

“We’re here to bring more competition to UK banking and ultimately make banking better for all UK consumers.”

Paul Pester, Chief Executive Officer, TSB

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

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Strategic report

Summary results

Summary balance sheet

	2015 £ million	2014 £ million	Change %
Loans and advances to customers	26,402.2	21,641.4	22.0
Other assets	5,215.8	5,530.0	(5.7)
Total assets	31,618.0	27,171.4	16.4
Customer deposits	25,915.7	24,624.9	5.2
Other liabilities	3,956.0	912.1	333.7
Shareholder's equity	1,746.3	1,634.4	6.8
Total equity and liabilities	31,618.0	27,171.4	16.4

Summary statutory income statement

	2015 £ million	2014 £ million	Change %
Net interest income	765.3	758.2	0.9
Other income	125.4	142.0	(11.7)
Total income	890.7	900.2	(1.1)
Operating expenses	(740.8)	(632.4)	(17.1)
Impairment	(82.3)	(97.6)	15.7
Statutory profit before taxation	67.6	170.2	(60.3)
Taxation	21.2	(35.7)	159.4
Statutory profit for the year	88.8	134.5	(34.0)

Segmental analysis of management basis profit before taxation

	2015 £ million	2014 £ million	Change %
Franchise net interest income	704.3	707.3	(0.4)
Franchise other income	129.7	147.8	(12.2)
Franchise operating expenses	(711.5)	(696.1)	(2.2)
People	(343.4)	(331.6)	(3.6)
Investment	(56.7)	(43.9)	(29.2)
Marketing	(54.7)	(61.1)	10.5
Other costs	(256.7)	(259.5)	1.1
Franchise impairment losses	(82.2)	(97.0)	15.3
Franchise profit before taxation	40.3	62.0	(35.0)
Mortgage Enhancement	63.2	71.7	(11.9)
Acquired ex-Northern Rock Loans	2.2	–	
Management profit before taxation	105.7	133.7	(20.9)
Non-management basis items ⁽¹⁾	(38.1)	36.5	(204.4)
Statutory profit before taxation	67.6	170.2	(60.3)

Key performance indicators

Operational

Mortgage gross new lending (£ million)	4,831.3	1,474.1	227.7%
Share of new personal bank account gross flow ⁽²⁾	6.8%	8.4%	(1.6)pp
Customer advocacy – net promoter score (NPS) ⁽³⁾	17	9	8

Financial

Franchise loan to deposit ratio	81.5%	76.5%	5.0pp
Common Equity Tier 1 Capital ratio	17.8%	23.0%	(5.2)pp
Leverage ratio (fully loaded)	5.2%	5.8%	(0.6)pp
Franchise banking net interest margin ⁽⁴⁾	3.61%	3.62%	(1)bps
Asset quality ratio (AQR) ⁽⁵⁾	0.37%	0.44%	7bps

(1) Items reported outside the Management basis results are shown on page 19.

(2) Source: CACI Current and Savings Account Market Database (CSDB) which includes current, packaged, youth, student and basic bank accounts, and new account openings excluding account upgrades. Data presented on a 2 month lag.

(3) 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. Calculated on 3 month rolling average October - December 2015 and 2014.

(4) Management basis net interest income divided by average loans and advances to customers, gross of impairment allowance.

(5) Impairment charge on loans and advances to customers divided by average loans and advances to customers, gross of impairment allowance.

Chief Executive Officer's statement

2015 was another significant year for TSB. It was a year in which TSB delivered both organic customer and balance sheet growth above its targets, acquired over £3.0 billion of UK customer mortgages and became a member of the Spanish banking group, Banco de Sabadell S.A. (Sabadell). The acquisition of TSB by Sabadell not only delivered a 30% return to our IPO shareholders and provided further endorsement of TSB's strategic potential but, additionally, provides more firepower to help deliver TSB's strategy of bringing more competition to UK banking.

Balance sheet growth has been strong and profits, while exceeding our plans, have declined as expected, on both a management and statutory basis. We remain very much on track to deliver against our key strategic objectives of delivering c.50% balance sheet growth which, when combined with the normalisation in UK interest rates and our continued focus on cost control, is intended to deliver double digit return on required equity five years from our IPO.

