.7**	**49.9**	**55.9**	**–**	**55.9**
Impaired mortgages(2)	**53.1**	**53.4**	**56.1**	**53.1**	**47.5**	**53.0**

At 31 December 2013	Franchise mainstream %	Franchise buy-to-let %	Franchise interest only %	Franchise total %	Mortgage Enhance-ment %	Total %
Less than 70%	64.8	72.5	64.7	65.9	–	65.9
70% to 80%	17.7	16.5	15.5	17.5	–	17.5
80% to 90%	10.4	5.3	8.2	9.7	–	9.7
90% to 100%	4.2	4.1	6.5	4.2	–	4.2
Greater than 100%	2.9	1.6	5.1	2.7	–	2.7
Total	**100.0**	**100.0**	**100.0**	**100.0**	**–**	**100.0**
Average loan to value(1)						
Stock	45.4	53.4	48.2	46.3	–	46.3
New mortgages	55.2	57.0	49.1	55.3	–	55.3
Impaired mortgages(2)	55.8	69.1	59.2	56.3	–	56.3

(1) Average LTV is calculated as total loans and advances as a percentage of the total collateral of these loans and advances.
(2) Impaired mortgages are defined as more than six months in arrears including mortgages in possession.

Mortgages greater than three months in arrears (excluding repossessions)

To assist with peer and industry benchmarking, the Group monitors the performance of mortgage accounts that are greater than three months in arrears as it is an indicator to the quality of secured portfolios.

	Number of cases		Total mortgage accounts		Value of debt*		Total mortgage balances	
	At 31 Dec 2014 Cases	At 31 Dec 2013 Cases	At 31 Dec 2014 %	At 31 Dec 2013 %	At 31 Dec 2014 £ million	At 31 Dec 2013 £ million	At 31 Dec 2014 %	At 31 Dec 2013 %
Repayment	**1,321**	1,411	**1.1**	1.2	**92.3**	98.2	**1.0**	1.0
Interest only	**778**	927	**1.6**	1.6	**115.1**	127.1	**1.6**	1.6
Franchise	**2,099**	**2,338**	**1.2**	**1.3**	**207.4**	**225.3**	**1.3**	**1.3**
Mortgage Enhancement	**26**	–	**0.1**	–	**3.7**	–	**0.1**	–
Total	**2,125**	**2,338**	**1.1**	**1.3**	**211.1**	**225.3**	**1.1**	**1.3**

* Value of debt represents total book value of mortgages in arrears.

Personal unsecured portfolio

The unsecured portfolio consists of bank account overdrafts, credit cards and fixed term personal loans up to £25,000. Total balances on the unsecured portfolio have remained broadly stable at £2,120.1 million as at 31 December 2014 (31 December 2013: £2,143.3 million).

	At 31 Dec 2014 £ million	At 31 Dec 2013 £ million
Loans and advances to customers		
Personal loans	**1,286.1**	1,313.3
Personal current accounts	**273.8**	281.9
Credit cards	**560.2**	548.1
Total	**2,120.1**	**2,143.3**

Impaired loans on the unsecured portfolio have reduced during 2014 to £71.5 million from £87.7 million as at 31 December 2013. These improvements have been driven by lower levels of arrears reflecting an improvement in the economic environment.

Business banking portfolio

During 2014, the Group completed the planned transfer to LBG of certain customers who have banking requirements not currently met by the Group's business banking proposition. This has led to a reduction in loans and advances to £224.0 million as at 31 December 2014 (31 December 2013: £323.9 million).

Impaired loans have reduced by 61.7% to £5.7 million as at 31 December 2014 (31 December 2013: £14.9 million). This is due to a number of factors including the reduction in the size of the portfolio, improved arrears rates, and a change to the impairment definition.

Forbearance

The Group operates a number of schemes to assist borrowers who are experiencing financial difficulties. Forbearance solutions may offer temporary relief in the form of reductions to contractual payments, and for customers who have longer term financial difficulties, term extensions and 'repair' approaches such as capitalisation of arrears.

Credit risk (continued)

(i) Franchise mortgages
Mortgage accounts which are currently or recently forborne continue to reduce. As at 31 December 2014, balances that are forborne reduced by £76.8 million to £134.9 million.

	Total loans and advances which are currently or recently forborne		Total current and recently forborne loans and advances which are impaired		Impairment provisions as % of loans and advances which are currently or recently forborne	
	At 31 Dec 2014 £ million	At 31 Dec 2013 £ million	At 31 Dec 2014 £ million	At 31 Dec 2013 £ million	At 31 Dec 2014 %	At 31 Dec 2013 %
Temporary forbearance arrangements						
Reduced contractual monthly payments(1)	**4.3**	33.7	**2.2**	5.0	**0.8**	2.7
Reduced payment arrangements(2)	**30.0**	36.0	**5.9**	3.4	**1.1**	2.1
	34.3	**69.7**	**8.1**	**8.4**	**1.1**	**2.4**
Permanent treatments						
Repair and term extensions(3)	**100.6**	142.0	**10.9**	9.6	**2.2**	1.8
Total	**134.9**	**211.7**	**19.0**	**18.0**	**1.9**	**2.0**

(ii) Personal unsecured
Unsecured balances which are forborne reduced by 18.6% to £39.4 million as at 31 December 2014. This is influenced by the improving economy and, in particular the reduction in unemployment rates.

	Total loans and advances which are currently or recently forborne		Total current and recently forborne loans and advances which are impaired		Impairment provisions as % of loans and advances which are currently or recently forborne	
	At 31 Dec 2014 £ million	At 31 Dec 2013(6) £ million	At 31 Dec 2014 £ million	At 31 Dec 2013(6) £ million	At 31 Dec 2014 %	At 31 Dec 2013(6) %
Temporary forbearance arrangements						
Reduced contractual monthly payment(4)	**15.7**	19.4	**15.5**	19.2	**41.6**	38.1
Reduced payment arrangements(5)	**13.4**	13.9	**12.8**	13.2	**46.0**	54.3
	29.1	**33.3**	**28.3**	**32.4**	**43.6**	**44.9**
Permanent treatments						
Repair and term extensions(3)	**10.3**	15.1	**3.5**	6.3	**11.3**	12.7
Total	**39.4**	**48.4**	**31.8**	**38.7**	**35.2**	**34.8**

(1) Includes temporary interest only arrangements and short term payment holidays granted in collections and where the concession has ended within the previous six months (temporary interest only) and previous 12 months (short term payment holidays).
(2) Includes customers who had an arrangement to pay less than the contractual amount at 31 December or where an arrangement ended within the previous three months.
(3) Includes capitalisation of arrears and term extensions which commenced during the previous 24 months and remaining as customers at 31 December 2014.
(4) Includes repayment plans and short term payment holidays granted in collections and where the concession has ended within the last six months.
(5) Includes customers who had an arrangement to pay less than the contractual amount at 31 December or where an arrangement ended within the last six months.
(6) December 2013 numbers have been re-stated from the first half 2014 reporting to include customers who had exited forbearance within the probationary periods as defined in (3) to (5).

Counterparty credit risk
A counterparty to a transaction which fails to honour its obligations under a contract as they fall due is considered to be a counterparty credit risk. This typically relates to contracts for financial instruments including derivative contracts and repurchase agreements. As a consequence of hedging market risk with other financial counterparties and placing surplus liquidity with appropriate counterparties, including the Bank of England, the Group has credit exposures to these counterparties.

As part of managing counterparty credit risk, the Group transacts with counterparties that have external obligor ratings equivalent to an investment grade, as measured by external credit rating agencies. In addition, robust due diligence is undertaken, obtaining appropriate internal approvals and setting appropriate counterparty credit limits. The taking of collateral and various risk mitigation techniques, such as break clauses (on an ad hoc basis), are also used in the course of business. As part of our governance, the counterparty credit risk policy requires that an appropriate master agreement is put in place for all counterparties, prior to trading, any exceptions being subject to specific approval from a senior credit risk officer.

Capital management

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The capital strength of the Group further improved during the year ended 31 December 2014 with the fully loaded CET1 ratio improving to 23.0% (December 2013: 19.0%) and the Total Capital ratio improving to 28.5% (December 2013: 19.0%).

The improvement in the CET1 ratio primarily relates to the issue of 445 million ordinary shares to Lloyds Bank plc for £200.0 million in May 2014, £134.5 million of retained profits and a reduction in the excess expected losses over impairment allowances. The improvement in CET1 capital has also led to a significant improvement in the leverage ratio to 5.8% at 31 December 2014 (31 December 2013: 4.7%). In addition to this, the Total Capital ratio also benefited from the issuance of subordinated debt to Lloyds Bank plc in May 2014.

At 31 December 2013 the Group's risk weighted assets (RWAs) were calculated under LBG's Internal Ratings Based (IRB) approach. While the Group received permission to use its own IRB models as a standalone business, it has currently only moved its Franchise mortgages and personal loan book to an IRB approach. The remainder of the Franchise book transferred to and has remained on the standardised basis approach, thereby reducing RWAs and excess expected loss. At 31 December 2014, this reduction in RWAs was offset by the inclusion of the Mortgage Enhancement portfolio and the change in methodology for calculating operational risk RWAs to use a steady state income basis which is more reflective of the scale of the Group's business than the historic three year method.

The Group plans to migrate, subject to PRA approval, all remaining Franchise personal unsecured customer asset portfolios to an IRB basis by June 2015. For illustrative purposes a pro forma CET1 ratio, on a full IRB basis (for the Franchise business), has been calculated which reflects the consequential increase in credit risk RWAs and excess expected loss. This pro forma ratio of 19.7% remains strong.

From 1 January 2014 capital adequacy is measured in accordance with CRD IV. Prior to this, capital adequacy was measured under the Basel II framework. Therefore, in order to aid comparison, comparatives for December 2013 have also been presented on a CRD IV basis.

Capital resources

	At 31 Dec 2014 CRD IV £ million	At 31 Dec 2013 CRD IV £ million	At 31 Dec 2013 Basel II* £ million
Shareholders' equity per balance sheet	**1,634.4**	1,306.7	1,306.7
Excess of expected losses over impairment provisions	**(41.0)**	(110.6)	(110.6)
Deferred tax assets	**–**	(14.1)	–
Intangible assets	**(0.4)**	–	–
Common Equity Tier 1/ Total Tier 1 capital	**1,593.0**	**1,182.0**	**1,196.1**
Tier 2 capital	**384.3**	–	–
Total capital resources	**1,977.3**	**1,182.0**	**1,196.1**

CRD IV basis

Risk-weighted assets	**6,930.2**	6,214.5
Common Equity Tier 1/ Total Tier 1 capital ratio (fully loaded)	**23.0%**	19.0%
Pro forma Common Equity Tier 1/Total Tier 1 capital ratio (fully loaded)	**19.7%**	
Total Capital ratio (fully loaded)	**28.5%**	19.0%

Basel II basis

Risk-weighted assets	6,123.5
Tier 1/Tier 1 capital ratio	19.5%
Total Capital ratio	19.5%

* Shareholders' equity per the balance sheet has been restated – see note 35.

Capital management (continued)

The movements in CET1, Tier 2 and Total Capital in the year are shown below:

	CET1/ Total Tier 1 £ million	Tier 2 £ million	Total capital resources £ million
At 31 December 2013 (CRD IV basis)	1,182.0	–	1,182.0
Profit attributable to ordinary shareholders	134.5	–	134.5
Share issuance	200.0	–	200.0
Change in excess of expected losses over impairment provisions	69.6	–	69.6
Issuance of subordinated debt	–	383.2	383.2
Change in excess of default provision over default expected loss	–	1.1	1.1
Change in deferred tax asset deduction	14.1	–	14.1
Movement in shares held by trusts	(9.1)	–	(9.1)
Change in intangible assets	(0.4)	–	(0.4)
Share-based compensation reserve	1.9	–	1.9
Movement in AFS reserve	0.4	–	0.4
At 31 December 2014	**1,593.0**	**384.3**	**1,977.3**

Risk-weighted assets

	At 31 Dec 2014 CRD IV £ million	At 31 Dec 2013 CRD IV £ million
Risk type analysis of risk-weighted assets		
Credit risk		
Franchise standardised approach	**1,300.6**	547.4
Franchise IRB approach	**3,187.3**	5,233.5
Total Franchise	**4,487.9**	**5,780.9**
Mortgage Enhancement standardised approach	**984.8**	–
Total credit risk	**5,472.7**	**5,780.9**
Operational risk	**1,451.5**	433.6
Market and counterparty risk	**6.0**	–
Total risk-weighted assets	**6,930.2**	**6,214.5**

Leverage ratio

The leverage ratio measure is defined as the ratio of Tier 1 capital to total exposure. This is intended to complement the risk based capital requirements with a simple, non-risk based 'backstop' measure.

The Group calculates its leverage ratio based on the exposure measure in the revised Basel III leverage ratio framework published in January 2014, and the CRR definition of Tier 1.

The Basel Committee has proposed that final adjustments to the definition and calibration of the leverage ratio are carried out in 2017, with a view to migrating to a Pillar 1 treatment in 2018. The Group continues to monitor Basel III developments and their adoption in the CRD IV framework.

In order to aid comparison, comparatives for December 2013 have also been presented in accordance with this definition.

Leverage ratio

	31 Dec 2014 £ million	31 Dec 2013 £ million
Total Tier 1 Capital for leverage ratio		
Shareholders' equity per balance sheet	**1,634.4**	1,306.7
Less: regulatory adjustments	**(41.4)**	(124.7)
	1,593.0	**1,182.0**
Exposures for leverage ratio		
Total statutory balance sheet assets	**27,171.4**	24,954.4
Removal of accounting value for derivatives	**(123.1)**	(99.4)
Exposure value for derivatives and securities financing transactions	**28.5**	46.1
Off-balance sheet	**405.0**	375.0
Other regulatory adjustments	**(41.4)**	(124.7)
Total exposures	**27,440.4**	**25,151.4**
Leverage ratio	**5.8%**	4.7%

The Group's leverage ratio is 5.8% which comfortably exceeds the Basel Committee's proposed minimum of 3%, applicable from 2018. The Group will continue to monitor closely the leverage ratio against the emerging rules and minimum calibration.

Other regulatory adjustments consist of adjustments that are required under CRD IV to be deducted from Tier 1 capital. The removal of these from the exposure measure ensures consistency is maintained between the capital and exposure components of the ratio.

Market risk

For more information:
Page 15 — Risk overview

Market risk occurs from a reduction in earnings, value or reserves caused by changes in the prices of financial instruments. In addition, market risk can arise as a result of changes in customer behaviour, which may affect the maturity profiles of the Group's assets and liabilities. The Group aims to maximise the value of its business by preserving its margins through management of market risk positions that arise through the natural course of business.

The Group's primary market risk is the interest rate risk arising from the Group's banking activities and as a result is exposed to the following categories of risk:

Re-pricing risk
The risk that assets and liabilities have a maturity mismatch, or re-price at different times to each other, exposing the Group's income and underlying value to unanticipated fluctuations as interest rates vary and the shape of the yield curve changes. This includes the risk from the investment of the Group's equity and bank account balances.

Basis risk
The risk that assets and liabilities re-price based on different interest rate indices (such as LIBOR or Base Rate) and expose the Group's earnings and margins to changes in the spread between indices.

Optionality risk
The risk from options embedded in retail and business banking assets and liabilities, such as the right for customers to top-up fixed rate savings accounts or to prepay mortgages.

Behavioural risk
The risk that maturity assumptions applied to retail and business banking products may change over time, or may themselves be a function of interest rate levels.

Residual risk
The small amount of interest rate risk to which the Group is exposed either prior to hedging with the external market or where the hedging is not entirely effective in mitigating such risk.

Margin compression
The risk of lower net interest margins in the current low interest rate environment, as the Group may be unable to pass on any rate reductions in full on rates paid on customer deposits.

The table below shows an illustration of how 12 month Net Interest Income (NII) would change in response to an immediate parallel shift to all relevant interest rates – market and administered.

	2014		2013	
	Up 25 bps £ million	Down 25 bps £ million	Up 25 bps £ million	Down 25 bps £ million
12 month NII sensitivity	**0.7**	**(8.2)**	0.7	(10.5)

Operational risk

For more information:
Page 15 — Risk overview

There are several activities undertaken by the Group that create operational risk, and each of them could result in a loss for the Group resulting from external events, or from failed internal processes, people risk, supplier management or systems failure. The Group employs a framework for managing its operational risk, with controls to prevent, detect and mitigate the consequences of operational risk events.

Third party service provider risk

The Group faces inherent risks associated to the ongoing effective delivery of the IT and operational services which are outsourced to LBG under the TSA. These services are subject to robust governance arrangements as specified in the contracts with LBG.

Information technology risk

The risks arising from the use of IT systems, cyber threats leading to information security and data loss and the running of digital services are managed using an Information Security framework which includes regular education and awareness training by all Partners and active monitoring of threats, resilience and controls.

Change risk

As the Group delivers on its strategy, the risk of failure in the change process to deliver the expected benefits, or maintain compliance with changing legal and regulatory requirements, is managed using a framework of defined processes, monitoring and governance.

Fraud and financial crime

The Group faces potential fraud and financial crime risk in each area of operation. A strong education and awareness training programme is undertaken regularly by all Partners to ensure an understanding of the threats the Group faces from fraudsters and other criminals including methods used such as cyber crime. This includes the controls and reporting processes that are in place for dealing with suspicious activity and complying with regulatory obligations. The Group employs robust transaction monitoring systems that help to report any unusual customer activity to the appropriate authorities. Reviews are regularly undertaken, along with business line reporting of key risk indicators, to confirm the effectiveness of the controls the Group has in place to protect against financial crime.

People risk

The Group is a significant employer in the UK and faces a number of people risks which could impact on the day-to-day operation of services. The ongoing pace of change and an increasingly rigorous regulatory environment may challenge the Group's people strategy, remuneration practices and retention of the Group's Partners. The Group aims to lead responsibly and manage people resource effectively, supporting and developing Partner talent and well-being, and meeting the legal and regulatory obligations related to its Partners.

Governance risk

Governance risk arises when our organisational infrastructure of decision making and control frameworks fails to ensure strategies and management instructions are implemented effectively. The Group has established governance arrangements to support the effective long term operation of the business, maximise shareholder value and meet regulatory and societal expectations. These arrangements are overseen by the Board.

Legal and regulatory

Due to the nature of the financial services industry, the Group has to comply with a complex legal and regulatory agenda. The Group monitors forthcoming regulatory change and will continue to invest in its people and IT systems to ensure standards are met and maintained. It continues to benefit from the investment made by LBG to progress compliance with changing regulatory requirements under the TSA. All legal and regulatory change faced by the Group is managed through an effective governance and oversight framework.

Financial reporting risk

The Group is exposed to the risk of reputational damage, loss of investor confidence and financial loss arising from the adoption of inappropriate accounting policies, ineffective controls over financial reporting, failure to manage the associated risks of changes in taxation, law, ownership or corporate structure and the failure to disclose accurate and timely information. The Group has a strong internal control framework designed to mitigate this risk.

Financial statements

for the year ended 31 December 2014

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Alignment with the Group's business model

The presentation of the Group's consolidated financial statements aligns with the execution of the Group's strategy, its business model and the management of the financial risk to which it is exposed. As such the consolidated financial statements are structured around the key elements of the Group's business model as explained on page 6.

Basis of preparation

On 31 January 2014, TSB Banking Group plc was incorporated and on 25 April 2014 became the new holding company for the TSB Group. This took place by way of a share for share exchange whereby TSB Banking Group plc issued shares to Lloyds Bank plc in return for obtaining 100% ownership of the issued share capital of TSB Bank plc. TSB Banking Group plc was subsequently listed on the London Stock Exchange on 25 June 2014.