Financial summary

TSB Group's strategic priority remains to grow customer balances. In this respect, 2015 was a pivotal year with Franchise loan balances increasing by £2.3 billion and deposit balances increasing by £1.3 billion. In addition, we have exceeded our 6% PCA share of flow of new and switching bank accounts target for eight consecutive quarters. Together, this performance illustrates that TSB continues to be an attractive destination for UK banking customers. The acquisition of a £3.0 billion portfolio of ex-Northern Rock loans was also completed which complemented and accelerates the delivery of our organic growth strategy and should materially enhance profitability over the next few years.

TSB Group delivered a 2015 profit before taxation, as measured on a management basis, of £105.7 million, a decrease of 20.9%, largely reflecting our investment in this balance sheet growth, the run-off of the Mortgage Enhancement portfolio, the impact of regulatory changes on fee income and lower fee income on bank accounts. All of these impacts were fully anticipated. Management profit is the basis of reporting used by the Board to assess performance without the distortion of one-off and volatile items which are included on a statutory basis.

On a statutory basis, profit before taxation of £67.6 million reflected a reduction of 60.3%, driven by the recognition in 2014 of a £63.7 million non-recurring pension gain and the recognition in 2015 of £23.9 million Sabadell transaction related and other business restructuring costs.

Our growth strategy

Since launching back on to high streets across Britain in September 2013, our three strategic pillars have remained the same - to provide great banking to more people, to help more people borrow well with TSB and to provide the kind of banking people tell us they want and we believe they deserve. We made significant progress on all three during 2015.

Providing great banking to more people

6.8% of all customers who opened a new current account or switched banks in the UK in 2015 chose TSB, resulting in eight consecutive quarters in which we have beaten our 6% target. Our performance in 2015 reflects the anticipated settling from the 8.4% share achieved in 2014 when our performance benefitted from the additional attention created from the launch of our Classic Plus current account and from TSB's high profile listing. Our 2015 performance shows that consumers continue to recognise the benefits of joining a bank that offers them more, as evidenced by the initial take up of our new '555' Classic Plus current account offer. This was launched in September and, in addition to 5% interest on our Classic Plus current account, enables customers to earn up to £5 per month cash back on contactless payments, including Apple Pay, and earn 5% interest on their monthly savings. The continued strong performance of our Classic Plus current account was instrumental in generating the 5% growth in customer deposits balances during 2015.

Helping more people to borrow well with TSB

The number of people choosing TSB for their mortgages has been the standout success of 2015, driven primarily by developing the capability for customers to secure a TSB mortgage via an independent mortgage broker. Our mortgage broker service, launched in January 2015, grew throughout the year and resulted in £5.5 billion of mortgage applications and £3.1 billion of mortgage advances by the year end. Unsecured lending remained broadly flat during 2015.

In total, growth in Franchise lending of £2.3 billion was ahead of the £1.5 billion we had planned for 2015. We further grew lending on our balance sheet by acquiring £3.0 billion of ex-Northern Rock mortgages and loans from Cerberus Capital Management on 7 December 2015. We are delighted to become the lender to these 34,000 home owners across the UK and provide a long-term home for their mortgages. With one of the highest capital ratios in the UK, TSB is well placed to support the loans. In addition, this portfolio will significantly enhance TSB's profitability which, in turn, will help us to continue to deliver our growth strategy with confidence.

Providing the kind of banking experience people want and deserve

We also continued to improve further the quality of our service during 2015, with *Which?* rating us the best high street bank for customer service for the second year running⁽¹⁾. Importantly, customers are also noticing these improvements with more people than ever before willing to recommend us to friends and family. This is reflected by our Net Promoter Score (NPS), our measure of customer advocacy, which increased to 17 from 9 at the start of the year.

(1) TSB ranked joint highest high street bank for customer service with Santander in 2015.

Chief Executive Officer's statement (continued)

Providing the kind of banking experience people want and deserve (continued)

Throughout 2015, TSB continued to invest in its branch, intermediary, digital and telephony channels to improve the choices TSB customers have in accessing their banking services. TSB customers are able to bank how, when and where they want – this is what we call 'Local Banking on Demand'. In 2015 we launched Apple Pay, rolled out Wi-Fi and started to introduce digital screens in our branches and equipped them with iPads to bring our digital services alive.