These consolidated financial statements of TSB Banking Group plc (the Group) comprise the results of TSB Banking Group plc consolidated with those of its subsidiaries, including TSB Bank plc. Comparative figures, as at and for the year ended 31 December 2013, are those of TSB Bank plc, except for the presentation of share capital, share premium and capital reorganisation reserve balances, which are presented as if TSB Banking Group plc had been the parent company during both years presented (see note 23).

These consolidated financial statements have been prepared in accordance with the Companies Act 2006 and with International Financial Reporting Standards (IFRS), as adopted by the European Union (EU). IFRS comprises accounting standards prefixed IFRS, issued by the International Accounting Standards Board (IASB) and those prefixed IAS, issued by the IASB's predecessor body, as well as interpretations issued by the IFRIC and its predecessor body. The Group has taken advantage of relaxations in hedge accounting requirements in the EU endorsed version of IAS 39 *Financial Instruments: Recognition and Measurement* adopted by the EU which are not available in the version issued by the IASB.

The consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of financial derivative contracts at fair value through profit or loss and available-for-sale financial assets. The Directors consider that it is appropriate to continue to adopt the going concern basis in preparing the consolidated financial statements.

Accounting policies

The significant accounting policies used in the preparation of the consolidated financial statements are presented in a manner consistent with the Group's business model and are therefore included in the relevant sections of the consolidated financial statements. In addition, the following accounting policy relates to the consolidated financial statements taken as a whole.

Consolidation

Subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when it is exposed to, or has rights to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Such power, generally but not exclusively, accompanies a shareholding of more than half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases. Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated.

Changes in accounting policy

From 1 January 2014 the Group changed its accounting policy for recognising the costs of the UK's FSCS levy to reflect guidance provided in IFRIC 21 *Levies*, an interpretation of IAS 37 *Provisions, contingent liabilities and contingent assets*. The effect of this change in accounting policy, which has been applied retrospectively with comparative periods restated, is set out in note 35.

Critical accounting estimates and judgements

The preparation of financial statements in accordance with IFRS requires management to make judgements, estimates and assumptions in applying the accounting policies that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates. Estimates, judgements and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The significant judgements made by management in applying accounting policies and the key sources of estimation uncertainty in these consolidated financial statements, which together are deemed critical to the results and financial position, are presented within the components of the Group's business model as shown in the table below. These areas are discussed in detail by the Audit Committee as set out on page 51 of the Governance section.

Critical accounting estimates and judgements	Note
Effective interest rate methodology	1
Impairment provisioning	10
Recoverability of deferred tax assets	20
Customer remediation provision	33

Index to the consolidated financial statements

for the year ended 31 December 2014

The Group's primary consolidated financial statements are set out on pages 102 to 105. The notes to these consolidated financial statements are structured to follow the Group's business model as set out on page 6 and are listed below

Sources of funding

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Deposits from banks	2	106
Debt securities in issue	3	106
Subordinated liabilities	4	107
Repurchase agreements	5	107
Fair value of financial liabilities	6	107

Money deposited by customers into their bank and savings accounts provide the majority of the funds we use to support lending to customers.

Loans

Loans and advances to customers	7	110
Commitments arising from the banking business	8	111
Loans and advances to banks	9	111
Allowance for impairment losses on loans and receivables	10	111
Available-for-sale financial assets	11	112
Fair value of financial assets	12	112

Funds deposited with TSB are used to support lending to customers who wish to borrow.

Income

Net interest income	13	114
Net fee and commission income	14	115
Other operating income/(expense)	15	115

We earn income in the form of interest that we receive on the loans we make to customers and we pay interest to savings and bank account customers on the money they deposit with us. We also earn other income from the provision of other banking services and commissions from the sale of certain products.

Charges

Operating expenses	16	117
Retirement benefit obligations	17	118
Share-based payments	18	118
Taxation (charge)/credit for the year	19	120
Deferred tax assets	20	121

Running a bank with 4.5 million customers comes with overheads. Charges we incur include the costs of paying our 8,700 TSB Partners, running our branches and paying for advertising and marketing. Customers unable to repay the money they borrow is also a cost in the form of an impairment charge. Finally the Group pays tax to HMRC.

Profits and returns to shareholders

Segmental analysis	21	122
Earnings per share	22	123
Shareholders' equity	23	124

The Board reviews the Group's performance. It decides whether profits are put aside for future investment in the business or for protection against the uncertainties that the Group faces or the profits may be returned to shareholders.

Managing financial risk

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The primary risks affecting the Group through its use of financial instruments are:

Credit risk

Funding and liquidity risk

Market risk

Other important disclosures

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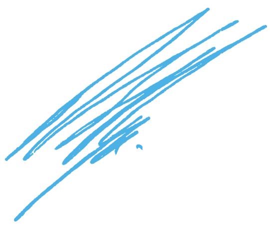
Consolidated balance sheet
as at 31 December 2014

Link to business model		Note	2014 £ million	2013* £ million
	Assets			
	Cash and balances at central banks		**4,396.3**	200.2
Page 109: Loans	Loans and receivables:			
	Loans and advances to customers	7	**21,641.4**	20,099.1
	Loans and advances to banks	9	**134.5**	4,124.7
	Available-for-sale financial assets	11	**339.7**	–
	Items in course of collection from banks		**135.7**	116.2
Page 116: Charges	Deferred tax assets	20	**108.1**	138.0
	Property, plant and equipment	31	**149.2**	122.6
	Other assets	32	**143.4**	54.2
Page 125: Managing financial risk	Derivative financial assets	28	**123.1**	99.4
	Total assets		**27,171.4**	**24,954.4**
	Liabilities			
Page 106: Sources of funding	Customer deposits	1	**24,624.9**	23,100.4
	Deposits from banks	2	**32.5**	234.7
	Debt securities in issue	3	**10.0**	1.4
	Subordinated liabilities	4	**405.5**	–
	Items in course of transmission to banks		**144.6**	63.6
	Other liabilities	33	**202.8**	97.7
	Retirement benefit obligations	17	**–**	64.3
Page 125: Managing financial risk	Derivative financial liabilities	28	**116.7**	85.6
	Total liabilities		**25,537.0**	**23,647.7**
	Equity			
Page 122: Profits and returns to shareholders	Share capital	23	**5.0**	0.1
	Share premium	23	**965.1**	–
	Merger reserve	23	**616.5**	–
	Available-for-sale reserve	23	**0.4**	–
	Capital reorganisation reserve	23	**(1,311.6)**	74.9
	Capital reserve	23	**410.0**	410.0
	Retained profits	23	**949.0**	821.7
	Shareholders' equity		**1,634.4**	**1,306.7**
	Total equity and liabilities		**27,171.4**	**24,954.4**

* Comparatives have been restated – see note 35.

The accompanying notes are an integral part of the consolidated financial statements.

The consolidated financial statements on pages 100 to 141 were approved by the Board of Directors on 24 February 2015 and signed on its behalf by:



Paul Pester
Chief Executive Officer

Darren Pope
Chief Financial Officer

Consolidated statement of comprehensive income

for the year ended 31 December 2014

Link to Business model		Note	2014 £ million	2013* £ million
	Income statement			
Page 114: Income	Interest and similar income	13	**979.1**	697.0
	Interest and similar expense	13	**(220.9)**	(233.2)
	Net interest income	13	**758.2**	**463.8**
	Fee and commission income	14	**208.6**	159.2
	Fee and commission expense	14	**(70.4)**	(49.3)
	Net fee and commission income	14	**138.2**	**109.9**
	Other operating income/(expense)	15	**3.8**	(32.4)
	Other income		**142.0**	**77.5**
	Total income		**900.2**	**541.3**
Page 116: Charges	**Operating expenses**			
	Other operating expenses		**(696.1)**	(376.2)
	Defined benefit pension scheme settlement gain	17	**63.7**	–
	Total operating expenses	16	**(632.4)**	**(376.2)**
	Operating profit before impairment losses and taxation		**267.8**	**165.1**
Page 109: Loans	Impairment losses on loans and advances to customers	10	**(97.6)**	(80.3)
	Profit before taxation		**170.2**	**84.8**
Page 116: Charges	Taxation	19	**(35.7)**	100.2
Page 122: Profits and returns to shareholders	**Profit for the year**	23	**134.5**	**185.0**
	Other comprehensive income			
	Items that will not be subsequently reclassified to profit or loss:			
	Post-retirement defined benefit scheme re-measurements before taxation		**–**	1.1
	Taxation	20	**–**	(1.9)
	Items that may be subsequently reclassified to profit or loss:			
	Movement in revaluation reserve in respect of available-for-sale financial assets		**0.5**	–
	Taxation	20	**(0.1)**	–
	Other comprehensive income/(expense) for the year, net of taxation		**0.4**	**(0.8)**
	Total comprehensive income for the year		**134.9**	**184.2**
	Basic earnings per share	22	**40.6p**	**336.4p**
	Diluted earnings per share	22	**40.6p**	**336.4p**

* Comparatives have been restated – see note 35.

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated statement of changes in equity

for the year ended 31 December 2014

	Share capital* £ million	Share premium £ million	Merger reserve £ million	Capital reorg-anisation reserve* £ million	Capital reserve £ million	Available-for-sale reserve £ million	Retained profits* £ million	Total £ million
Balance at 1 January 2013	0.1	–	–	74.9	–	–	637.5	712.5
Comprehensive income								
Profit for the year	–	–	–	–	–	–	185.0	185.0
Other comprehensive income	–	–	–	–	–	–	(0.8)	(0.8)
Total comprehensive income	**–**	**–**	**–**	**–**	**–**	**–**	**184.2**	**184.2**
Transactions with owners								
Capital contribution	–	–	–	–	410.0	–	–	410.0
Balance at 31 December 2013	**0.1**	**–**	**–**	**74.9**	**410.0**	**–**	**821.7**	**1,306.7**
Balance at 1 January 2014	**0.1**	**–**	**–**	**74.9**	**410.0**	**–**	**821.7**	**1,306.7**
Comprehensive income								
Profit for the year	**–**	**–**	**–**	**–**	**–**	**–**	**134.5**	**134.5**
Other comprehensive income	**–**	**–**	**–**	**–**	**–**	**0.4**	**–**	**0.4**
Total comprehensive income	**–**	**–**	**–**	**–**	**–**	**0.4**	**134.5**	**134.9**
Transactions with owners								
Insertion of new parent	**0.5**	**769.5**	**616.5**	**(1,386.5)**	**–**	**–**	**–**	**–**
Issue of new shares	**4.4**	**195.6**	**–**	**–**	**–**	**–**	**–**	**200.0**
Movement in shares held by trusts	**–**	**–**	**–**	**–**	**–**	**–**	**(9.1)**	**(9.1)**
Value of Partner services	**–**	**–**	**–**	**–**	**–**	**–**	**1.9**	**1.9**
Total transactions with owners	**4.9**	**965.1**	**616.5**	**(1,386.5)**	**–**	**–**	**(7.2)**	**192.8**
Balance at 31 December 2014	**5.0**	**965.1**	**616.5**	**(1,311.6)**	**410.0**	**0.4**	**949.0**	**1,634.4**

* Comparatives have been restated – see note 35.

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated cash flow statement

for the year ended 31 December 2014

	Note	2014 £ million	2013* £ million
Profit before taxation		**170.2**	84.8
Adjustments for			
Change in operating assets	34	**5,697.6**	4,408.6
Change in operating liabilities	34	**1,568.5**	(7,490.9)
Non-cash and other items	34	**41.1**	213.5
Taxation paid		**(3.7)**	(68.7)
Net cash provided by/(used in) operating activities		**7,473.7**	**(2,852.7)**
Cash flows from investing activities			
Purchase of property, plant and equipment		**(85.8)**	(37.5)
Purchase of financial assets		**(3,682.1)**	(15,148.4)
Purchase of financial liabilities		**–**	17,383.8
Purchase of shares held by trusts		**(9.1)**	–
Proceeds from disposal of financial assets and liabilities		**–**	374.7
Net cash (used in)/provided by investing activities		**(3,777.0)**	**2,572.6**
Cash flows from financing activities			
Proceeds from debt securities issued		**10.0**	–
Interest paid on debt securities		**(0.6)**	–
Repurchase of debt securities	3	**(0.8)**	–
Proceeds from subordinated liabilities issued	30	**383.0**	–
Interest paid on subordinated liabilities		**(11.4)**	–
Proceeds from shares issued	23	**200.0**	–
Proceeds from repurchase agreements	5	**32.5**	–
Capital contribution received		**–**	410.0
Net cash provided by financing activities		**612.7**	**410.0**
Change in cash and cash equivalents		**4,309.4**	129.9
Cash and cash equivalents at beginning of year		**174.4**	44.5
Cash and cash equivalents at end of year	34	**4,483.8**	**174.4**

* Comparatives have been restated – see note 35.

The accompanying notes are an integral part of the consolidated financial statements.

Sources of funding

For more information:
Business model — Page 6
Business review — Page 20

Money deposited by our customers into their bank and savings accounts provide the majority of the funds we use to support lending to customers. We also raise a small proportion of funds from other sources that diversify our funding profile and our shareholders also provide some funding in the form of equity in the business.

Accounting policies relevant to sources of funding

(a) Financial liabilities

'Financial liabilities' is the term used to describe the Group's deposits and funding. It includes customer deposits, deposits from banks, debt securities in issue, subordinated liabilities, items in course of transmission to banks and derivative financial liabilities (see accounting policy (k) under Managing financial risk).

Financial liabilities which are not derivatives are measured at amortised cost. Issues of financial liabilities measured at amortised cost are recognised on settlement date. A financial liability is derecognised from the balance sheet when the Group has discharged its obligations, the contract is cancelled or the contract expires.

Borrowings (which include deposits from banks, customer deposits, debt securities in issue and subordinated liabilities) are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. These instruments are subsequently stated at amortised cost using the effective interest method.

1. Customer deposits

	2014 £ million	2013* £ million
Non-interest bearing bank accounts	**4,777.3**	4,373.6
Interest bearing bank accounts	**2,791.6**	2,122.8
Savings accounts	**17,056.0**	16,604.0
Total customer deposits	**24,624.9**	**23,100.4**

* Amounts have been reclassified to provide consistency with current year presentation.

At 31 December 2014 £1,937.1 million (2013: £1,115.5 million) of customer deposits had a residual maturity of greater than one year. There are no amounts due to LBG companies included in customer deposits above (2013: £nil).

Significant judgements and estimates relevant to income – effective interest rate methodology
The Group uses the effective interest rate (EIR) method to determine the recognition of interest expense on customer deposits. At 31 December 2014, the Group had deferred for accounting purposes £16.6 million of interest expense in respect of bonus interest on certain savings products. This amount will be recognised as interest expense over the expected remaining life of the relevant savings balances. The assessment of this period requires management judgement including the extent to which recent historical repayment behaviour is indicative of future expected behaviour.

2. Deposits from banks

	2014 £ million	2013 £ million
Deposits from banks	**32.5**	234.7
Total deposits from banks	**32.5**	**234.7**

At 31 December 2014 deposits from banks comprise repurchase agreements (note 5). No deposits from banks have a contractual residual maturity of greater than one year (2013: £nil). All deposits from banks relate to amounts due to LBG companies.

3. Debt securities in issue

	2014 £ million	2013 £ million
Preference shares	**–**	1.4
Securitisation notes (note 7)	**10.0**	–
Total debt securities in issue	**10.0**	**1.4**

On 21 January 2014, the Group repurchased all of the issued preference share capital of £1.4 million from its then immediate parent company, TSB Intermediate Company 2 Limited. The preference shares were immediately cancelled. The Group paid a consideration of £0.8 million, being the fair value of the preference shares at the date of repurchase, and recognised a gain on the extinguishment of this liability of £0.6 million. The balance at 31 December 2014 represents the balance of debt securities issued by Cape Funding No. 1 plc (see note 7).

4. Subordinated liabilities

	2014 £ million	2013 £ million
Fixed/floating rate reset callable subordinated Tier 2 notes due May 2026	**383.2**	–
Accrued interest	**3.5**	–
Fair value hedge accounting adjustment	**18.8**	–
Total subordinated liabilities	**405.5**	**–**

On 1 May 2014, TSB Banking Group plc issued £385.0 million of fixed/floating rate reset callable subordinated Tier 2 notes at an issue price of 99.493% of the principal amount to Lloyds Bank plc. The notes pay interest at a rate of 5.75% per annum, payable semi-annually in arrears until 6 May 2021 at which time the interest rate becomes three month LIBOR plus 3.43% per annum payable quarterly in arrears. The Company has the option to redeem these notes on 6 May 2021 and quarterly thereafter, subject to approval of the PRA.

5. Repurchase agreements

During the year, the Group established capability to undertake repurchase agreements in order to provide additional flexibility to raise short term cash from the financial markets. At 31 December 2014, the Group had entered into repurchase agreements which transferred the legal title of certain gilts, in return for cash, together with an agreement to repurchase the gilts at a later date and at a predetermined price. The gilts were not derecognised from the Group's balance sheet as substantially all of the rewards, including interest income on the gilts, and risks, including credit and interest rate risks, are retained by the Group. In all cases, the transferee has the right to sell or repledge the gilts concerned, subject to delivering equivalent securities at the repurchase date.

The table below presents the carrying values of the transferred gilts and the associated repurchase agreement liabilities. The associated liabilities represent the Group's obligation to repurchase the transferred assets (see note 2).

At 31 December 2014	Carrying amount of transferred assets £ million	Carrying amount of associated liabilities £ million
Available-for-sale financial assets (note 11)	**32.9**	**(32.5)**

6. Fair value of financial liabilities

The following table summarises the carrying values of financial liabilities presented on the Group's balance sheet. The fair values presented in the table are at a specific date and may be significantly different from the amount which will actually be paid on the maturity or settlement date.

		2014		2013	
	Note	Carrying value £ million	Fair value £ million	Carrying value £ million	Fair value £ million
Financial liabilities					
Customer deposits	1	**24,624.9**	**24,679.7**	23,100.4	23,142.1
Debt securities in issue	3	**10.0**	**10.0**	1.4	0.8
Subordinated liabilities	4	**405.5**	**404.9**	–	–
Derivative financial liabilities	28	**116.7**	**116.7**	85.6	85.6

The carrying amount of deposits from banks and items in course of transmission to banks is a reasonable approximation of fair value. Fair value is the price that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. As quoted market prices are not available for the Group's financial instruments, fair values have been determined using valuation techniques which, to the extent possible, use market observable inputs, but in some cases use non-market observable inputs. Valuation techniques used include discounted cash flow analysis and, where appropriate, comparison to instruments with characteristics similar to those of the instruments held by the Group.

Sources of funding (continued)

6. Fair value of financial liabilities (continued)

Valuation hierarchy of financial liabilities
The table below analyses the fair values of financial liabilities of the Group which are carried at fair value or for which fair value is disclosed above.

At 31 December 2014	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total fair value £ million	Total carrying value £ million
Customer deposits	–	**24,679.7**	–	**24,679.7**	**24,624.9**
Debt securities in issue	–	**10.0**	–	**10.0**	**10.0**
Subordinated liabilities	–	**404.9**	–	**404.9**	**405.5**
Derivative financial liabilities	–	**116.7**	–	**116.7**	**116.7**
At 31 December 2013					
Customer deposits	–	23,142.1	–	23,142.1	23,100.4
Debt securities in issue	–	0.8	–	0.8	1.4
Derivative financial liabilities	–	85.6	–	85.6	85.6

The fair value of deposits repayable on demand is considered to be equal to their carrying value. The fair value for all other customer deposits is estimated using discounted cash flows applying either market rates, where applicable, or current rates for deposits of similar remaining maturities. The Group's subordinated liabilities and derivative financial liabilities, which comprise interest rate swaps, are valued using discounted cash flows where the most significant input is interest yield curves developed from publicly quoted rates and by reference to instruments with similar risk characteristics as the instruments held by the Group.

Liabilities carried at fair value or for which fair values are disclosed have been classified into three levels according to the quality and reliability of information used to determine the fair values. Derivative financial instruments are the only liabilities of the Group that are carried at fair value.

Level 1
Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2
Level 2 valuations are those where quoted market prices are not available, for example where the instrument is traded in a market that is not considered to be active or valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.

Level 3
Level 3 portfolios are those where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data.

Loans

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Funds deposited with the Group are primarily used to support lending to customers. The Group lends money to customers using different products, including mortgages, credit cards, unsecured personal loans and overdrafts. A portion of the funds deposited with the Group are held in reserve – we call that our liquidity portfolio, which enables the Group to meet unexpected future funding requirements.

Accounting policies relevant to loans

(b) Financial assets

'Financial assets' is the term used to describe the Group's loans to customers and other institutions. It includes loans and advances to customers, loans and advances to banks, available-for-sale financial assets, cash and balances with central banks, items in course of collection from banks and derivative financial assets (see accounting policy (k) under Managing financial risk).

On initial recognition, financial assets which are not derivatives are classified as loans and receivables or available-for-sale financial assets. Purchases and sales of financial assets and liabilities are recognised on trade date, being the date that the Group is committed to purchase or sell an asset.

Financial assets are derecognised when the contractual right to receive cash flows from those assets has expired or when the Group has transferred its contractual right to receive the cash flows from the assets and either:

– Substantially all of the risks and rewards of ownership have been transferred; or

– The Group has neither retained nor transferred substantially all of the risks and rewards, but has transferred control.

(i) Loans and receivables

Loans and receivables include loans and advances to customers, loans and advances to banks and other eligible assets. Loans and advances are initially recognised when cash is advanced to the borrower at fair value inclusive of transaction costs or, for other eligible assets, their fair value at the date of acquisition. Financial assets classified as loans and receivables are accounted for at amortised cost using the effective interest method less provision for impairment.

Where the Group enters into securitisation transactions to finance certain loans and advances to customers using a structured entity funded by the issue of debt, these loans and advances continue to be recognised by the Group together with a corresponding liability for the funding where the Group retains control of the structured entity.

(ii) Available-for-sale financial assets

The Group classifies financial assets as available-for-sale when the instruments are not derivatives and are not held for trading purposes or otherwise designated at fair value through profit or loss, or at amortised cost. Available-for-sale investments are held at fair value with gains and losses arising from changes in fair value recognised in other comprehensive income. Interest is calculated using the effective interest method and is recognised in the income statement in net interest income. On disposal, the cumulative gain or loss previously recognised in other comprehensive income is recognised in the income statement.

(iii) Repurchase agreements

Financial instruments sold under a repurchase agreement, under which substantially all the risks and rewards of ownership are retained by the Group continue to be recognised on the balance sheet and the sale proceeds are recorded in deposits from banks. The difference between the sale and repurchase price is recognised over the life of the agreement as interest expense using the effective interest method.

(c) Impairment of financial assets

(i) Accounted for at amortised cost

At each balance sheet date the Group assesses whether, as a result of one or more events occurring after initial recognition, there is objective evidence that a financial asset or group of financial assets has become impaired.

If there is objective evidence that an impairment loss has been incurred, an allowance is established which is calculated as the difference between the balance sheet carrying value of the asset and the present value of estimated future cash flows discounted at that asset's original EIR. If an asset has a variable interest rate, the discount rate used for measuring the impairment loss is the current EIR.

Subsequent to the recognition of an impairment loss on a financial asset or a group of financial assets, interest income continues to be recognised on an EIR basis, on the asset's carrying value net of impairment provisions. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, such as an improvement in the borrower's credit rating, the allowance is adjusted and the amount of the reversal is recognised in the income statement.

(ii) Collective basis

Impairment allowances for portfolios of homogenous loans such as residential mortgages, personal loans and credit card balances, and for loan losses that have been incurred but not separately identified at the balance sheet date, are determined on a collective basis.

(iii) Homogenous groups of loans

Impairment is assessed on a collective basis for homogenous groups of loans that are not considered individually impaired. The asset is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment.

Loans (continued)

(c) Impairment of financial assets (continued)

(iii) Homogenous groups of loans (continued)
The criteria that the Group uses to determine that there is objective evidence of an impairment loss may include:

- Delinquency in contractual payments of principal and/or interest;
- Indications that the borrower or group of borrowers is experiencing significant financial difficulty;
- Restructuring of debt to reduce the burden on the borrower;
- Breach of loan covenants or conditions; and
- Initiation of bankruptcy or individual voluntary arrangement proceedings.

In respect of the Group's secured mortgage portfolios, the impairment allowance is calculated based on a definition of impaired loans which are those six months or more in arrears (or in certain cases where the borrower is bankrupt or is in possession). The estimated cash flows are calculated based on historical experience and are dependent on estimates of the expected value of collateral which takes into account expected future movements in house prices, less costs to sell.

For unsecured personal lending portfolios, the impairment trigger is generally when the balance is two or more instalments in arrears or where the customer has exhibited one or more of the impairment characteristics set out above. While the trigger is based on the payment performance or circumstances of each individual asset, the assessment of future cash flows uses historical experience of cohorts of similar portfolios such that the assessment is considered to be collective. Future cash flows are estimated on the basis of the contractual cash flows of the assets in the cohort and historical loss experience for similar assets. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

(iv) Write-offs
A loan or advance is normally written off, either partially or in full, against the related allowance when the proceeds from realising any available security have been received or there is no realistic prospect of recovery (as a result of the customer's insolvency, ceasing to trade or other reason) and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the statement of comprehensive income.

7. Loans and advances to customers

	2014 £ million	2013 £ million
Mortgages – Franchise	**16,580.7**	17,728.7
Mortgages – Mortgage Enhancement	**2,802.7**	–
Unsecured lending and business banking	**2,344.1**	2,467.2
Gross lending	**21,727.5**	**20,195.9**
Allowance for impairment losses on loans and advances to customers (note 10)	**(86.1)**	(96.8)
Total loans and advances to customers	**21,641.4**	**20,099.1**

At 31 December 2014 £19,422.2 million of loans and advances to customers (2013: £17,835.7 million) had a contractual residual maturity of greater than one year.

Loans and advances to customers include loans securitised under the Group's securitisation programme, which have been sold by TSB Bank plc to a special purpose entity (Cape Funding No. 1 plc). As Cape Funding No. 1 plc is funded by the issue of debt on terms whereby the majority of the risks and rewards of the portfolio are retained, it is consolidated fully and all of these loans are retained on the Group's balance sheet, with the related notes in issue included within debt securities in issue.

The balance of the loans subject to the Group's securitisation programme and the carrying value of the notes in issue are listed in the table below.

	31 December 2014		31 December 2013	
	Loans and advances securitised £ million	Notes in Issue £ million	Loans and advances securitised £ million	Notes in Issue £ million
Cape Funding No. 1 plc	**2,876.3**	**2,925.0**	–	–
Less held by the Group		**2,915.0**		–
Total securitisation notes (note 3)		**10.0**		**–**

8. Commitments arising from the banking business

In the normal course of business, the Group provides commitments to lend to its customers as presented below.

Undrawn formal standby facilities, credit lines and other commitments to lend:

	2014 £ million	2013 £ million
Mortgage offers made	**247.3**	203.7
Credit cards	**2,655.0**	2,451.0
Other	**789.3**	794.4
Total commitments	**3,691.6**	**3,449.1**

Of the amounts shown above, £254.7 million (2013: £213.8 million) was irrevocable. All commitments to lend to customers shown in the table above have a contractual maturity of less than one year.

9. Loans and advances to banks

	2014 £ million	2013 £ million
Loans and advances to banks	**134.5**	4,124.7
Total loans and advances to banks	**134.5**	**4,124.7**

At 31 December 2014 and 2013 all loans and advances to banks had a contractual residual maturity of less than one year and relate to balances with LBG companies.

10. Allowance for impairment losses on loans and receivables

	Mortgages £ million	Unsecured retail and small business £ million	Total £ million
At 1 January 2013	11.5	24.4	35.9
Advances written off	(3.2)	(96.5)	(99.7)
Recoveries of advances written off in previous years	–	13.5	13.5
Transfer of business	12.8	54.0	66.8
Charge to the income statement	2.9	77.4	80.3
At 31 December 2013	**24.0**	**72.8**	**96.8**
Advances written off	(3.9)	(118.2)	(122.1)
Recoveries of advances written off in previous years	–	13.8	13.8
Charge/(credit) to the income statement	(0.2)	97.8	97.6
At 31 December 2014	**19.9**	**66.2**	**86.1**

Included in the Group's total allowance for loans and advances to customers is £63.0 million (2013: £75.2 million) related to lending that was determined to be impaired at 31 December 2014.

Loans (continued)

Significant judgements and estimates relevant to loans
The allowance for impairment losses is management's best estimate of losses incurred in the portfolio at the balance sheet date. At 31 December 2014 the Group recognised an impairment allowance against loans and advances to customers of £86.1 million (2013: £96.8 million).

The impairment allowance is subject to estimation uncertainty and in particular is sensitive to changes in economic and credit conditions, including the interdependency of house prices, unemployment rates, interest rates, borrowers' behaviour, and consumer bankruptcy trends. It is inherently difficult to estimate how changes in one or more of these factors might impact the impairment allowance. However, given the relative size of the Group's mortgage portfolio, a key variable is house prices which determine the collateral value supporting loans in such portfolios. The value of this collateral is estimated by applying changes in house price indices to the original assessed value of the property. If average house prices had been 10% lower than those estimated at 31 December 2014, the Group's allowance for impairment losses would have been approximately £2.8 million higher.

The adequacy of the provision is estimated using models which use a variety of inputs, including recent historical experience to estimate the level of incurred losses in the portfolio. In certain circumstances adjustments are made to the modelled outcomes to reflect where, in management's judgement, the modelled outcomes are not sufficiently sensitive to current economic conditions. At 31 December 2014, the Group's impairment allowance included £21.0 million of post model adjustments, the largest component reflecting the effect of the current historical low interest rates environment on customer behaviour.

A collective unimpaired provision is made for loan losses that have been incurred but have not been separately identified at the balance sheet date. This provision is sensitive to changes in the time between the loss event and the date the impairment is specifically identified. This period is known as the loss emergence period. During the second half of 2014, the Group extended the loss emergence period on unsecured lending from two months to three months to reflect changes in the time it takes customers to reach impairment which increased the impairment charge by £5.5 million.

11. Available-for-sale financial assets

	2014 £ million	2013 £ million
Gilts	**339.7**	–

At 31 December 2014 gilts with a carrying value of £32.9 million were subject to repurchase agreements (note 5). At 31 December 2014 all of the Group's available-for-sale financial assets had a contractual maturity of greater than one year.

12. Fair value of financial assets

The following table summarises the carrying values of financial assets presented on the Group's balance sheet. The fair values presented in the table are at a specific date and may be significantly different from the amount which will actually be paid on the maturity or settlement date.

		2014		2013	
	Note	Carrying value £ million	Fair value £ million	Carrying value £ million	Fair value* £ million
Financial assets					
Loans and advances to customers	7	**21,641.4**	**21,451.6**	20,099.1	19,888.4
Available-for-sale financial assets	11	**339.7**	**339.7**	–	–
Derivative financial assets	28	**123.1**	**123.1**	99.4	99.4

* Amounts have been represented on a basis consistent with December 2014.

The carrying amount of cash and balances at central banks, items in course of collection from banks and loans and advances to banks is a reasonable approximation of fair value.

Fair value is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. As quoted market prices are not available for the Group's financial instruments, fair values have been determined using valuation techniques which, to the extent possible, use market observable inputs, but in some cases use non-market observable inputs. Valuation techniques used include discounted cash flow analysis and pricing models and, where appropriate, comparison to instruments with characteristics similar to those of the instruments held by the Group.

12. Fair value of financial assets (continued)

Valuation hierarchy of financial assets

The table below analyses the fair values of the financial assets of the Group which are carried at fair value or for which fair value is disclosed above.

At 31 December 2014	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total fair value £ million	Total carrying value £ million
Loans and advances to customers	**–**	**–**	**21,451.6**	**21,451.6**	**21,641.4**
Available-for-sale financial assets	**339.7**	**–**	**–**	**339.7**	**339.7**
Derivative financial assets	**–**	**123.1**	**–**	**123.1**	**123.1**
At 31 December 2013					
Loans and advances to customers	–	–	19,888.4	19,888.4	20,099.1
Derivative financial assets	–	99.4	–	99.4	99.4

The Group provides loans and advances at both fixed and variable rates. Fair value is principally estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Group and other financial institutions. Certain loans secured on residential properties are made at a fixed rate for a limited period, typically two to five years, after which the loans revert to the relevant variable rate. The fair value of such loans is estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period. Available-for-sale financial assets are valued using quoted market prices. The Group's derivative financial assets are all interest rate swaps and are valued using a discounted cash flow model where the most significant input is interest yield curves which are developed from publicly quoted rates.

Income

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We earn income in the form of interest that we receive on the loans we make to customers and we pay interest to savings and bank account customers on the money they deposit with us. We also earn other income from fees we charge for the provision of banking services and commissions from the sale of certain third party products such as general insurance.

Accounting policies relevant to recognising income

(d) Interest income and expense
Interest income and expense are recognised in the income statement for all interest-bearing financial instruments using the effective interest rate method. The EIR method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense. The EIR is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability.

The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts paid or received by the Group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument and all other premiums or discounts. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss (see accounting policy (c) on impairment of financial assets).

(e) Fees and commission income and expense
Fees and commissions which are not an integral part of the EIR are generally recognised when the service has been provided.

13. Net interest income

	2014 £ million	2013 £ million
Interest and similar income		
Loans and advances to banks	**6.9**	109.4
Loans and advances to customers	**972.2**	587.6
Total interest and similar income	**979.1**	**697.0**
Interest and similar expense		
Deposits from banks	**(1.9)**	(46.1)
Customer deposits	**(219.0)**	(187.1)
Total interest and similar expense	**(220.9)**	**(233.2)**
Net interest income	**758.2**	**463.8**

Included within interest and similar income is £10.4 million (2013: £8.3 million) in respect of impaired financial assets. Included in net interest income above is £6.9 million (2013: £109.4 million) receivable from LBG companies and £17.6 million (2013: £46.1 million) payable to LBG companies.

14. Net fee and commission income

	2014 £ million	2013 £ million
Fee and commission income		
Bank accounts	**98.6**	82.0
Credit and debit card fees	**65.6**	45.3
Insurance commission income	**22.9**	23.0
Other	**21.5**	8.9
Total fee and commission income	**208.6**	**159.2**
Fee and commission expense		
Bank accounts	**(55.4)**	(42.7)
Credit and debit card fees	**(6.0)**	(6.2)
Other	**(9.0)**	(0.4)
Total fee and commission expense	**(70.4)**	**(49.3)**
Net fee and commission income	**138.2**	**109.9**

Fees and commissions which are an integral part of the EIR are recognised in net interest income. Included in net fee and commission income above is £22.9 million (2013: £23.0 million) receivable from LBG companies and £7.3 million (2013: £1.4 million) payable to LBG companies.

15. Other operating income/(expense)

	2014 £ million	2013 £ million
Fair value movement on instruments held at fair value through profit or loss	**1.7**	(35.9)
Gain on repurchase of preference shares	**0.6**	–
Rent receivable	**1.3**	1.3
Other income	**0.2**	2.2
Total other operating income/(expense)	**3.8**	**(32.4)**

Charges

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Running a bank with 4.5 million customers comes with overheads. Charges we incur include the costs of paying our 8,700 TSB Partners, running our IT systems and branches, developing new products and services, meeting regulatory requirements and paying for advertising and marketing. Occasionally, our customers' circumstances change and they are unable to repay the money they borrow from us causing us to incur impairment losses. Finally, the Group pays tax to HMRC on the profits we earn.

Accounting policies relevant to recognised charges

(f) Pensions and other post-retirement benefits

The Group operates defined contribution pension plans under which the Group pays fixed contributions. The costs of the Group's defined contribution plans are charged to the income statement, as an operating expense, in the period in which they fall due.

(g) Share-based compensation

The Group operates a number of equity-settled, share-based compensation plans, in respect of services received from certain of its Partners. The fair value of the options or share awards granted in exchange for Partner services is recognised as an expense. The total amount to be expensed is determined by reference to the fair value of the option or share award granted, including any market performance conditions and any non-vesting conditions.

The impact of any service and non-market performance vesting conditions are not included in the fair value and instead are included in estimating the number of awards or options that are expected to vest.

The total expense is recognised over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. A corresponding credit is recognised in equity. In addition, in some circumstances employees may provide services in advance of the grant date and therefore the grant date fair value is estimated for the purposes of recognising the expense during the period between service commencement period and grant date.

At the end of each reporting period, the Group revises its estimates of the number of options or share awards that are expected to vest based on the non-market and service vesting conditions. The impact of the revision to original estimates, if any, is recognised in the income statement, with a corresponding adjustment to equity.

(h) Taxation

Current corporation tax which is payable on taxable profits is recognised as an expense in the period in which the profits arise.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

Deferred tax is determined using tax rates that have been enacted or substantively enacted by the balance sheet date that are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred and current tax assets and liabilities are offset when they arise in the same tax reporting group and where there is both a legal right of offset and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

16. Operating expenses

	2014 £ million	2013* £ million
Staff costs		
Wages and salaries	**231.7**	96.6
Social security costs	**25.6**	8.5
Defined benefit pension scheme settlement gain	**(63.7)**	–
Other pensions costs	**31.8**	25.3
Share-based payments (note 18)	**9.3**	3.1
Other staff costs	**43.4**	5.1
Total staff costs	**278.1**	**138.6**
Premises and equipment expenses		
Rent	**31.0**	18.9
Rates	**14.5**	10.0
Other	**29.0**	15.4
Total premises and equipment expenses	**74.5**	**44.3**
Other expenses		
Recharges from Lloyds Banking Group companies	**–**	159.6
Transitional Services Agreement costs	**97.8**	–
Professional fees	**34.2**	0.6
Advertising and promotion	**68.5**	0.8
Financial Services Compensation Scheme levy	**16.0**	3.9
Other	**46.1**	14.6
Total other expenses	**262.6**	**179.5**
Depreciation (note 31)	**17.2**	13.8
Total operating expenses	**632.4**	**376.2**

* Comparatives have been restated – see note 35.

The average monthly number of persons on a headcount basis employed by the Group during the year was 8,427 (2013: 4,721), all of whom were employed in the UK.

Included in other expenses are fees paid to the Group's auditors in respect of work carried out for the Group of £1.2 million (2013: £0.6 million). Of this amount, £1.0 million (2013: £0.6 million) was in respect of the audit of the Group's financial statements and £0.2 million (2013: £nil) was in respect of non-audit services primarily related to the Group's listing. Also included in other expenses was £0.2 million (2013: £nil) paid to LBG in respect of a review by their auditors, PwC, of controls undertaken on the Group's behalf by LBG under the TSA.

Charges (continued)

17. Retirement benefit obligations

On 31 March 2014, TSB Partners were transferred to the Group from LBG under the terms of the Transfer of Undertakings (Protection of Employment) Regulations 2006. At this point, those who were members of LBG defined benefit pension schemes became deferred members of those schemes. No settlement payment was required and the Group has no further liability to these schemes. Consequently, a gain of £63.7 million was recognised in operating expenses in the income statement reflecting the economic substance of the transaction.