Our banking app has been improved during 2015 and we have seen a 14% year on year increase in transactions completed by our customers online. We have taken the opportunity to co-locate 17 branches in 15 locations across the UK where we had two or more branches within approximately 500 metres of each other. In each case, we have invested to improve the service available and the appearance of the more conveniently located branch.

None of this would have been possible without the hard work and dedication of our 8,600 Partners in whom we have continued to invest. During 2015, 6,400 Partners undertook a significant development programme to deliver an even better TSB experience to our customers.

However, we continue to face headwinds

The business continues to face external headwinds beyond its control. Interest rates have remained at a record low for longer than many expected which limits opportunities to increase net interest margin. We also continue to see competitive pressure on the net interest margin and expect to see further modest declines in 2016 as we continue to grow our mortgage portfolio. Accordingly, we have maintained a focus on costs by simplifying our business. Our underlying costs for 2015 were almost £40 million lower than we predicted at the time of the IPO. We expect to hold costs broadly flat over the next 12 months. In addition, as further explained on pages 8 to 11, TSB faces a number of risks arising from our growth strategy and business model.

Joining the Sabadell Group gives TSB additional firepower

A highlight of 2015 was TSB becoming a member of the Spanish banking group Sabadell. The deal, which concluded at the end of June, was testament to the strong strategic performance of TSB since it was launched on the London Stock Exchange almost exactly a year earlier. The Sabadell offer price of 340p per share in cash represented a 30.8% premium to the price at the time of the IPO which, combined with the capabilities offered by Sabadell to accelerate the execution of TSB Group's strategy, encouraged the TSB Board to recommend its acceptance to shareholders. Being a member of the Sabadell Group will provide TSB Group with experience that will support the growth of business banking in the UK and offers the opportunity to migrate our banking platform to provide significant operational and financial benefits whilst enhancing the customer experience. Work to consider a migration to the Sabadell platform has commenced and, while there is much work ahead, our plans are on track.

Helping local communities to thrive

In 2015, we decided to break with past convention by giving all TSB Partners the opportunity to support a local good cause close to their heart instead of supporting one national charity. All branches and offices supported the programme and nearly 500 charities have benefitted. In 2015, over £800,000 has been raised and shared with those charities. In addition to fundraising activity, TSB also encourages staff to spend a day, when they would normally be working, in their community supporting a local good cause.

Bringing more competition to UK retail banking

Even with our strong performance in attracting new customers, the big five banks continue to maintain a stranglehold on the UK banking market. We agree with the Competition and Markets Authority (CMA) that, despite the emergence of new banks, there is a significant lack of competition in the UK retail banking market. More choice is not the same as more competition. This is why we have been working with the CMA to encourage recommendations that create a market that operates in the best interests of all consumers. The CMA's provisional findings are, of course, a helpful first step but we believe more needs to be done to truly make banking work for customers.

The problem is compounded by a lack of transparency and low levels of customers switching bank accounts because of a switching service that does not work for all UK consumers. We believe customers should be able to make informed choices and switch with ease. Specifically, the switching service needs to be improved for those who are trapped by their current provider; and a standard format monthly bill that spells out the true cost of banking should be made mandatory. TSB continues to work with the CMA to encourage real competition and shift banks' focus towards the long-term interests of their customers and address culture in banking.

Conclusion

Overall, 2015 has seen TSB go from strength to strength. We have exceeded both our growth and profit expectations, enhanced our digital offering and acquired a large and well seasoned book of high yielding mortgages to further enhance our profitability and ability to compete going forward. We have done all this while delivering a 30% return to our original shareholders and improving the quality of our customers' banking experience.



Paul Pester
Chief Executive Officer

How we make money – our business model

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 truthful 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 both our customers' and the shareholder's interests.

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. We aim to preserve this margin and to manage the potential impact on income and reserves from changes in interest rates through the appropriate 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 reinvested in the business. The execution of this business model requires the taking of certain risks and we take actions to mitigate all of them.