The expense recognised in operating expenses in the income statement is as follows:

	2014 £ million	2013 £ million
Current service cost	**4.6**	15.0
Settlement gain	**(63.7)**	–
Past service cost	**–**	0.6
Interest cost	**0.7**	2.9
Plan administration costs	**0.2**	1.0
Total net (gain)/expense	**(58.2)**	**19.5**

The amounts recognised on the balance sheet were as follows:

	2014 £ million	2013 £ million
Share of present value of funded obligations	**–**	578.2
Share of fair value of scheme assets	**–**	(513.9)
Retirement benefit obligations liability	**–**	**64.3**

The movements in the liability previously recognised on the balance sheet are as follows:

	£ million
At 31 December 2013	64.3
Net gain recognised in the income statement	(58.2)
Re-measurements	–
Contributions paid	(6.1)
At 31 December 2014	**–**

18. Share-based payments

(i) TSB share schemes

During the year, following the listing of the Group's shares, a number of share-based compensation schemes were introduced as part of the Group's new remuneration policy. These TSB share schemes comprise both share option schemes and share awards. The income statement expense in respect of these share schemes is as follows:

	2014 £ million	2013 £ million
Share option schemes	**0.8**	–
Share awards	**1.1**	–
Total expense	**1.9**	**–**

18. Share-based payments (continued)

Share option schemes

TSB Sharesave

Eligible employees can choose to enter into a contract to save up to £500 per month and, at the maturity date, three years from the start of the savings contract, have the option to use these savings within six months to acquire shares in the Group at a 20% discount to the market price on the date of the Sharesave invitation. Movements in the number of TSB Sharesave options outstanding are set out below:

	Number of options (000s)	Weighted Average exercise price (pence)
Outstanding at 1 January 2014	–	–
Granted	6,585	225.48
Exercised	–	–
Forfeited	(70)	225.48
Cancelled	(214)	225.48
Outstanding at 31 December 2014	**6,301**	**225.48**
Exercisable at 31 December 2014	**–**	**–**

The remaining contractual life of the options outstanding at 31 December 2014 was two years and nine months.

The fair value of options granted in 2014, determined using a Black-Scholes valuation model, was 92 pence per option. The significant inputs into the model are shown below:

Share price at date of Sharesave invitation	281.85p
Exercise price	225.48p
Volatility	30%
Interest free rate	1.5%
Dividend yield	0%

Ordinarily volatility would be determined by reference to the historical share price over the most recent three year period, being the period commensurate with the option term. However, as a newly listed entity, the Group did not have a relevant trading history at the date of the grant of the above share options. Therefore, volatility was determined by comparing the TSB share price volatility in the period from the Group's listing on 25 June 2014 to 30 September 2014 with a comparator group comprising UK listed banks and FTSE 250 financial companies and extrapolating the Group's relative share price volatility in this period against the comparator group's historic volatility over the most recent three year historical period leading up to the grant date of the TSB Sharesave options.

Share Awards

Free shares

On 25 June 2014, the Group made an award of £100 of free shares to each TSB Partner. The shares awarded are held in trust for a mandatory period of three years on the Partner's behalf, during which period the employee is entitled to any dividends paid on such shares. The award is subject to a non-market based condition whereby if a TSB Partner leaves the Group within the three year holding period for other than 'good' leaver reasons (such as retirement or redundancy) all of the shares awarded will be forfeited.

Share incentive plan (SIP) – matching shares

In October 2014, the Group commenced a SIP, Sharematch. The Group undertakes to match shares purchased by Partners, up to the value of £30 per month, which are held in trust for a mandatory period of three years on the TSB Partner's behalf. During this period the TSB Partner is entitled to any dividends paid on such shares. As with free shares, if a TSB Partner leaves the Group within the three year holding period under anything other than 'good' leaver status, all of the matching shares are forfeited. Similarly, if TSB Partners sell their purchased shares within three years, their matching shares are forfeited.

Charges (continued)

18. Share-based payments (continued)

Share awards

During 2014, the Group announced a change to Group wide remuneration policy. The new policy includes the adoption of a new long term plan, the SPA, which is designed to support sustained corporate and personal performance. The award is payable in both cash and TSB shares and will be released in equal instalments over five years subject to the achievement of both corporate and personal vesting performance conditions. The Group also announced that Partners who had awards under the LBG LTIP would receive substitution awards over TSB shares should they become good leavers and cease to accrue benefits under the former LBG awards. During 2014, the Group recognised an expense of £1.1 million (2013: £nil) in respect of the equity settled elements of TSB share awards.

(ii) Lloyds Banking Group share schemes

During the year the Group's ultimate parent company, Lloyds Banking Group plc, continued to operate a number of share-based payment schemes, all of which are equity settled. The aggregate cost of the LBG schemes included in operating expenses was £7.4 million (2013: £3.1 million).

19. Taxation (charge)/credit for the year

	2014 £ million	2013* £ million
UK corporation tax		
Current tax on profit for the year	**(7.6)**	(20.0)
Adjustments in respect of prior years	**1.7**	2.1
Current tax charge	**(5.9)**	**(17.9)**
Deferred tax (note 20)		
Origination and reversal of temporary differences		
Deferred tax on business transfers	**(16.3)**	141.4
Deferred tax on pension	**(14.0)**	0.1
Accelerated capital allowances	**(1.1)**	–
Other	**(0.6)**	(0.5)
Reduction in UK corporation tax rate	**2.2**	(20.6)
Adjustments in respect of prior years	**–**	(2.3)
Deferred tax (charge)/credit	**(29.8)**	**118.1**
Taxation (charge)/credit	**(35.7)**	**100.2**

* Comparatives have been restated – see note 35.

A reconciliation of the charge that would result from applying the average UK corporation tax rate to the PBT to the actual taxation (charge)/credit for the year is presented below:

	2014 £ million	2013* £ million
Profit before taxation	**170.2**	**84.8**
Taxation charge at average UK corporation tax rate of 21.5% (2013: 23.25%)	**(36.6)**	(19.7)
Factors affecting (charge)/credit		
Deferred tax asset arising from business transfers (note 20)	**–**	141.4
UK corporation tax rate change	**2.2**	(20.6)
Disallowed and non-taxable items	**(3.0)**	(0.7)
Adjustments in respect of prior years	**1.7**	(0.2)
Taxation (charge)/credit	**(35.7)**	**100.2**

* Comparatives have been restated – see note 35.

20. Deferred tax assets

The movement in deferred tax assets is as follows:

	2014 £ million	2013 £ million
At 1 January	**138.0**	21.8
Income statement (charge)/credit (note 19)	**(29.8)**	118.1
Amount charged to shareholders' equity		
Movements in available-for-sale reserve	**(0.1)**	–
Post retirement benefit scheme re-measurements	**–**	(1.9)
At 31 December	**108.1**	**138.0**

The deferred tax movement in the income statement comprises the following temporary differences:

	2014 £ million	2013 £ million
Temporary differences arising from business transfers	**15.2**	(121.6)
Pensions and other post-retirement benefits	**13.0**	2.5
Accelerated capital allowances	**1.0**	0.2
Other temporary differences	**0.6**	0.8
	29.8	**(118.1)**

Deferred tax assets are comprised as follows:

	2014 £ million	2013 £ million
Deferred tax impact of business transfers	**106.4**	121.6
Pension and other post-retirement benefits	**0.1**	13.1
Revaluations of available-for-sale financial assets	**(0.1)**	–
Other temporary differences	**1.7**	3.3
Total deferred tax assets	**108.1**	**138.0**

Significant judgements and estimates – recoverability of deferred tax assets

At 31 December 2014, the Group recognised deferred tax assets of £108.1 million. Of this, £106.4 million reflects temporary differences that arose from the application of taxation transfer pricing rules to the transfer of assets and liabilities from LBG during 2013. In assessing the carrying value of the deferred tax asset arising from the transfer, management judgement was required in estimating the market value of the transferred balances which took into account an independent valuation of the transferred balances which was subsequently agreed with HMRC during the year. Recoverability of the deferred tax asset also requires management judgement in assessing future levels of taxable profits expected to arise against which these temporary differences can be offset. The Group's expectations of the level of future taxable profits takes into account the Group's Board approved medium term plan and associated risk factors including future economic outlook and regulatory change. At 31 December 2014, the deferred tax asset arising from the transfer of assets and liabilities from LBG was recognised in full.

Profits and returns to shareholders

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The Board reviews the Group's performance regularly on both a management and statutory basis and decides whether profits are put aside for future investment in the business, for protection against the uncertainties the Group faces or returned to shareholders.

Accounting policies relevant to profits and returns to shareholders

(i) Share capital
Shares are classified as equity instruments when there is no contractual obligation to deliver cash or other assets to another entity on terms that may be unfavourable. Ordinary shares are classified as equity.

(j) Shares held by trusts
Shares held by trusts are ordinary shares of TSB Banking Group plc purchased by the Group. The consideration for the purchase of these shares is deducted from shareholders' equity. On the sale or reissue of the shares the consideration received is credited to equity, net of any directly attributable incremental costs.

21. Segmental analysis
The segmental results are presented in a manner which is consistent with internal reporting provided to the Executive Committee which is considered to be the chief operating decision maker. The segmental results are presented on a management basis, which excludes certain volatile and non-recurring items and is the basis reviewed by the Executive Committee. The Group's reportable segments have been identified as 'Franchise' and 'Mortgage Enhancement' reflecting its organisational and management structures.

Franchise comprises the retail banking business carried out in the UK which offers a broad range of retail financial services including current accounts, savings products, personal loans, credit cards and mortgages.

Mortgage Enhancement is a separate portfolio of mortgage assets which was assigned to the Group by LBG with effect from 28 February 2014. This segment was established in response to a review by the Office of Fair Trading of the effect on competition of the divestment of TSB and is designed to enhance the Group's profitability by over £230 million.

The Executive Committee's review includes a consideration of each segment's net interest income and consequently the interest income and expense for each reportable segment is presented on a net basis.

Year ended 31 December 2014	Franchise £ million	Mortgage Enhancement £ million	Total £ million
Net interest income	707.3	79.8	787.1
Other income	147.8	(7.5)	140.3
Total income	855.1	72.3	927.4
Operating expenses	(696.1)	–	(696.1)
Impairment	(97.0)	(0.6)	(97.6)
Profit before taxation (management basis)	62.0	71.7	133.7
Losses on derivatives and hedge accounting			(3.1)
Derivative fair value unwind			(24.1)
Defined benefit pension scheme settlement gain			63.7
Statutory profit before taxation			170.2

At 31 December 2014	Franchise £ million	Mortgage Enhancement £ million	Total £ million
Segment loans and advances to customers	18,839.3	2,802.1	21,641.4
Segment customer deposits	24,624.9	–	24,624.9

21. Segmental analysis (continued)

Year ended 31 December 2013	Franchise £ million	Mortgage Enhance-ment £ million	Total £ million
Net interest income	473.8	–	473.8
Other income	113.4	–	113.4
Total income	**587.2**	**–**	**587.2**
Operating expenses	(376.2)	–	(376.2)
Impairment	(80.3)	–	(80.3)
Profit before taxation (management basis)	**130.7**	**–**	**130.7**
Losses on derivatives			(39.3)
Derivative fair value unwind			(6.6)
Statutory profit before taxation			**84.8**

At 31 December 2013			
Segment loans and advances to customers	20,099.1	–	20,099.1
Segment customer deposits	23,100.4	–	23,100.4

The table below provides a reconciliation from the management basis to the statutory results.

Year ended 31 December 2014	Manage-ment basis £ million	Loss on derivatives and hedge accounting £ million	Derivative fair value unwind £ million	Defined benefit pension scheme settlement gain £ million	Statutory basis £ million
Net interest income	**787.1**	**(28.9)**	**–**	**–**	**758.2**
Other income	**140.3**	**25.8**	**(24.1)**	**–**	**142.0**
Total income	**927.4**	**(3.1)**	**(24.1)**	**–**	**900.2**
Operating expenses	**(696.1)**	**–**	**–**	**63.7**	**(632.4)**
Impairment	**(97.6)**	**–**	**–**	**–**	**(97.6)**
Profit before taxation	**133.7**	**(3.1)**	**(24.1)**	**63.7**	**170.2**
Year ended 31 December 2013					
Net interest income	473.8	(10.0)	–	–	463.8
Other income	113.4	(29.3)	(6.6)	–	77.5
Total income	**587.2**	**(39.3)**	**(6.6)**	**–**	**541.3**
Operating expenses	(376.2)	–	–	–	(376.2)
Impairment	(80.3)	–	–	–	(80.3)
Profit before taxation	**130.7**	**(39.3)**	**(6.6)**	**–**	**84.8**

22. Earnings per share

	2014 £ million	2013 £ million
Profit attributable to shareholders	**134.5**	**185.0**
	Shares million	**Shares million**
Weighted average number of shares in issue – basic	**331.1**	55.0
Adjustment for share options	**0.4**	–
Weighted average number of shares in issue – diluted	**331.5**	**55.0**
	pence	**pence**
Basic earnings per share	**40.6**	336.4
Diluted earnings per share	**40.6**	336.4

Profits and returns to shareholders (continued)

22. Earnings per share (continued)

Basic earnings per share is calculated by dividing the profit attributable to shareholders by the weighted average number of ordinary shares in issue during the year excluding ordinary shares purchased and held by trusts.

On 25 April 2014, the Group issued 50 million ordinary shares in exchange for the acquisition of the entire share capital of TSB Bank plc increasing the total ordinary shares in issue at that date to 55 million. The weighted average number of ordinary shares in issue has been adjusted as if the share exchange had occurred at the beginning of the comparative period. The weighted average number of shares in issue also reflects the issue of a further 445 million shares on 19 May 2014 which are included in the calculation of weighted average from this date. Had these shares been in issue from the beginning of the comparative period, basic and diluted earnings per share would have been 26.9 pence (2013: 37.0 pence).

23. Shareholders' equity

	Share capital £ million	Share premium £ million	Merger reserve £ million	Capital reorganisation reserve £ million	Capital reserve £ million	Available-for-sale reserve £ million	Retained profits £ million
At 1 January 2014	**75.0**	–	–	–	**410.0**	–	**810.2**
Restatements							
Insertion of new parent company	**(74.9)**	–	–	**74.9**	–	–	–
Change in accounting policy	–	–	–	–	–	–	**11.5**
At 1 January 2014 – restated	**0.1**	–	–	**74.9**	**410.0**	–	**821.7**
Share for share exchange	**0.5**	**769.5**	**616.5**	**(1,386.5)**	–	–	–
Issue of new shares	**4.4**	**195.6**	–	–	–	–	–
Movement in shares held by trusts	–	–	–	–	–	–	**(9.1)**
Value of Partner services	–	–	–	–	–	–	**1.9**
Net movement in available-for-sale reserve	–	–	–	–	–	**0.4**	–
Profit for the year	–	–	–	–	–	–	**134.5**
At 31 December 2014	**5.0**	**965.1**	**616.5**	**(1,311.6)**	**410.0**	**0.4**	**949.0**

Restatements
On 31 January 2014, LBG established a newly incorporated public limited company, TSB Banking Group plc, with 50,000 ordinary £1 shares, which increased to 5.0 million one pence ordinary shares following a 100 for 1 share split on 4 April 2014. TSB Banking Group plc became the new holding company for the Group by way of a share for share exchange with Lloyds Bank plc on 25 April 2014. As a consequence of the insertion of the new holding company, share capital and the capital reorganisation reserve have been restated from those of TSB Bank plc, as if TSB Banking Group plc had been the holding company of the TSB Group during all periods presented. The effect of this and the change to the Group's accounting policies are set out in note 35.

Share for share exchange
On 25 April 2014, TSB Banking Group plc issued 50 million one pence ordinary shares in exchange for the acquisition of the entire share capital of TSB Bank plc, which following a 100 for 1 share split on 4 April 2014, comprised of 7,500,000,100 one pence ordinary shares.

The issuance of TSB Banking Group plc shares was recorded at the carrying amount of the net assets of TSB Bank plc at the date of acquisition of £1,386.5 million. The nominal value of the shares issued was £0.5 million and the minimum premium amount required by the Companies Act 2006 of £769.5 million was transferred to share premium. The balance of £616.5 million was transferred to the Merger Reserve.

Issue of new shares
On 19 May 2014, TSB Banking Group plc issued 445.0 million one pence ordinary shares at a premium of £0.4394 per share to its immediate parent company, Lloyds Bank plc, for cash proceeds of £200.0 million. At 31 December 2014, TSB Banking Group plc had in issue 500.0 million one pence ordinary shares allotted and fully paid up.

Managing financial risk

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Financial instruments are necessary for the Group's activities and, as a consequence, the risks associated with financial instruments represent a significant component of the risks faced by the Group. The primary risks affecting the Group through its use of financial instruments are credit risk, funding and liquidity risk and market risk. A summary of the Group's use of financial instruments and information about the management of these risks is presented below.

Accounting policies relevant to managing financial risk

(k) Derivative financial instruments and hedge accounting
All derivative financial instruments are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow as appropriate. Derivatives are carried on the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative.

Changes in the fair value of any derivative instrument are recognised immediately in the income statement.

Fair value is the exit price from the perspective of market participants who hold the asset or owe the liability at the measurement date.

Hedge accounting allows one financial instrument, generally a derivative such as a swap, to be designated as a hedge of another financial instrument such as a loan or deposit or a portfolio of such instruments. At the inception of the hedge relationship, formal documentation is drawn up specifying the hedging strategy, the hedged item and the hedging instrument and the methodology that will be used to measure the effectiveness of the hedge relationship in offsetting changes in the fair value of the hedged risk. In its application of the hedge accounting policy, the Group follows the requirements of the EU endorsed version of IAS 39 *Financial Instruments: Recognition and Measurement* adopted by the EU which are not available in the version issued by the IASB. The effectiveness of the hedging relationship is tested both at inception and throughout its life and, if at any point, it is concluded that it is no longer highly effective in achieving its documented objective, hedge accounting is discontinued.

The Group designates certain derivatives as hedges of the fair value changes arising from interest rate risk inherent in recognised assets or liabilities (fair value hedges). Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged item attributable to the hedged risk are no longer recognised in the income statement. The cumulative adjustment that has been made to the carrying amount of the hedged item is amortised to the income statement using a straight line method over the period to maturity.

24. Measurement basis of financial instruments

The following tables analyse the carrying amounts of the financial instruments by category and by balance sheet heading.

At 31 December 2014	Fair value £ million	Loans and receiv-ables £ million	Held at amortised cost £ million	Available-for-sale £ million	Total £ million
Financial liabilities					
Customer deposits	–	–	24,624.9	–	24,624.9
Deposits from banks	–	–	32.5	–	32.5
Debt securities in issue	–	–	10.0	–	10.0
Subordinated liabilities	–	–	405.5	–	405.5
Items in course of transmission to banks	–	–	144.6	–	144.6
Derivative financial liabilities	116.7	–	–	–	116.7
Total financial liabilities	**116.7**	**–**	**25,217.5**	**–**	**25,334.2**
Financial assets					
Cash and balances at central banks	–	–	4,396.3	–	4,396.3
Loans and advances to customers	–	21,641.4	–	–	21,641.4
Loans and advances to banks	–	134.5	–	–	134.5
Available-for-sale financial assets	–	–	–	339.7	339.7
Items in course of collection from banks	–	–	135.7	–	135.7
Derivative financial assets	123.1	–	–	–	123.1
Total financial assets	**123.1**	**21,775.9**	**4,532.0**	**339.7**	**26,770.7**

Managing financial risk (continued)

24. Measurement basis of financial instruments (continued)

At 31 December 2013	Fair value £ million	Loans and receiv-ables £ million	Held at amortised cost £ million	Available-for-sale £ million	Total £ million
Financial liabilities					
Customer deposits	–	–	23,100.4	–	23,100.4
Deposits from banks	–	–	234.7	–	234.7
Debt securities in issue	–	–	1.4	–	1.4
Items in course of transmission to banks	–	–	63.6	–	63.6
Derivative financial instruments	85.6	–	–	–	85.6
Total financial liabilities	**85.6**	**–**	**23,400.1**	**–**	**23,485.7**
Financial assets					
Cash and balances at central banks	–	–	200.2	–	200.2
Loans and advances to customers	–	20,099.1	–	–	20,099.1
Loans and advances to banks	–	4,124.7	–	–	4,124.7
Items in course of collection from banks	–	–	116.2	–	116.2
Derivative financial assets	99.4	–	–	–	99.4
Total financial assets	**99.4**	**24,223.8**	**316.4**	**–**	**24,639.6**

25. Credit risk

Credit risk appetite is set at Board level and is described and reported through a suite of metrics devised from a combination of accounting and credit portfolio performance measures, which include the use of various credit risk rating systems as inputs and measure the credit risk of loans and advances to customers and banks at a counterparty level using three components: (i) the probability of default by the counterparty on its contractual obligations; (ii) the current exposures to the counterparty and their likely future development, from which the Group derives the exposure at default; and (iii) the likely loss ratio on the defaulted obligations, the loss given default. The Group uses a range of approaches to mitigate credit risk, including internal control policies, obtaining collateral, using master netting agreements and other credit risk transfers, such as asset sales. The Group's credit risk exposure, which arises wholly in the United Kingdom, is set out below.

(i) Maximum credit exposure

The maximum credit risk exposure of the Group in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held and the maximum exposure to loss is considered to be the balance sheet carrying amount or, for non-derivative off-balance sheet transactions, their contractual nominal amounts.

	2014 £ million	2013 £ million
Loans and advances to customers*	**21,641.4**	20,099.1
Loans and advances to banks	**134.5**	4,124.7
Available-for-sale financial assets	**339.7**	–
Items in course of collection from banks	**135.7**	116.2
Derivative financial assets	**123.1**	99.4
	22,374.4	**24,439.4**
Lending commitments – revocable	**3,436.9**	3,235.3
Lending commitments – irrevocable	**254.7**	213.8
Maximum credit risk exposure	**26,066.0**	**27,888.5**

* Amounts shown net of related impairment allowances.

25. Credit risk (continued)

(ii) Credit quality of assets

Loans and receivables

The analysis of lending between mortgages and other loans and advances to customers has been prepared based upon the type of exposure.

	Loans and advances to customers			Loans and advances to banks
31 December 2014	Mortgages £ million	Unsecured lending and business banking £ million	Total £ million	£ million
Neither past due nor impaired	**18,948.1**	**2,227.1**	**21,175.2**	**134.5**
Past due but not impaired	**307.5**	**39.8**	**347.3**	**–**
Impaired – no provision required	**62.6**	**–**	**62.6**	**–**
Provision held	**65.2**	**77.2**	**142.4**	**–**
Gross	**19,383.4**	**2,344.1**	**21,727.5**	**134.5**
Allowance for impairment losses (note 10)	**(19.9)**	**(66.2)**	**(86.1)**	**–**
Net	**19,363.5**	**2,277.9**	**21,641.4**	**134.5**
31 December 2013				
Neither past due nor impaired	17,263.8	2,311.6	19,575.4	4,124.7
Past due but not impaired	326.2	63.6	389.8	–
Impaired – no provision required	57.7	–	57.7	–
Provision held	81.0	92.0	173.0	–
Gross	**17,728.7**	**2,467.2**	**20,195.9**	**4,124.7**
Allowance for impairment losses (note 10)	(24.0)	(72.8)	(96.8)	–
Net	**17,704.7**	**2,394.4**	**20,099.1**	**4,124.7**

No impairment allowances have been raised in respect of amounts due from LBG companies.

Loans and advances which are neither past due nor impaired

	Loans and advances to customers			Loans and advances to banks
31 December 2014	Mortgages £ million	Unsecured lending and business banking £ million	Total £ million	£ million
Good quality	**18,937.0**	**1,718.7**	**20,655.7**	**134.5**
Satisfactory quality	**10.0**	**420.8**	**430.8**	**–**
Lower quality	**–**	**42.9**	**42.9**	**–**
Below standard, but not impaired	**1.1**	**44.7**	**45.8**	**–**
Total loans and advances which are neither past due nor impaired	**18,948.1**	**2,227.1**	**21,175.2**	**134.5**
31 December 2013				
Good quality	17,242.9	1,661.8	18,904.7	4,124.7
Satisfactory quality	20.9	535.2	556.1	–
Lower quality	–	55.9	55.9	–
Below standard, but not impaired	–	58.7	58.7	–
Total loans and advances which are neither past due nor impaired	**17,263.8**	**2,311.6**	**19,575.4**	**4,124.7**

Classifications reflect expected recovery levels as well as probabilities of default assessed using internal rating models. Good quality lending includes all the lower assessed default probabilities and all loans with low expected losses in the event of a default, with other categories reflecting progressively higher risks and lower expected recoveries.

Managing financial risk (continued)

25. Credit risk (continued)

Loans and advances which are past due but not impaired

	Loans and advances to customers			Loans and advances to banks
31 December 2014	Mortgages £ million	Unsecured retail and small business £ million	Total £ million	£ million
0-30 days	**140.1**	**28.5**	**168.6**	**–**
30-60 days	**62.8**	**11.3**	**74.1**	**–**
60-90 days	**45.6**	**–**	**45.6**	**–**
90-180 days	**59.0**	**–**	**59.0**	**–**
Over 180 days	**–**	**–**	**–**	**–**
Total loans and advances which are past due but not impaired	**307.5**	**39.8**	**347.3**	**–**
31 December 2013				
0-30 days	161.3	44.3	205.6	–
30-60 days	65.4	16.5	81.9	–
60-90 days	39.6	2.8	42.4	–
90-180 days	59.9	–	59.9	–
Over 180 days	–	–	–	–
Total loans and advances which are past due but not impaired	**326.2**	**63.6**	**389.8**	**–**

A financial asset is past due if a counterparty has failed to make a payment when contractually due.

Derivative assets
An analysis of derivative assets is presented in note 28.

(iii) Collateral held as security for financial assets
The Group holds collateral against loans and advances to customers in the form of mortgages over residential property and second charges over business assets, including commercial and residential property.

Mortgages
An analysis by LTV ratio of the Group's residential mortgage lending is presented below. The value of collateral used in determining the LTV ratios has been estimated based upon the last actual valuation, adjusted to take into account subsequent movements in house prices, after making allowance for indexation error and dilapidations.

At 31 December 2014	Neither past due nor impaired £ million	Past due but not impaired £ million	Impaired £ million	Gross £ million
Less than 70%	**15,139.0**	**192.1**	**63.3**	**15,394.4**
70% to 80%	**2,288.8**	**50.4**	**23.1**	**2,362.3**
80% to 90%	**976.4**	**31.0**	**17.7**	**1,025.1**
90% to 100%	**400.3**	**18.9**	**9.6**	**428.8**
Greater than 100%	**143.6**	**15.1**	**14.1**	**172.8**
Total	**18,948.1**	**307.5**	**127.8**	**19,383.4**
At 31 December 2013				
Less than 70%	11,449.0	164.8	60.1	11,673.9
70% to 80%	3,036.2	51.8	20.5	3,108.5
80% to 90%	1,658.1	46.2	18.9	1,723.2
90% to 100%	692.3	31.2	16.0	739.5
Greater than 100%	428.2	32.2	23.2	483.6
Total	**17,263.8**	**326.2**	**138.7**	**17,728.7**

Unsecured lending and business banking
At 31 December 2014, unimpaired unsecured and business banking lending amounted to £2,266.9 million (2013: £2,375.2 million).

25. Credit risk (continued)

At 31 December 2014, impaired unsecured and business banking lending amounted to £30.9 million (2013: £36.0 million), net of an impairment allowance of £46.3 million (2013: £56.0 million). Non-mortgage retail lending is unsecured, with no collateral held in respect of retail credit cards, overdrafts or unsecured personal loans.

For business banking lending, collateral primarily consists of second charges over commercial and residential property. Where collateral is held, lending decisions are predominantly based on an obligor's ability to repay from normal business operations rather than reliance on any collateral provided. Collateral values are assessed at the time of loan origination and reassessed if there is observable evidence of distress of the borrower. At 31 December 2014, credit risk is mitigated by collateral held of £182.8 million (2013: £245.1 million).

(iv) Collateral repossessed

	2014 £ million	2013 £ million
Residential property	**15.6**	12.9
Total collateral repossessed	**15.6**	**12.9**

The Group does not take physical possession of properties or other assets held as collateral and uses external agents to realise the value as soon as practicable, generally at auction, to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations.

(v) Treatment of customers experiencing financial stress

The Group operates a number of schemes to assist borrowers who are experiencing financial stress. The material elements of these schemes through which the Group has granted a concession, whether temporarily or permanently, are set out on page 93.

26. Funding and liquidity risk

Definition and exposure

Liquidity risk is defined as the risk that the Group has insufficient financial resources to meet its financial obligations as they fall due, or can secure them only at excessive cost. Funding risk is defined as the risk that the Group does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient. Liquidity exposure represents the mismatch of potential outflows in any future period measured against expected inflows. Liquidity risk is managed, monitored and measured from both an internal and regulatory perspective.

Sources of funding

The Group's funding and liquidity position is underpinned by its significant customer deposit base. A substantial proportion of the retail deposit base is made up of customer current and savings accounts which, although repayable on demand, have historically in aggregate provided a stable source of funding. The Group therefore has minimal requirement for wholesale funding.

The Group's funding structure also helps to reduce the amount of liquidity that the Group is required to hold. In May 2014, the Group exited the LBG UK defined Liquidity Group and established a standalone liquid asset portfolio. At 31 December 2014, the Group's primary liquidity portfolio totalled £4,509.0 million of which £4,169.3 million was held on deposit with the Bank of England, and £339.7 million was held in a portfolio of UK gilts. Prior to this, all liquidity was held on deposit with LBG.

Risk appetite

The funding and liquidity risk appetite for the Group is set and approved annually by the Group's Board. Risk is reported against this appetite through various metrics to enable the Group to manage the funding and liquidity position. The risk appetite is established under a liquidity risk management framework that ensures that the Group has sufficient financial resources of appropriate quality for the Group's funding profile.

Measurement and monitoring

A series of measures are used across the Group to monitor both short term and long term liquidity. Liquidity is measured quantitatively and qualitatively on a daily basis and reported internally. Daily liquidity reporting is actively monitored and monthly reporting procedures are in place to update and inform senior management. All liquidity policies and procedures are subject to periodic independent internal oversight. The loan to deposit ratio is one of the risk appetite measures that is used to monitor the shape of the balance sheet.

Contractual maturities for financial liabilities form an important source of information for the management of liquidity risk. The table overleaf analyses the financial liabilities of the Group by relevant contractual maturity grouping on an undiscounted future cash flow basis based on the remaining period at the balance sheet date. Balances with no fixed maturity are included in the over five years category.

Managing financial risk (continued)

26. Funding and liquidity risk (continued)

At 31 December 2014	Up to 1 month £ million	1-3 months £ million	3-12 months £ million	1-5 years £ million	Over 5 years £ million	Total £ million
Customer deposits	**21,855.3**	**290.6**	**709.3**	**1,878.3**	**–**	**24,733.5**
Deposits from banks	**32.5**	**–**	**–**	**–**	**–**	**32.5**
Debt securities in issue	**–**	**–**	**–**	**–**	**10.0**	**10.0**
Subordinated liabilities	**–**	**–**	**22.1**	**88.6**	**418.2**	**528.9**
Items in course of transmission to banks	**144.6**	**–**	**–**	**–**	**–**	**144.6**
Gross settled derivatives – outflows	**3.5**	**14.9**	**56.7**	**153.7**	**96.2**	**325.0**
Gross settled derivatives – inflows	**(1.7)**	**(8.2)**	**(30.0)**	**(105.3)**	**(56.5)**	**(201.7)**
Total	**22,034.2**	**297.3**	**758.1**	**2,015.3**	**467.9**	**25,572.8**
At 31 December 2013						
Customer deposits	20,700.5	753.2	612.7	1,118.7	–	23,185.1
Deposits from banks	234.7	–	–	–	–	234.7
Debt securities in issue	–	–	–	–	1.4	1.4
Items in course of transmission to banks	63.6	–	–	–	–	63.6
Gross settled derivatives – outflows	5.2	12.0	41.3	217.5	6.7	282.7
Gross settled derivatives – inflows	(3.9)	(9.4)	(40.0)	(134.4)	(6.2)	(193.9)
Total	**21,000.1**	**755.8**	**614.0**	**1,201.8**	**1.9**	**23,573.6**

27. Capital resources

The Group seeks to maintain a strong capital base which meets both its regulatory requirements and supports the growth of the business, even under stressed conditions. The table below presents the Group's regulatory capital resources. From 1 January 2014 capital resources have been measured in accordance with CRD IV. Prior to this, they were measured under the Basel II framework.

	2014 £ million	2013 £ million
Shareholders' equity	**1,634.4**	1,306.7
Regulatory deductions	**(41.4)**	(110.6)
Common Equity Tier 1/Total Tier 1 capital	**1,593.0**	**1,196.1**
Tier 2 capital	**384.3**	–
Total capital resources	**1,977.3**	**1,196.1**

Total capital resources increased during 2014 primarily reflecting the issue of Tier 2 capital in the form of subordinated liabilities on 1 May 2014 (note 4), the issue of ordinary shares on 19 May 2014 (note 23) and retained profits in the year. Further information is available in the Risk report on page 95.

28. Market risk

Definition and exposure

Market risk is the risk of a reduction in earnings, value or reserves caused by changes in the prices of financial instruments. In addition, market risk can arise as a result of changes in customer behaviour, which may affect the maturity profiles of the Group's assets and liabilities. The Group's market risk consists almost entirely of exposure to changes in interest rates, including the margin between customer and market rates. This is the potential impact on earnings and value that could occur when, if rates fall, liabilities cannot be re-priced as quickly or by as much as assets; or when, if rates rise, assets cannot be re-priced as quickly or by as much as liabilities.

Management and measurement

Risk exposure is monitored monthly using, primarily, net interest income and earnings sensitivity. This methodology considers all re-pricing mismatches in the current balance sheet and calculates the change in net interest income that would result from a set of defined interest rate shocks. A limit structure exists to ensure that risks stemming from residual and temporary positions or from changes in assumptions about customer behaviour remain within the Group's risk appetite.

28. Market risk (continued)

A 12 month view of the sensitivity of net interest income is calculated on the basis of the Group's current balance sheet with re-pricing dates adjusted according to behavioural assumptions. At 31 December 2014, the projected change in 12 month net interest income in response to an immediate parallel shift in all relevant interest rates, market and administered, would be an increase of £0.7 million (2013: £0.7 million) from a 25bps increase in rates, and a decrease of £8.2 million (2013: £10.5 million) from a 25bps decrease. The measure, however, is relatively simplistic in that it assumes all interest rates move at the same time and by the same amount.

Derivative financial instruments

The Group holds derivative financial instruments in the normal course of its banking business for interest rate risk management and margin stabilisation purposes. Derivatives are held at fair value on the Group's balance sheet. The fair values and notional amounts of derivative instruments are presented in the following table:

	31 December 2014			31 December 2013		
	Contract/ notional amount £ million	Fair value of assets £ million	Fair value of liabilities £ million	Contract/ notional amount £ million	Fair value of assets £ million	Fair value of liabilities £ million
Interest rate swaps	**10,874.0**	**56.8**	**(42.8)**	13,491.0	99.4	(85.6)
Designated as fair value hedges	**5,246.8**	**66.3**	**(73.9)**	–	–	–
Total	**16,120.8**	**123.1**	**(116.7)**	**13,491.0**	**99.4**	**(85.6)**

From 1 January 2014, the Group has established fair value hedge accounting relationships for interest rate risk. The Group designates certain of its fixed rate customer loans, debt securities available-for-sale, bank accounts, savings accounts and subordinated debt in fair value hedge accounting relationships. Gains of £74.2 million (2013: £nil) were recognised on the derivatives in hedge accounting relationships. Losses of £74.6 million (2013: £nil) were recognised on the hedged items attributable to the hedged interest rate risk.

Derivative assets of £108.9 million (2013: £76.5 million) are expected to be recovered after more than one year. Derivative liabilities of £112.3 million (2013: £74.2 million) are expected to be settled after more than one year.

Offsetting financial assets and financial liabilities

The following information relates to financial assets and liabilities which have not been set off but for which the Group has enforceable master netting agreements in place with counterparties.

				Related amounts where set off in the balance sheet is not permitted		
31 December 2014	Gross amounts £ million	Amounts offset £ million	Net amounts reported on the balance sheet £ million	Related financial instrument amounts not offset £ million	Cash collateral received/ pledged £ million	Potential net amount £ million
Derivative financial assets	**123.1**	**–**	**123.1**	**(113.7)**	**–**	**9.4**
Total	**123.1**	**–**	**123.1**	**(113.7)**	**–**	**9.4**
Derivative financial liabilities	**(116.7)**	**–**	**(116.7)**	**113.7**	**3.0**	**–**
Total	**(116.7)**	**–**	**(116.7)**	**113.7**	**3.0**	**–**
31 December 2013						
Derivative financial assets	99.4	–	99.4	(85.6)	–	13.8
Total	**99.4**	**–**	**99.4**	**(85.6)**	**–**	**13.8**
Derivative financial liabilities	(85.6)	–	(85.6)	85.6	–	–
Total	**(85.6)**	**–**	**(85.6)**	**85.6**	**–**	**–**

Other important disclosures

Accounting policies relevant to this section

(l) Provisions and contingent liabilities
Provisions are recognised in respect of present obligations arising from past events where it is probable that outflows of resources will be required to settle the obligations and they can be reliably estimated.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

Contingent assets are possible assets that arise from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the Group's control. These are disclosed where an inflow of economic benefits is probable, and are recognised only when it is virtually certain that an inflow of economic benefits will arise.

(m) Property, plant and equipment
Property, plant and equipment are recognised at cost less accumulated depreciation. Cost includes the original purchase price of the assets and the costs attributable to bringing the asset into working condition for its intended use. The value of land (included in premises) is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between the cost and the residual value over their estimated useful lives, as follows:

Premises (excluding land):
– Freehold/long and short leasehold premises: shorter of 50 years or the remaining period of the lease.

– Leasehold improvements: shorter of ten years and, if lease renewal is not likely, the remaining period of the lease.

Equipment:
– Fixtures and furnishings: 0-10 years.

– Other equipment and motor vehicles: 2-8 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount it is written down immediately. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

(n) Operating leases
The leases entered into by the Group as lessee are primarily operating leases. Operating lease rentals payable are charged to the income statement on a straight-line basis over the period of the lease. When an operating lease is terminated before the end of the lease period, any payment made to the lessor by way of penalty is recognised as an expense in the period of termination.

29. Contingent liabilities

(i) The Financial Services Compensation Scheme
The FSCS is the UK's independent statutory compensation fund of last resort for customers of authorised financial services firms and pays compensation if a firm is unable or likely to be unable to pay claims against it. The FSCS is funded by levies on the authorised financial services industry. Each deposit-taking institution contributes towards the FSCS levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year, which runs from 1 April to 31 March.