Components of our Business model	Description	Further information	
		Review of our performance	Financial statements
Sources of funding	Money deposited by customers into their bank and savings accounts provides the majority of the funds we use to support lending to customers. We also raise funds from other sources, including equity invested by the shareholder.	Page 14	Page 56
Loans	Funds deposited with TSB are used to support lending to customers who wish to borrow. A portion of funds are held in reserve to meet any unexpected funding requirements.	Page 16	Page 59
Income	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.	Page 17	Page 65
Charges	Running a bank with 4.7 million customers comes with overheads. Charges we incur include the costs of paying our 8,600 TSB Partners, running our branches, investing in our business 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, TSB Group pays tax to Her Majesty's Revenue and Customs (HMRC).	Page 18	Page 67
Profits and returns to the shareholder	The Board reviews TSB Group's performance. It decides whether profits are put aside for future investment in the business, for protection against the uncertainties that TSB Group faces, or returned to the shareholder in the form of dividends. Currently all returns are being reinvested in the business.	Page 19	Page 72

Our strategy and key performance indicators

Strategic priority	2015 performance	Key performance indicator												
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, and in an increasingly competitive environment, TSB delivered 6.8% share of flow of all new and switching bank accounts. Q4 2015 is the 8th consecutive quarter where we exceeded our 6% target.	Share of personal bank account gross flow (%)<table><tr><th>2015</th><th>2014</th></tr><tr><td>6.8%</td><td>8.4%</td></tr></table> Share of PCA stock (%)⁽¹⁾<table><tr><th>2015</th><th>2014</th></tr><tr><td>4.4%</td><td>4.3%</td></tr></table>	2015	2014	6.8%	8.4%	2015	2014	4.4%	4.3%				
2015	2014													
6.8%	8.4%													
2015	2014													
4.4%	4.3%													
Help more people borrow well														
Grow Franchise customer lending by 40% to 50% over a five year period from IPO.	- As expected, and driven by the launch of the new intermediary channel in January 2015, Franchise lending balances grew by £2.3 billion in the year. - This strong start has seen £5.5 billion of mortgage loan applications received by the intermediary channel in 2015. TSB was named mortgage lender of the quarter by Mortgage Strategy Magazine in both the first and second quarters of 2015. We launched a range of products through this channel to include house purchase, remortgaging and buy-to-let mortgages, all of which are provided through over 7,000 brokers. - During 2015 we continued to launch innovative products that meet the needs of our customers. ‘Fix and Flex’ allows customers to fix their interest rate for 10 years with added flexibility to switch without penalty to a new product after five years. This product won the ‘Innovation in Personal Finance’ award at the Moneyfacts Awards 2015. We also launched ‘Breathing Space’, which allows customers to make lower payments in the first year of their mortgage. - Unsecured lending remained relatively flat in a congested and competitive environment.	Mortgages gross lending (£m)<table><tr><th>2015</th><th>2014</th></tr><tr><td>4,831.3</td><td>1,474.1</td></tr></table> Unsecured loan growth (£m)<table><tr><th>2015</th><th>2014</th></tr><tr><td>(29.7)</td><td>(23.1)</td></tr></table>	2015	2014	4,831.3	1,474.1	2015	2014	(29.7)	(23.1)				
2015	2014													
4,831.3	1,474.1													
2015	2014													
(29.7)	(23.1)													
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 have continued to invest in our digital proposition through 2015, launching our new mobile banking app (which makes it simpler for our customers to bank with us wherever they may be) and Apple Pay. - We extended the opening hours of almost 600 of our branches in 2015 including extending Saturday opening hours in over 150 locations. We also reviewed 15 locations across the UK where we had two or more branches within approximately 500 metres of each other and made arrangements to absorb 17 lesser used branches into the 15 more convenient branches. In each case we invested in the more convenient branch to improve the customer experience. - We provided training to all 6,400 customer-facing TSB Partners to further improve their skills and techniques in delivering an exceptional customer experience. Separately, we have removed sales targets from TSB’s customer facing Partners, releasing them to focus solely on meeting the needs of our customers, and providing them with a better banking experience. - Evidence of our progress is reflected in our Bank net promoter score, which improved 8 points from last year.	Customer advocacy (Net Promoter Score)<table><tr><th>2015</th><th>2014</th></tr><tr><td>17</td><td>9</td></tr></table> Reportable banking and credit card complaints (per 1,000 customers)⁽²⁾<table><tr><th>2015</th><th>2014</th></tr><tr><td>0.9</td><td>1.0</td></tr></table> Digital penetration of new PCA customers (%)<table><tr><th>2015</th><th>2014</th></tr><tr><td>89.9</td><td>84.2</td></tr></table>	2015	2014	17	9	2015	2014	0.9	1.0	2015	2014	89.9	84.2
2015	2014													
17	9													
2015	2014													
0.9	1.0													
2015	2014													
89.9	84.2													