Following the default of a number of deposit takers in 2008, the FSCS borrowed funds from HM Treasury to meet the compensation costs for customers of those firms. Although the substantial majority of this loan, which totalled approximately £15.8 billion at 31 December 2014, will be repaid from funds the FSCS receives from asset sales, surplus cash flow or other recoveries in relation to the assets of the firms that defaulted, any shortfall and interest cost will be funded by deposit-taking participants of the FSCS. In January 2015, the FSCS forecast that it expects to require to levy a capital shortfall of £1.1 billion on all deposit-taking participants to enable it to repay the balance of the HM Treasury loan. During 2014, the Group has paid, as required, its share of the 2013/14 interest and the 2014/15 capital elements of the levy and provided for its share of the 2014/15 interest element, payable September 2015. The amount of future compensation costs levies payable by the Group depends on a number of factors including participation in the market at 31 December, the level of protected deposits and the population of deposit-taking participants.

(ii) Legal and regulatory matters
During the ordinary course of business, the Group is subject to threatened and actual legal proceedings (which may include class action lawsuits brought on behalf of customers and other third parties), regulatory investigations, regulatory challenges and enforcement actions. All such material matters are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of the Group incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required to settle the obligation at the relevant balance sheet date. In some cases it will not be possible to form a view, either because the facts are unclear or because further time is needed to properly assess the merits of the case and no provisions are held against such matters. However the Group does not currently expect the final outcome of any such case to have a material adverse effect on its financial position, operations or cash flows.

30. Related party transactions

The Group's related parties include its parent, other LBG companies and key management personnel.

(i) Key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group which, from 1 January 2014 is the Board and Executive Committee of TSB Banking Group plc. The compensation paid or payable to key management personnel is shown in the table below.

	2014 £ 000	2013 £ 000
Salaries and other short term benefits	**6,900**	1,281
Post-employment benefits	**734**	123
Share-based payments	**1,257**	–
Total	**8,891**	**1,404**

Prior to 1 January 2014, key management personnel included only the Directors of TSB Bank plc. As most of these Directors were employed by other parts of LBG and not paid specifically in respect of their services provided to TSB Bank plc, the disclosure for 2013 reflects an apportionment of compensation for the relevant Directors to reflect services provided to TSB Bank plc.

Information in respect of Directors' remuneration is provided in the Directors' remuneration report on pages 56 to 78.

The tables below detail, on an aggregated basis, related party transactions, balances outstanding at the year end and related income and expense in respect of key management personnel.

	2014 £ 000	2013 £ 000
Loans		
At 1 January	**63**	63
Advanced during the year (includes key management personnel appointed during the year)	**244**	2
Interest charged during year	**4**	2
Repayments made during the year	**(64)**	(4)
At 31 December	**247**	**63**

The loans attracted interest at customer rates. No provisions have been recognised in respect of loans given to key management personnel (2013: £nil).

	2014 £ 000	2013 £ 000
Deposits		
At 1 January	**404**	127
Received during the year (includes key management personnel appointed during the year)	**2,192**	496
Interest expense on deposits (includes former key management personnel)	**5**	6
Repaid during the year	**(1,865)**	(225)
At 31 December	**736**	**404**

All deposits placed by key management personnel are at customer rates.

Other important disclosures (continued)

30. Related party transactions (continued)

(ii) Balances with Lloyds Banking Group companies

The Group enters into banking transactions with LBG companies in the normal course of its business. These include loans, deposits and investment related transactions and are carried out on commercial terms and at market rates. These are included in the Group's consolidated balance sheet as follows:

	2014 £ million	2013 £ million
Assets included within:		
Items in course of collection from banks	**2.4**	–
Loans and advances to banks	**134.5**	4,124.7
Derivative financial assets	**–**	99.4
Other assets	**43.1**	3.7
	180.0	**4,227.8**
Liabilities included within:		
Deposits from banks	**32.5**	234.7
Items in course of transmission to banks	**3.4**	–
Derivative financial liabilities	**0.9**	85.6
Debt securities in issue	**10.0**	1.4
Subordinated liabilities	**405.5**	–
Other liabilities	**17.2**	0.5
	469.5	**322.2**

Due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. In respect of transactions with LBG companies during 2014, the Group recognised net interest expense of £10.7 million (2013: net interest income £63.3 million), net fee and commission income of £15.6 million (2013: £21.6 million), income of £9.7 million in respect of derivative financial instruments (2013: expense of £35.9 million) and incurred expenses of £97.8 million under the TSA. In 2013, the Group incurred net recharges of £159.6 million from LBG companies in respect of various services provided between the Group and LBG companies.

On 1 May 2014, the Group exited the LBG UK Defined Liquidity Group and established a standalone liquid asset portfolio which at 31 December 2014 was held on deposit with the Bank of England. Prior to this all liquidity was held on deposit with LBG and was recognised in loans and advances to banks.

The Group and Lloyds Bank plc entered into the Tier 2 Subscription Agreement relating to the subscription by Lloyds Bank plc of Tier 2 securities that were issued for net proceeds of £383.0 million on 1 May 2014.

On 20 May 2014, the Group entered into the £2.5 billion RMBS Funding Facility arrangement with LBG and others (including Cape Funding No. 1 plc, established by the Group) to part fund the transfer of the economic benefit of a £3.4 billion portfolio of mortgage loans by LBG to the Group. Debt securities in issue of £10.0 million reflect the drawdown of funding from this securitisation programme. The balance at 31 December 2013 of £1.4 million reflects preference shares which were repurchased on 21 January 2014 from TSB Bank's then immediate parent company.

(iii) Transactions with Lloyds Banking Group companies

A number of transactions were undertaken with LBG companies to prepare the Group for its admission to the London Stock Exchange, to improve its medium term profitability and to formalise arrangements over the provision of IT and certain operational services which are explained as follows:

Corporate structuring and associated transactions

- Transferring colleagues to the Group – On 31 March 2014, TSB employees (now known as TSB Partners) were transferred to TSB from LBG under the terms of the Transfer of Undertakings (Protection of Employment) Regulations 2006. At this point, those who were members of LBG defined benefit pension schemes became deferred members of those schemes and the Group's defined benefit pension scheme deficit was derecognised. No settlement payment was required and consequently the Group recorded a one-off gain of £63.7 million reflecting the transfer of the defined benefit pension scheme deficit.

- Establishing a Group holding company – On 25 April 2014, TSB Banking Group plc became the holding company of the Group following a share for share exchange in which it acquired 100% of the issued share capital of TSB Bank plc from Lloyds Bank plc (note 23).

- Capitalising the Group for growth – On 1 May 2014, TSB Banking Group plc issued £385.0 million of Tier 2 dated subordinated debt and, on 19 May 2014, issued 445 million ordinary shares for proceeds of £200.0 million. Both issues of

30. Related party transactions (continued)

capital were wholly subscribed for by Lloyds Bank plc. On 13 October 2014, the Tier 2 dated subordinated debt was admitted to listing on the Official List of the UKLA and to trading on the London Stock Exchange's Regulated Market.

– Listing the Group – On 25 June 2014, TSB Banking Group plc achieved a premium listing on the London Stock Exchange, with a free-float of 38.5%. The free float increased to approximately 50% on 26 September 2014 following a further partial sell-down by LBG.

Formalising arrangements and agreements with LBG

– Transitional Services Agreement – From 1 January 2014, the Group transitioned from operating within the LBG shared service model. On 9 June 2014 TSB and LBG formally entered into the TSA and LTSA for the provision of IT services and certain operational activities.

– Mortgage Valuation Services – On 30 May 2014 the Group and LBG entered into an agreement for the provision of mortgage valuation and associated panel management services to the Group by Colleys.

– Separation Agreement – On 9 June 2014, the Group and LBG entered into the Separation Agreement. This governs (among other things) the allocation of certain pre-IPO liabilities, including liability for breach of law and regulation and of customer terms and conditions and also governs certain aspects of the relationship between the Group and LBG following IPO.

– Relationship Agreement and Tax Separation Deed – On 9 June 2014, the Group and LBG entered into the Relationship Agreement and Tax Separation Deed. The principal purpose of the Relationship Agreement is to ensure that the Group is capable at all times of carrying on its business independently of LBG and its associates. The Tax Separation Deed regulates certain aspects of the separation of the Group from any LBG tax groups.

– General Insurance Distribution Agreement – On 9 June 2014, the Group and Lloyds Bank Insurance Services Limited (LBIS) entered into the General Insurance Distribution Agreement. Pursuant to the General Insurance Distribution Agreement, the Group agreed to promote and sell to TSB Bank customers certain home insurance products that are underwritten by LBIS.

– Mortgage Intermediary Platform Build Agreement – On 9 June 2014, the Group and LBG entered into the Mortgage Intermediary Platform Build Agreement under which LBG agreed to complete the build of a mortgage intermediary platform for TSB. The build of this channel has now completed and it commenced trading in January 2015.

Enhancing the Group's medium term profitability

– Services Arrangements with LBG – On 1 January 2014, the Group transitioned from operating within the LBG shared service model to a standalone business cost structure. IT services and certain operational activities are however still being provided by LBG under a TSA. The TSA runs until the end of 2016 when it will be replaced by the LTSA which is expected to increase the Group's cost base by over £100 million p.a. from 2017.

– Mortgage Enhancement – With effect from 28 February 2014, in response to a review by the Office of Fair Trading of the effect on competition of the divestment of TSB from LBG, the economic benefit of a £3.4 billion portfolio of mortgage loans was assigned to the Group by LBG. This was designed to enhance the Group's PBT by a cumulative £230 million and, during 2014, increased PBT by £71.7 million. This portfolio is subject to a call option exercisable by LBG, after the £230 million profit target has been achieved.

(iv) UK Government

In January 2009, the UK government through HM Treasury became a related party of LBG following its subscription for ordinary shares issued under a placing and open offer. As at 31 December 2014, HM Treasury held a 24.8% interest in LBG's ordinary share capital and consequently HM Treasury remained a related party of the Group. During the year ended 31 December 2014; this percentage holding reduced from 32.7% at 31 December 2013 following the UK government's sale of 5,555 million shares on 31 March 2014 and 46 million shares in December 2014.

In accordance with IAS 24 *Related Party Disclosures*, UK government-controlled entities are related parties of the Group. The Group regards the Bank of England and entities controlled by the UK government, including The Royal Bank of Scotland Group plc, Northern Rock (Asset Management) plc and Bradford & Bingley plc, as related parties.

In the ordinary course of business, the Group may from time to time access market-wide facilities provided by central banks. There were no significant transactions with other UK Government-controlled entities (including UK Government-controlled banks) during the year that were not made in the ordinary course of business or that were unusual in nature or condition.

(v) Indemnity for customer remediation costs

The Group has been indemnified by its intermediate parent company, Lloyds Bank plc, in respect of redress costs arising from past misconduct. At 31 December 2014 the Group recognised a recoverable under the indemnity of £22.2 million (2013: £3.7 million) as set out in note 32.

Other important disclosures (continued)

31. Property, plant and equipment

	Premises £ million	Equipment £ million	Total £ million
Cost			
At 1 January 2013	84.0	66.3	150.3
Additions	50.1	27.7	77.8
Write offs	–	(21.3)	(21.3)
At 31 December 2013	**134.1**	**72.7**	**206.8**
Additions	32.6	11.2	43.8
At 31 December 2014	**166.7**	**83.9**	**250.6**
Accumulated depreciation			
At 1 January 2013	36.8	54.9	91.7
Depreciation charge for the year (note 16)	8.9	4.9	13.8
Write offs	–	(21.3)	(21.3)
At 31 December 2013	**45.7**	**38.5**	**84.2**
Depreciation charge for the year (note 16)	10.5	6.7	17.2
At 31 December 2014	**56.2**	**45.2**	**101.4**
Carrying amount			
At 31 December 2014	**110.5**	**38.7**	**149.2**
At 31 December 2013	**88.4**	**34.2**	**122.6**

At 31 December 2014, capital expenditure that was authorised and contracted for but not provided and incurred, was £1.9 million (2013: £nil).

Operating lease commitments

Where the Group is the lessee, the future minimum lease payments under non-cancellable premises operating leases are as follows:

	2014 £ million	2013 £ million
Not later than 1 year	**29.5**	28.9
Later than 1 year and no later than 5 years	**97.6**	92.7
Later than 5 years	**72.5**	77.8
Total operating lease commitments	**199.6**	**199.4**

Operating lease payments represent rental payable by the Group for certain of its properties. Some of these operating lease arrangements have renewal options and rent escalation clauses, although the effect of these is not material. No arrangements have been entered into for contingent rental payments.

32. Other assets

	2014 £ million	2013 £ million
Other assets and prepayments	**67.6**	50.5
Collateral placed with central clearing houses	**53.6**	–
Amounts recoverable under customer remediation indemnity (note 33)	**22.2**	3.7
Total other assets	**143.4**	**54.2**

Included in other assets above are amounts due to LBG companies of £43.1 million (2013: £3.7 million).

33. Other liabilities

	2014 £ million	2013 £ million
Accruals and deferred income	**116.4**	36.1
Other creditors	**49.5**	54.3
Customer remediation provision	**22.2**	3.7
Collateral deposited by central clearing houses	**8.9**	–
Current tax liabilities	**5.8**	3.6
Total other liabilities	**202.8**	**97.7**

Included in other creditors above are amounts due to LBG companies of £17.2 million (2013: £0.5 million).

Significant judgements and estimates – customer remediation provisions
The Group is protected from losses arising from historic misconduct under an indemnity provided by Lloyds Bank plc. However, technically the Group retains the primary liability for the Group's alleged misconduct to certain customers and accordingly a provision for customer remediation of £22.2 million (2013: £3.7 million) has been recognised. The Group has recognised an equivalent recoverable under the indemnities provided by Lloyds Bank plc (note 32). The size of the liability follows an assessment of emerging themes in customer complaints, an assessment of broader industry commentary including the alleged mis-selling of payment protection insurance, added value current accounts, credit card protection and interest rate hedging products, and discussions with regulators. The ultimate cost and timing of payments are uncertain as a result of the inherent difficulties in estimating factors such as future levels of customer complaints and remediation settlements. The provision represents management's current best estimate.

34. Notes to the cash flow statement

The following table presents further analysis of balances in the cash flow statement:

	2014 £ million	2013 £ million
Change in loans and advances to banks	**4,084.0**	3,558.6
Change in loans and advances to customers	**1,726.4**	879.2
Change in derivative assets	**(23.7)**	–
Change in other operating assets	**(89.1)**	(29.2)
Change in operating assets	**5,697.6**	**4,408.6**
Change in deposits from banks	**(105.8)**	(7,931.0)
Change in customer deposits	**1,540.3**	394.3
Change in derivative liabilities	**31.1**	–
Change in other operating liabilities	**102.9**	45.8
Change in operating liabilities	**1,568.5**	**(7,490.9)**
Depreciation and amortisation	**17.2**	13.8
Allowance for loan losses	**97.6**	80.3
Other non-cash items	**(73.7)**	119.4
Non-cash and other items	**41.1**	**213.5**
Analysis of cash and cash equivalents as shown in the balance sheet		
Cash and balances with central banks	**4,396.3**	200.2
Less: mandatory reserve deposits*	**(47.0)**	(25.8)
	4,349.3	**174.4**
Loans and advances to banks with maturity less than three months	**134.5**	–
Total cash and cash equivalents	**4,483.8**	**174.4**

* Mandatory reserve deposits are held with local central banks in accordance with statutory requirements; these deposits are not available to finance the Group's day-to-day operations.

Other important disclosures (continued)

35. Restatement of prior year information

The comparative figures have been restated to reflect the insertion of the new parent company (see note 23) and to reflect a change to the Group's accounting policies.

From 1 January 2014 the Group changed its accounting policy for recognising the costs of the UK's FSCS levy to reflect guidance provided in IFRIC 21 *Levies*, an interpretation of IAS 37 *Provisions, contingent liabilities and contingent assets*. IFRIC 21 clarifies that the obligating event that gives rise to a liability to pay the FSCS levy is the activity that triggers the payment of the levy, which for the FSCS levy, is being a deposit gathering financial institution at the start of the levy year each April, and an entity does not have a constructive obligation to pay a levy that will be triggered by operating in a future period. Prior to 1 January 2014, the Group's policy was to recognise a liability on the basis of a constructive obligation at 31 December in the previous year.

The following tables summarise the restatements:

Consolidated statement of comprehensive income

Year ended 31 December 2013	2013 £ million	Change to accounting policy £ million	Restated £ million
Interest and similar income	697.0	–	697.0
Interest and similar expense	(233.2)	–	(233.2)
Net interest income	**463.8**	**–**	**463.8**
Fee and commission income	159.2	–	159.2
Fee and commission expense	(49.3)	–	(49.3)
Net fee and commission income	**109.9**	**–**	**109.9**
Other operating income	(32.4)	–	(32.4)
Other income	**77.5**	**–**	**77.5**
Total income	**541.3**	**–**	**541.3**
Operating expenses	(386.5)	10.3	(376.2)
Trading surplus	**154.8**	**10.3**	**165.1**
Impairment	(80.3)	–	(80.3)
Profit before taxation	**74.5**	**10.3**	**84.8**
Taxation	102.6	(2.4)	100.2
Profit for the period	**177.1**	**7.9**	**185.0**

35. Restatement of prior year information (continued)

Consolidated balance sheet at 31 December 2013

	At 31 Dec 2013 £ million	Change to accounting policy £ million	Insertion of new parent £ million	Restated £ million
Assets				
Cash and balances at central banks	200.2	–	–	200.2
Items in course of collection from banks	116.2	–	–	116.2
Loans and receivables				
Loans and advances to banks	4,124.7	–	–	4,124.7
Loans and advances to customers	20,099.1	–	–	20,099.1
	24,223.8	**–**	**–**	**24,223.8**
Derivative financial assets	99.4	–	–	99.4
Property, plant and equipment	122.6	–	–	122.6
Deferred tax assets	138.0	–	–	138.0
Other assets	54.2	–	–	54.2
Total assets	**24,954.4**	**–**	**–**	**24,954.4**
Liabilities				
Deposits from banks	234.7	–	–	234.7
Customer deposits	23,100.4	–	–	23,100.4
Items in course of transmission to banks	63.6	–	–	63.6
Derivative financial liabilities	85.6	–	–	85.6
Debt securities in issue	1.4	–	–	1.4
Other liabilities	109.2	(15.1)	–	94.1
Retirement benefit obligations	64.3	–	–	64.3
Current tax liabilities	–	3.6	–	3.6
Total liabilities	**23,659.2**	**(11.5)**	**–**	**23,647.7**
Equity				
Share capital	75.0	–	(74.9)	0.1
Capital reserve	410.0	–	–	410.0
Capital reorganisation reserve	–	–	74.9	74.9
Retained profits	810.2	11.5	–	821.7
Shareholders' equity	**1,295.2**	**11.5**	**–**	**1,306.7**
Total equity and liabilities	**24,954.4**	**–**	**–**	**24,954.4**

Other important disclosures (continued)

35. Restatement of prior year information (continued)

Consolidated balance sheet at 1 January 2013

	At 1 Jan 2013 £ million	Change to accounting policy £ million	Insertion of new parent £ million	Restated £ million
Assets				
Cash and balances at central banks	50.6	–	–	50.6
Items in course of collection from banks	32.5	–	–	32.5
Loans and receivables				
Loans and advances to banks	7,946.6	–	–	7,946.6
Loans and advances to customers	6,640.4	–	–	6,640.4
	14,587.0	**–**	**–**	**14,587.0**
Property, plant and equipment	58.6	–	–	58.6
Deferred tax assets	21.8	–	–	21.8
Other assets	25.1	–	–	25.1
Total assets	**14,775.6**	**–**	**–**	**14,775.6**
Liabilities				
Deposits from banks	8,191.4	–	–	8,191.4
Customer deposits	5,688.8	–	–	5,688.8
Items in course of transmission to banks	15.4	–	–	15.4
Debt securities in issue	1.4	–	–	1.4
Other liabilities	53.1	(4.8)	–	48.3
Retirement benefit obligations	63.3	–	–	63.3
Current tax liabilities	53.3	1.2	–	54.5
Total liabilities	**14,066.7**	**(3.6)**	**–**	**14,063.1**
Equity				
Share capital	75.0	–	(74.9)	0.1
Capital reorganisation reserve	–	–	74.9	74.9
Retained profits	633.9	3.6	–	637.5
Shareholders' equity	**708.9**	**3.6**	**–**	**712.5**
Total equity and liabilities	**14,775.6**	**–**	**–**	**14,775.6**

36. Future accounting developments

The following pronouncements may impact the Group's consolidated financial statements but are not applicable for the year ended 31 December 2014 and have not been applied in preparing these consolidated financial statements. The full impact of these accounting changes is being assessed by the Group.

Pronouncement	Nature of Change	IASB effective date
IFRS 9 ***Financial Instruments****	Replaces IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 requires financial assets to be classified into three measurement categories: fair value; amortised cost; and fair value through other comprehensive income, on the basis of the objective of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instruments. The requirements for derecognition are unchanged from IAS 39. The standard also retains most of the IAS 39 requirements for financial liabilities except for those designated at fair value through profit or loss whereby that part of the fair value change attributable to an entity's own credit risk is recorded in other comprehensive income. Changes are also made to the impairment of financial assets measured at amortised cost, which will be based on expected rather than incurred credit losses. The hedge accounting requirements are more closely aligned with risk management practices and follow a more principle-based approach. The impact of IFRS 9 on the Group is still being assessed.	Annual periods beginning on or after 1 January 2018
IFRS 15 ***Revenue from Contracts with Customers****	Replaces IAS 18 *Revenue* and other existing revenue recognition interpretations and requires revenue to be recognised when goods or services are transferred to customers and at an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. The standard does not apply to financial instruments or lease contracts. The impact of IFRS 15 is still being assessed.	Annual periods beginning on or after 1 January 2017

* As at 24 February 2015, this pronouncement is awaiting EU endorsement.

37. Approval of the consolidated financial statements

These consolidated financial statements were approved by the Directors of TSB Banking Group plc on 24 February 2015.

The ultimate controlling party of the Group is Lloyds Banking Group plc which is incorporated in Scotland. Copies of the consolidated annual report and accounts of Lloyds Banking Group plc may be obtained from Lloyds Banking Group's head office at 25 Gresham Street, London EC2V 7HN or downloaded via www.lloydsbankinggroup.com.

Report of the independent auditors on the consolidated financial statements

Independent auditors' report to the members of TSB Banking Group plc

Our opinion
In our opinion, TSB Banking Group plc's consolidated financial statements (the "financial statements"):

- give a true and fair view of the state of the Group's affairs as at 31 December 2014 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

What we have audited
TSB Banking Group plc's financial statements comprise the:

- consolidated balance sheet as at 31 December 2014;
- consolidated statement of comprehensive income for the year then ended;
- consolidated statement of changes in equity for the year then ended;
- consolidated cash flow statement for the year then ended; and
- notes to the consolidated financial statements, which include a summary of significant accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report and Accounts (the "Annual Report"), rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and IFRSs as adopted by the EU.

Our audit approach

Overview	
Materiality	– Overall Group materiality: £11.8 million which represents 1% of total revenue.
Audit scope	– We performed an audit of the complete financial information of the Group. – As the Group outsources many of its IT systems to service providers, we obtained reports from their auditors about their control environments. We determined, in light of those reports, the extent and nature of the detailed testing that we needed to perform at TSB.
Areas of focus	– Credit risk and impairment provisioning. – Revenue recognition – Effective Interest Rate ("EIR") accounting. – Financial reporting impact of separation from Lloyds Banking Group plc. – Conduct risk provisions. – Hedge accounting.

The scope of our audit and our areas of focus
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK and Ireland)").

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. In particular, we looked at where the Directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

The risks of material misstatement that had the greatest effect on our audit, including the allocation of our resources and effort, are identified as "areas of focus" in the table below. We have also set out how we tailored our audit to address these specific areas in order to provide an opinion on the financial statements as a whole, and any comments we make on the results of our procedures should be read in this context. This is not a complete list of all risks identified by our audit.

Area of focus	How our audit addressed the area of focus
Credit risk and impairment provisioning	
See page 109 of the financial statements for the Directors' disclosure of the related accounting policies and also page 51 for the Audit Committee's consideration of principal risks. We focused on this area because the Directors make complex and subjective judgements over both timing of recognition of provisions for impairment of its loans and advances and the estimate of the size of any such impairment. The impairment provision of £86.1 million was calculated on a modelled basis for portfolios of loans and advances. This includes post model adjustments. The Group applies judgement in selecting appropriate assumptions in calculating the impairment provisions. These include the expectation of loss once a customer has defaulted and the expectation of the numbers of customers who are impaired but have not shown signs of their impairment. The Group also applies Post Model Adjustments ("PMAs") to the outputs of the models in calculating the total provision recognised, these are judgemental in nature and reflect emerging trends or issues not captured in the models.	We assessed and tested the design and operating effectiveness of the controls over the data inputs and governance of the models that calculate the provisions. Following our testing of the controls, we did not amend the nature and extent of our planned audit testing. Our detailed work in auditing the impairment provisions included: – testing key assumptions used within the models to internal and external information; – comparing the principal assumptions within the models with our knowledge of other banks and historical experience within TSB; – checking that the calculation methodology within each of the models was in line with accepted practice and accounting standards; – reading the model calculation scripts to check that their application was consistent with our understanding of the model methodologies; – examining the basis for the further adjustments made to the results produced by those models, exercising scepticism of the motivation behind the adjustments; and – we also challenged the Group on the completeness of their modelling approach from our industry knowledge of model methodologies and common areas of model adjustment. We found the Group's year end impairment provision to be consistent with the requirements of accounting standards.
Revenue recognition – Effective Interest Rate ("EIR") accounting	
See page 114 of the financial statements for the Directors' disclosure of the related accounting policies and also page 51 for the Audit Committee's consideration of principal risks. We focused our work in relation to revenue recognition on EIR accounting due to the inherent subjectivity involved in determining the appropriate period across which to spread the revenue and the resultant adjustment that is reflected in the current year's revenue and the potential that this may have a material impact in any one accounting period. The most significant balance of the net EIR asset of £17.5 million related to Savings products of £16.6 million. The most significant factor that drives customer behaviour in terms of moving their savings from one product to another, and hence, affects the unwind of the EIR balance is changes in interest rates. Forecasting future interest rate movements and estimating the EIR adjustment is, inherently a matter of judgement and hence, there is a risk of material misstatement.	We tested the design and operating effectiveness of the controls over the transfer of data from the source banking systems to the general ledger. This provided us comfort that interest and fees were correctly accounted for in the general ledger accounts. Our testing of the controls did not identify any weaknesses that would cause us to change our audit approach. We then traced the amounts of the EIR adjustments recognised in the year from the calculation spreadsheets to the general ledger. Where the net EIR asset was material (e.g. for Savings products), we used our industry expertise and knowledge to independently recompute the expected EIR adjustment, using our own independently formed assumptions about future interest rate movements and compared this with the Group's adjustment. Where management had applied judgement in determining future customer behaviour, we assessed the consistency of their adjustment with other internal and market information. Our testing did not find any material matters that we considered necessary to report to the Audit Committee.

Report of the independent auditors on the consolidated financial statements (continued)

Area of focus	How our audit addressed the area of focus
Financial reporting impact of separation from Lloyds Banking Group ("LBG")	
See page 116 of the financial statements for the Directors' disclosure of the related accounting policies for further information. We focused on this area because of the complexity and unusual nature of transactions which require accounting judgement that have been brought about by the separation from LBG. Our specific areas of attention related to the: – defined benefit pension scheme gain; and – deferred tax asset ("DTA") and unwind of this due to the Part VII mortgage transfers. The defined benefit pension scheme gain recognised in the income statement of £63.7 million was material and the interpretation of the accounting standards in treating the transaction was complex. It arose because, during the year, TSB staff exited legacy LBG defined benefit pension schemes and became members of the TSB defined contribution scheme. The initial DTA recognised of £121.6 million was material and the selection of a suitable unwind period required judgement. Furthermore the asset valuation was supported by forward looking profitability projections, which are inherently subjective.	For the pension gain, we assessed the accounting for this transaction to ensure it was compliant with accounting standards. In our assessment we gave consideration to whether this transaction could be accounted for as a contribution to capital. We agreed that the transaction is appropriately accounted as a gain through the income statement and that this is compliant with accounting standards. With respect to the DTA, we assessed the appropriateness of the valuation and eight year unwind period applied with reference to correspondence from HMRC and the output of independent valuations, obtained by the Group, over the fair value of the transferred portfolio. We were satisfied with the methodology applied in arriving at the valuation. We challenged the Group's medium term forecast profitability assumptions used to support the DTA valuation and tested for evidence of bias and developments in the economic environment and business since the plan was approved. To do this, we considered the key assumptions underpinning the forecast, being loans and customer deposits growth. We also considered the future growth assumptions in the context of economic forecasts available. We then applied reasonable sensitivities to these key assumptions within the medium term plan to determine how much they would need to change before an impairment of the DTA was caused. Based on our sensitivity analysis, we determined that the likelihood of an impairment driven by errors in the estimates was low.
Conduct risk provisions	
See page 132 of the financial statements for the Directors' disclosure of the related accounting policies and also page 51 for the Audit Committee's consideration of principal risks. Conduct risk is a significant point of focus across the banking industry and the calculation of the related provisions is an inherently subjective area. Judgement is required both in identifying areas of mis-selling and then in estimating a provision in respect of the customers who may be affected by the issue. Although the Group has arrangements in place with LBG in regards to legacy conduct claims, the agreement is complex and requires a detailed analysis of the nature of the issue, customers and when the mis-selling took place before any claims can be made by TSB to LBG. The Group identified material areas relating to the historic sales of Added Value Accounts, Payment Protection Insurance, Interest Rate Hedging Products and Credit Card Protection products and recognised a provision of £22.2 million.	We assessed conduct risk in light of our industry experience and knowledge of certain areas of known mis-selling. We tested the approach used in calculating the conduct risk provisions to make sure it was supported by accounting standards and market practice. We read the relevant clauses in the agreement in place between LBG and the Group in respect of the settlement and responsibility for legacy conduct claims. We assessed the assumptions used in calculating the estimated provisions relating to conduct risk of £22.2 million, which included the likely future levels of claims, the rate at which claims were being approved and the average value of settlements and redress. We requested and read underlying customer data to test the assumptions and also considered the rate at which claims were being made. We found the Group's provision in respect of conduct risk to be calculated consistently with their stated approach and supported by underlying data. We challenged the Group on common areas of mis-selling affecting UK banks and did not identify any that were not already considered by management that would have a material impact.

Area of focus	How our audit addressed the area of focus
Hedge accounting	
See page 125 of the financial statements for the Directors' disclosure of the related accounting policies. In order to reduce the income statement volatility associated with the valuation of derivatives used for hedging interest rate risk, the Group designated a number of hedge relationships from 1 January 2014 notably hedging interest rate risk within the fixed rate product and Treasury portfolios. Compliance with IAS 39 requires a number of factors to be considered, including the demonstration of retrospective and prospective hedge effectiveness. Complying with the detailed requirements of the standard is complex, especially with regard to the models used to calculate historic hedge effectiveness. If compliance with the accounting standards cannot be demonstrated there would be a material impact to the financial statements.	We read the hedge documentation in the context of the requirements of IAS 39 and our knowledge of hedge accounting within the banking industry and considered it to be compliant with the requirements of IFRS and hence, to support the relationships designated as hedges. We tested each type of hedge relationship and selected a sample of models that are used by the Group to support hedge effectiveness. From this sample we: – Traced the inputs of the hedge effectiveness models to supporting documentation or to source systems around which we had satisfactorily tested the controls; – Understood the basis of the hedge effectiveness calculation being performed by the model; and – Independently re-performed the hedge effectiveness calculation, including consideration of the model's valuation of the hedged items and derivatives. For relationships where hedge ineffectiveness had been identified by the Group, we checked that this had been recognised in the income statement in line with the requirements of IAS 39. Our testing did not find any material matters which we considered necessary to report to the Audit Committee.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the different operating locations of the Group, the accounting processes and controls, the impact of material outsourced service providers, and the industry in which the Group operates.

As part of our risk assessment we assessed the control environment in place at the Group's material outsourced service providers to the extent relevant for our audit. The Group relies on these providers for key IT systems and controls. Our assessment involved obtaining and reading the relevant controls reports, issued by the auditors of the providers, in accordance with generally accepted assurance standards for such work, to gain an understanding of the service providers' control environments and to consider the operating and accounting structure at the entities. Following this assessment we applied professional judgement to determine the extent of testing required over each balance in the financial statements.

The Group is structured into two segments: Franchise and Mortgage Enhancement.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall Group materiality	£11.8 million.
How we determined it	1% of total revenue.
Rationale for benchmark applied	We have applied this benchmark as revenue growth is a key performance measure against which the Group is assessed and is currently more appropriate than profit before taxation.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £590,000 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Report of the independent auditors on the consolidated financial statements (continued)

Going concern
Under the Listing Rules we are required to review the Directors' statement, set out on page 82, in relation to going concern. We have nothing to report having performed our review.

As noted in the Directors' statement, the Directors have concluded that it is appropriate to prepare the financial statements using the going concern basis of accounting. The going concern basis presumes that the Group has adequate resources to remain in operation, and that the Directors intend it to do so, for at least one year from the date the financial statements were signed. In drawing this conclusion, the Directors have considered the regulatory capital position of the Group as well as the funding and liquidity position of the Group.

As part of our audit we have concluded that the Directors' use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's ability to continue as a going concern.

Other required reporting

Consistency of other information

Companies Act 2006 opinions
In our opinion:

– the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
– the information given in the Corporate governance statement as set out on pages 42 to 47 with respect to internal control and risk management systems and about share capital structures is consistent with the financial statements.

ISAs (UK and Ireland) reporting
Under ISAs (UK and Ireland) we are required to report to you if, in our opinion:

Information in the Annual Report is: – materially inconsistent with the information in the audited financial statements; or – apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or – otherwise misleading.	We have no exceptions to report arising from this responsibility.
The statement given by the Directors on page 83, in accordance with provision C.1.1 of the UK Corporate Governance Code ("the Code"), that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's performance, business model and strategy is materially inconsistent with our knowledge of the Group acquired in the course of performing our audit.	We have no exceptions to report arising from this responsibility.
The section of the Annual Report on page 51, as required by provision C.3.8 of the Code, describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.	We have no exceptions to report arising from this responsibility.

Adequacy of information and explanations received
Under the Companies Act 2006 we are required to report to you if, in our opinion, we have not received all the information and explanations we require for our audit. We have no exceptions to report arising from this responsibility.

Directors' remuneration
Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of Directors' remuneration specified by law are not made. We have no exceptions to report arising from these responsibilities.

Corporate governance statement
Under the Companies Act 2006 we are required to report to you if, in our opinion, a corporate governance statement has not been prepared by the parent company. We have no exceptions to report arising from this responsibility.

Under the Listing Rules we are required to review the part of the Corporate governance statement relating to the parent company's compliance with ten provisions of the UK Corporate Governance Code. We have nothing to report having performed our review.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the Directors

As explained more fully in the Statement of Directors' responsibilities, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What an audit of financial statements involves

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the Directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Other matters

We have reported separately on the parent company financial statements of TSB Banking Group plc for the year ended 31 December 2014 and on the information in the Directors' remuneration report that is described as having been audited.

Allan McGrath (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
24 February 2015

Parent company balance sheet
as at 31 December 2014

	Note	2014 £ million	2013 £ million
Assets			
Non-current assets			
Investment in subsidiaries	4	**1,588.4**	–
Loans to subsidiaries	4	**386.7**	–
Total	4	**1,975.1**	–
Current assets			
Amounts due from subsidiaries		**0.1**	–
Total assets		**1,975.2**	**–**
Liabilities			
Non-current liabilities			
Subordinated liabilities	2	**386.7**	–
Current liabilities			
Amounts due to subsidiaries		**1.7**	–
Total liabilities		**388.4**	**–**
Equity			
Share capital	3	**5.0**	–
Share premium	3	**965.1**	–
Merger reserve	3	**616.5**	–
Retained profits		**0.2**	–
Shareholders' equity		**1,586.8**	**–**
Total equity and liabilities		**1,975.2**	**–**

The accompanying notes are an integral part of the financial statements.

The parent company financial statements on pages 148 to 152 were approved by the Board of Directors on 24 February 2015 and signed on its behalf by:

Paul Pester
Chief Executive Officer

Darren Pope
Chief Financial Officer

Parent company statement of changes in equity

for the period ended 31 December 2014

	Share capital £ million	Share premium £ million	Merger reserve £ million	Retained profits £ million	Total £ million
Share capital issued on 31 January 2014	0.1	–	–	–	0.1
Comprehensive income					
Total comprehensive loss for the period	–	–	–	(0.5)	(0.5)
Transactions with owners					
Share for share exchange	0.5	769.5	616.5	–	1,386.5
Issue of new shares	4.4	195.6	–	–	200.0
Movement in shares held by trusts	–	–	–	(1.2)	(1.2)
Value of Partner services	–	–	–	1.9	1.9
Total transactions with owners	**4.9**	**965.1**	**616.5**	**0.7**	**1,587.2**
Balance at 31 December 2014	**5.0**	**965.1**	**616.5**	**0.2**	**1,586.8**

Total comprehensive loss for the period comprises only the loss for the period. No statement of comprehensive income has been shown for the parent company, as permitted by section 408 of the Companies Act 2006.

Parent company cash flow statement

for the period ended 31 December 2014

	2014 £ million	2013 £ million
Profit before taxation	**(0.6)**	–
Adjustments for		
Change in operating liabilities	**1.7**	–
Net cash provided by operating activities	**1.1**	**–**
Cash flows from investing activities		
Investment in subsidiary share capital	**(200.0)**	–
Purchase of financial assets	**(383.0)**	–
Interest received on financial assets	**11.0**	–
Purchase of shares held by trusts	**(1.2)**	–
Net cash provided by investing activities	**573.2**	**–**
Cash flows from financing activities		
Proceeds from subordinated liabilities issued	**383.0**	–
Interest paid on subordinated liabilities	**(11.0)**	–
Proceeds from share issue	**200.1**	–
Net cash provided by financing activities	**572.1**	**–**
Change in cash and cash equivalents	**–**	–
Cash and cash equivalents at beginning of year	**–**	–
Cash and cash equivalents at end of year	**–**	**–**

The accompanying notes are an integral part of the financial statements.

Notes to the parent company financial statements

for the period ended 31 December 2014

1. Basis of preparation

On 31 January 2014, TSB Banking Group plc (the Company) was incorporated and on 25 April 2014, became the new holding company of the TSB Group. The financial statements are the first to be reported by the Company and are prepared on a going concern basis and in accordance with IFRS as adopted by the European Union EU. IFRS comprises accounting standards prefixed IFRS issued by the IASB and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the IFRIC and its predecessor body. The Company's financial statements are presented in accordance with the Companies Act 2006. The Company is domiciled and incorporated in the UK and registered in England and Wales. The financial statements are prepared on the historical cost basis.

The accounting policies that are applicable to the Company are included in the Group accounting policies and the following policy is also applicable.

Investment in subsidiaries

Subsidiaries are all entities, including special purpose entities, over which the Company has the power to govern the financial and operating policies. Investments in subsidiaries are initially recognised at cost and subsequently held at cost less any impairment charge. An impairment charge is recognised when the carrying amount of the investment exceeds its recoverable amount.

2. Subordinated liabilities

	2014 £ million	2013 £ million
Fixed/floating rate reset callable subordinated Tier 2 notes due May 2026	**383.2**	–
Accrued interest	**3.5**	–
	386.7	–

On 1 May 2014, TSB Banking Group plc issued £385.0 million of fixed/floating rate reset callable subordinated Tier 2 notes at an issue price of 99.493% of the principal amount to Lloyds Bank plc. The notes pay interest at a rate of 5.75% per annum, payable semi-annually in arrears until 6 May 2021 at which time the interest rate becomes three month LIBOR plus 3.43% per annum payable quarterly in arrears. The Company has the option to redeem these notes on 6 May 2021 and quarterly thereafter, subject to approval of the Prudential Regulatory Authority. At 31 December 2014, the entire issue of notes was issued to LBG.

3. Share capital, share premium and merger reserve

Details of the Company's share capital, share premium and merger reserve are set out in note 23 to the consolidated financial statements.

4. Related party transactions

The Company enters into transactions with related parties in the normal course of its business. The tables below detail, on an aggregated basis, related party transactions, balances outstanding at the year-end and related income.

(i) Key management personnel

The key management personnel of the Group and the Company are the same. The relevant disclosures are set out in note 30 to the consolidated financial statements. The Company has no employees.

(ii) Investment in subsidiaries

	2014 £ million
At 1 January	–
Acquisition of TSB Bank plc via share for share exchange	**1,386.5**
Subscription for new shares in TSB Bank plc	**200.0**
Value of Partner services	**1.9**
At 31 December	**1,588.4**

Details of the share for share exchange and subscription for new shares in TSB Bank plc are set out in note 23 to the consolidated financial statements. The principal subsidiary of the Company is TSB Bank plc.

(iii) Loans to subsidiaries

	2014 £ million
At 1 January	–
New issues	**386.7**
At 31 December	**386.7**

On 1 May 2014, the Company subscribed for fixed/floating rate reset callable subordinated Tier 2 notes due May 2026 issued by its principal subsidiary, TSB Bank plc.

Notes to the parent company financial statements
for the period ended 31 December 2014

4. Related party transactions (continued)

(iv) Other related party transactions
Details of other related party transactions are given in note 30 to the consolidated financial statements.

5. Financial instruments

(i) Measurement basis of financial instruments
The following table analyses the carrying amounts of the Company's financial instruments:

At 31 December 2014	Fair value £ million	Loans and receivables £ million	Held at amortised cost £ million	Total £ million
Financial assets				
Loans to subsidiaries	–	386.7	–	386.7
Total financial assets	–	386.7	–	386.7
Financial liabilities				
Subordinated liabilities	–	–	386.7	386.7
Total financial liabilities	–	–	386.7	386.7

(ii) Fair value of financial assets and liabilities

	2014	
	Carrying value £ million	Fair value £ million
Financial assets		
Loans to subsidiaries	386.7	404.9
Financial liabilities		
Subordinated liabilities	386.7	404.9

The valuation techniques for the Company's financial assets and liabilities are set out in notes 6 and 12 to the consolidated financial statements.

(iii) Valuation hierarchy of financial assets and liabilities carried at amortised cost
The table below analyses the fair values of the financial assets and liabilities of the Company which are carried at amortised cost.

At 31 December 2014	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total fair value £ million	Total carrying value £ million
Financial assets					
Loans to subsidiaries	–	404.9	–	404.9	386.7
Financial liabilities					
Subordinated liabilities	–	404.9	–	404.9	386.7

(iv) Credit risk
The Company's credit risk arises solely from amounts due from its wholly owned subsidiary, TSB Bank plc.

(v) Liquidity risk
The table below analyses the financial liabilities of the Company by relevant contractual maturity grouping on an undiscounted future cash flow basis based on the remaining period at the balance sheet date.

At 31 December 2014	Up to 1 month £ million	1-3 months £ million	3-12 months £ million	1-5 years £ million	Over 5 years £ million	Total £ million
Subordinated liabilities	–	–	22.1	88.6	418.2	528.9
Total	–	–	22.1	88.6	418.2	528.9

Report of the independent auditors on the parent company financial statements

Independent auditors' report to the members of TSB Banking Group plc

Our opinion
In our opinion, TSB Banking Group plc's parent company financial statements (the "financial statements"):

– give a true and fair view of the state of the parent company's affairs as at 31 December 2014 and of its cash flows for the year then ended;
– have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
– have been prepared in accordance with the requirements of the Companies Act 2006.

What we have audited
TSB Banking Group plc's financial statements comprise:

– the parent company balance sheet as at 31 December 2014;
– the parent company statement of changes in equity for the year then ended;
– the parent company cash flow statement for the year then ended; and
– the notes to the parent company financial statements, which include a summary of significant accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report and Accounts (the "Annual Report"), rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006.

Other required reporting

Consistency of other information

Companies Act 2006 opinions
In our opinion, the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

ISAs (UK and Ireland) reporting
Under International Standards on Auditing (UK and Ireland) ("ISAs (UK and Ireland)") we are required to report to you if, in our opinion, information in the Annual Report is:

– materially inconsistent with the information in the audited financial statements; or
– apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Company acquired in the course of performing our audit; or otherwise misleading.

We have no exceptions to report arising from this responsibility.

Adequacy of accounting records and information and explanations received
Under the Companies Act 2006 we are required to report to you if, in our opinion:

– we have not received all the information and explanations we require for our audit; or
– adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
– the financial statements and the part of the Directors' remuneration report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Directors' remuneration report – Companies Act 2006 opinion
In our opinion, the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

Other Companies Act 2006 reporting
Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of Directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the Directors
As explained more fully in the Statement of Directors' responsibilities, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Report of the independent auditors on the parent company financial statements (continued)

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What an audit of financial statements involves
We conducted our audit in accordance with ISAs (UK and Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

– whether the accounting policies are appropriate to the parent company's circumstances and have been consistently applied and adequately disclosed;
– the reasonableness of significant accounting estimates made by the Directors; and
– the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Other matter
We have reported separately on the Group financial statements of TSB Banking Group plc for the year ended 31 December 2014.

Allan McGrath (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
24 February 2015

Additional information

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Forward looking statements

This Annual Report contains forward looking statements with respect to the business, strategy and plans of the TSB Banking Group, its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about the Group or the Group's management's beliefs and expectations are forward looking statements. By their nature, forward looking statements involve risk and uncertainty because they relate to future events and circumstances that will or may occur. The Group's actual future business, strategy, plans and/or results may differ materially from those expressed or implied in these forward looking statements as a result of a variety of factors, including, but not limited to, UK domestic and global economic and business conditions; the ability to access sufficient funding to meet the Group's liquidity needs; risks concerning borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability and the impact of any sovereign credit rating downgrade or other sovereign financial issues; market-related risks including in relation to interest rates and exchange rates; changing demographics and market-related trends; changes in customer preferences; changes to laws, regulation, accounting standards or taxation, including changes to regulatory capital or liquidity requirements; the policies and actions of governmental or regulatory authorities in the UK or the European Union or other jurisdictions in which the Group operates; the implementation of the Recovery and Resolution Directive and banking reform following the recommendations made by the Independent Commission on Banking; the ability to attract and retain senior management and other employees; the extent of any future impairment charges or write-downs caused by depressed asset valuations, market disruptions and illiquid markets; the effects of competition and the actions of competitors, including non-bank financial services and lending companies; exposure to regulatory scrutiny, legal proceedings, regulatory investigations or complaints and other factors. The forward looking statements contained in this Annual Report are made as at the date of this Annual Report and the Group undertakes no obligation to update any of its forward looking statements.

Shareholder information

Annual Report
A copy of this Annual Report is available on our website www.tsb.co.uk.

Annual General Meeting (AGM)
The AGM will be held at the offices of CMS at Cannon Place, 78 Cannon Street, London EC4N 6HL on Wednesday, 22 April 2015 at 10.30am. Further details about the meeting, including the proposed resolutions, can be found in our notice of AGM which will be available shortly on our website www.tsb.co.uk.

Shareholder enquiries
For queries about your shareholding or to tell us about changes to your circumstances, please contact Equiniti Limited using the details shown below. Equiniti Limited maintains shareholder records on our behalf and deals with shareholder enquiries either in writing or by telephone:

By post
Equiniti Limited
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA

By telephone
UK telephone
0871 384 2825

Overseas telephone
+44 121 415 0830

Telephone lines are open 8.30am to 5.30pm, Monday to Friday. Calls to 0871 numbers are charged at 8p per minute plus network extras. Calls from outside the United Kingdom are charged at applicable international rates. The call prices quoted were correct at February 2015.

Institutional investors
If you are an institutional investor you can contact our investor relations team:

By telephone
020 7003 9419

By email
investor.relations@tsb.co.uk.

Reports and communications
The Group issues regulatory announcements through the Regulatory News Service (RNS), and are available on our website www.tsb.co.uk/investors/ where you can also find our statutory reports and shareholder communications.

Digital communications – Shareview by Equiniti Limited
Shareview, the website provided by Equiniti, allows shareholders to sign up to receive email communications and also provides the opportunity to self-manage your shareholding online. Shareholders can also access frequently asked questions, useful fact sheets, guidance notes, downloadable forms and a secure messaging system.

See www.shareview.co.uk and help.shareview.co.uk for further details.

Share price information
Shareholders can access both the latest and historical share prices via our website www.tsb.co.uk/investors/share-performance/. For a real time buying or selling price, you will need to contact a stockbroker.

Share fraud warning
Share dealing can be open to fraud, and we want to remind you to be aware of this and help you spot the signs.

While fraudsters may use different methods to try to con you, there are some common things to watch out for:

- Unsolicited calls offering you the chance to buy or sell shares or investments overseas with the promise of huge returns;
- High pressure sales tactics, such as emphasising the urgency, telling you you'll miss out if you don't invest right now, and just how much you'll lose if you don't;
- Incentives such as free reports, gifts or discounts; and
- Asking you to transfer money abroad, for example to Spain, Dubai or the US.

Being given a UK number to call back on is no guarantee of a legitimate broker – tricks include using call forwarding to overseas numbers, or not hanging up so that you remain connected to them and the UK number dialled does not actually go through a network.

Do not disclose your personal information
As a registered shareholder in TSB Banking Group plc, your name, address and number of shares held is a matter of public record by law. If your shares are held in a nominee account on your behalf this information is not publicly available.

You should never
- Give personal details to any caller, especially when you do not already have an existing relationship.

Genuine callers won't mind you taking their details and calling back – but when you do, remember the issue of fake numbers, and always wait for a dialling tone before dialling. Check out their company name and details on the internet before calling.

TSB Banking Group plc will not
- Sell your private information to any third party, for example for marketing purposes. (We may engage third parties to assist us with activity relating to your shares, for example, asset reunification);
- Contact you by telephone to buy or sell shares; or
- Ask you for credit card or bank account details in relation to any services or offers that you have not requested.

More help and advice
The FCA offers helpful information and advice on share fraud on their website www.fca.org.uk.

If you receive a suspicious call, contact the FCA:

Consumer Helpline – 0800 111 6768
(outside UK: +44 20 7066 1000)
Email: consumer.queries@fca.org.uk.

Or use their share fraud reporting form at www.fca.org.uk/consumers/scams/investment-scams/share-fraud-and-boiler-room-scams/reporting-form.

If you believe you are already the victim of share sale fraud and have paid money over, you should contact Action Fraud on 0300 123 2040 or report this online at www.actionfraud.police.uk/report_fraud.

Glossary

Arrears
A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan is unpaid or overdue. Such a customer is also said to be in a state of delinquency and the entire outstanding balance is delinquent.

Asset Quality Ratio (AQR)
The impairment charge for the year in respect of loans and advances to customers expressed as a percentage of average loans and advances to customers.

Bank Net promoter score (NPS)
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.

Basel II
The capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the 'International Convergence of Capital Measurement and Capital Standards'.

Basel III
The capital reforms and introduction of a global liquidity standard proposed by the Basel Committee on Banking Supervision in 2010 and phased in through CRD IV from 1 January 2014 onward.

Basis point (bps)
One hundredth of a per cent (0.01%). 100 basis points is 1%. Used in quoting movements in interest rates.

Buy-to-let mortgages
Buy-to-let mortgages are those mortgages offered to customers purchasing residential property as a rental investment.

Capital Requirements Directive (CRD) IV
On 27 June 2013, the European Commission published, through the official journal of the European Union, its legislation for a CRD and Capital Requirements Regulation (CRR), which form the CRD IV package. Amendments were subsequently made to the Regulation published on 30 November 2013. The package implements the Basel III proposals in addition to the inclusion of new proposals on sanctions for non-compliance with prudential rules, corporate governance and remuneration. The rules were implemented from 1 January 2014 onwards, with certain sections yet to be phased in.

Collectively assessed loan impairment provision
A provision established following an impairment assessment on a collective basis for homogenous groups of loans, such as credit card receivables and personal loans, that are not considered individually significant and for loan losses that have been incurred but not separately identified at the balance sheet date.

Common Equity Tier 1 (CET1) capital
The highest quality form of regulatory capital under CRD IV that comprises common shares issued and related share premium, retained earnings and other reserves less specified regulatory adjustments.

Common Equity Tier 1 ratio
Common Equity Tier 1 Capital as a percentage of risk weighted assets.

Contractual maturities
Contractual maturity refers to the final payment date of a loan or other financial instrument, at which point all the remaining outstanding principal will be repaid and interest is due to be paid.

Core Tier 1 capital
As defined by the PRA mainly comprising shareholders' equity after other regulatory deductions.

Core Tier 1 ratio
Core Tier 1 capital as a percentage of risk-weighted assets.

Cost:income ratio
Operating expenses as a percentage of total income.

Coverage ratio
Impairment provisions as a percentage of impaired loans.

Customer deposits
Money deposited by account holders. Such funds are recorded as liabilities of the Group.

Delinquency
See Arrears.

Expected Loss (EL)
Expected loss represents the anticipated loss, in the event of default, on a credit risk exposure modelled under the internal ratings based approach. EL is determined by multiplying the associated probability of default, loss given default and exposure at default together and assumes a 12 month time horizon.

Exposure at Default (EAD)
Exposure at default represents the estimated exposure to a customer in the event of default. In determining EAD amounts, consideration is made of the extent to which undrawn commitments may be drawn down at the point of default and the application of credit risk mitigation (i.e. eligible financial collateral).

Financial Services Compensation Scheme (FSCS)
The Financial Services Compensation Scheme (FSCS) is the UK's independent statutory compensation fund for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it. The FSCS is funded by management expenses levies and, where necessary, compensation levies on authorised firms.

Forbearance
Forbearance takes place when a concession is made on the contractual terms of a loan in response to an obligor's financial difficulties.

Franchise
TSB's business excluding the Mortgage Enhancement.

Impaired loans
Impaired loans are loans where the Group does not expect to collect all the contractual cash flows or to collect them when they are contractually due.

Impairment allowances
Impairment allowances are a provision held on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. An impairment allowance may either be individual or collective.

Impairment losses
An impairment loss is the reduction in value that arises following an impairment review of an asset that determines that the asset's value is lower than its carrying value. For impaired financial assets measured at amortised cost, impairment losses are the difference between the carrying value and the present value of estimated future cash flows, discounted at the asset's original effective interest rate.

Individually/collectively assessed
Impairment is measured individually for assets that are individually significant, and collectively where a portfolio comprises homogenous assets and where appropriate statistical techniques are available.

Internal assessed loan impairment provisions
Impairment loss provisions for individually significant impaired loans are assessed on a case-by-case basis, taking into account the financial condition of the counterparty, any guarantor and the realisable value of any collateral held.

Internal Capital Adequacy Assessment Process (ICAAP)
The Group's own assessment, based on Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events as they apply on a solo level and on a consolidated level.

Internal Ratings Based approach (IRB)
A methodology of estimating the credit risk within a portfolio by utilising internal risk parameters to calculate credit risk regulatory capital requirements.

Leverage ratio
Tier 1 capital divided by the exposure measure. Basel III reforms introduced a leverage ratio framework designed to reinforce risk based capital requirements with a simple, transparent, non-risk based 'backstop' measure.

Loan to deposit ratio
The ratio of loans and advances to customers net of allowance for impairment losses divided by customer deposits.

Loans past due
Loans are past due when a counterparty has failed to make a payment when contractually due.

Loan to value ratio (LTV)
The LTV ratio is a mathematical calculation which expresses the amount of a mortgage balance outstanding as a percentage of the total appraised value of the property. A high LTV indicates that there is less value to protect the lender against house price falls or increases in the loan if repayments are not made and interest is added to the outstanding balance of the loan.

Loss Given Default (LGD)
Loss given default represents the estimated proportion of an EAD amount that will be lost in the event of default. It is calculated after taking account of credit risk mitigation and includes the cost of recovery.

Master netting agreement
An agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.

Mortgage Enhancement
The business segment created to reflect the transfer of the economic benefit of a £3.4 billion portfolio of mortgages to the Group from LBG with effect from 28 February 2014.

Net interest income (NII)
The difference between interest received on assets and interest paid on liabilities.

Net interest margin
Net interest margin is net interest income as a percentage of average interest-earning assets.

Pillar 1
The first pillar of the Basel III framework sets out the quantitative elements – the minimum regulatory capital requirements for credit, operational and market risks.

Pillar 2
The second pillar of the Basel III framework sets out the qualitative expectations that should be met through the supervisory review process. This includes the ICAAP, governance process and the Supervisory Review Process. It sets out the review process for a bank's capital adequacy; the process under which the supervisors evaluate how well financial institutions are assessing their risks and the actions taken as a result of these assessments.

Pillar 3
The third pillar of the Basel III framework aims to encourage market discipline by setting out disclosure requirements for banks on their capital, risk exposures and risk assessment processes. These disclosures are aimed at improving the information made available to the market.

Probability of default
An estimate of the likelihood that a customer will default on their obligation within the next year.

Repurchase agreements
Short term funding agreements which allow a borrower to sell a financial asset as collateral for cash. As part of the agreement the borrower agrees to repurchase the security at some later date, usually less than 30 days, repaying the proceeds of the loan.

Risk-weighted assets
A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with CRD IV.

Securitisation
Securitisation is a process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities.

Standardised approach
The standardised approach to calculating credit risk capital requirements requires the use of a standard set of risk weights prescribed by the regulator. Use may be made of external credit ratings supplied by the external credit assessment institutions to assign risk weights to exposures. Standardised approaches, following prescribed methodologies, also exist for calculating market risk and operational risk requirements.

Subordinated liabilities
Liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer.

Tier 1 capital
A measure of a bank's financial strength defined by CRD IV. It captures Common Equity Tier 1 Capital plus other Tier 1 securities in issue, subject to deductions.

Tier 1 capital ratio
Tier 1 capital as a percentage of risk-weighted assets.

Tier 2 capital
A component of regulatory capital defined by CRD IV, mainly comprising qualifying subordinated loan capital and eligible collective impairment allowances.

Abbreviations

AGM	Annual General Meeting
AQR	Asset Quality Ratio
CET1	Common Equity Tier 1
CRD IV	Capital Requirements Directive IV
DTR	Disclosure and Transparency Rules
EIR	Effective interest rate
FCA	Financial Conduct Authority
FTE	Full time equivalent
HMRC	Her Majesty's Revenue and Customs
IAS	International Accounting Standard
ICAAP	Internal Capital Adequacy Assessment Process
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standard
ILAA	Individual Liquidity Adequacy Assessment
IPO	Initial public offering
ISAE	International Standard on Assurance Engagements
LBG	Lloyds Banking Group
LTIP	Long Term Incentive Plan
LTSA	Long Term Services Agreement
LTV	Loan to value
NII	Net interest income
NPS	Net promoter score
PBT	Profit before taxation
PCA	Personal current account
PRA	Prudential Regulatory Authority
SPA	Sustainable Performance Award
TSA	Transitional Services Agreement
UKLA	UK Listing Authority

“

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