(1) Source: CACI Current and Savings Account Market Database (CDSB). Data presented on a 2 month lag.

(2) Calculated based on complaints during the second half of each year. 2014 includes credit related unsecured lending complaints. Both periods 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 1.2 for 2014 to 1.7 in 2015.

Risk management in TSB

TSB Group's business model and strategy naturally require a careful assessment, and acceptance, of a number of risks. Therefore a strong and robust approach to risk management exists that is designed to support the business strategy and mitigate the risk and offer protection for customers, Partners and our shareholder. There are four key strategic and business model drivers that provide the context for risk management in TSB.

A new challenger bank, growing quickly	TSB Group is a rapidly growing challenger bank with a clear strategy that leverages a transparent and straightforward business model.
Reliant on a competitor for outsourced services	Information technology and associated banking services are supplied to TSB Group by LBG under a Transitional Services Agreement (TSA).
Part of an international banking group	Since joining the Sabadell Group in June 2015, work to consider a migration to the Sabadell banking platform has commenced.
Evaluating emerging risks	TSB Group evaluates emerging risks from changes to the competitive landscape and regulatory and economic developments.

Risk culture

The risk culture that is embedded throughout TSB Group seeks to ensure that all Partners deliver the right outcomes for customers and other stakeholders both in terms of 'what' they do and 'how' they do it. TSB Group's risk culture encourages all Partners to identify, assess and manage risk within their area of responsibility and supports clear escalation and reporting of risks to senior management and the Board. TSB Group's approach to remuneration throughout the business reinforces its strong risk management culture.

Risk appetite and strategy

The Board sets TSB Group's risk appetite and strategy, cascading accountability to appropriately qualified Partners. Through clear and consistent communication, the Board ensures that senior management implements risk appetite and risk policies that either limits, or where appropriate, prohibits activities, relationships and situations that could be detrimental to the risk profile of TSB Group.

Stress and scenario testing are widely used throughout TSB Group to assess and support the business strategy. Such testing includes stress testing required for capital and liquidity regulatory submissions; the Internal Capital Adequacy Assessment Process (ICAAP) and the Individual Liquidity Adequacy Assessment Process (ILAAP), together with reverse stress tests which attempt to produce illustrative scenarios of what might cause TSB Group to fail.

Risk management

TSB Group organises its risk management activities across three lines of defence. This ensures 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 manage the risks relevant to their areas. They establish controls to ensure compliance with TSB Group's policies and the risk appetite parameters set out and approved by the Board.
Second line of defence: Risk function	TSB Group's Risk function provides independent oversight and challenge through testing the effectiveness of business line risk management, as well as providing TSB Group-wide risk reporting. It recommends risk strategy and TSB 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	TSB 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 TSB Group's risk management activities to the Board and senior management.

Risk management in TSB (continued)

Risk Governance

TSB Group's risk committees are responsible for providing oversight over the effectiveness of the risk management framework set out by the Board. Additionally, they monitor and challenge risk exposures and take appropriate action to ensure the acceptability of TSB Group's overall risk profile. All committees within the governance structure are responsible for ensuring that a risk and control environment is established within its area of authority, 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 pages 21 to 28.

Principal risks and uncertainties

The principal risks and uncertainties faced by TSB Group, organised around four strategic and business model drivers are described below, together with an explanation of how these have evolved during 2015.

A new challenger bank, growing quickly	
Conduct and customer risks; delivering fair outcomes for our customers	To provide a banking experience that customers want and deserve. TSB Group's approach to conduct enables it to deliver the basics of banking whilst delivering compelling value propositions for customers that sets it apart from the competition. To deliver this sustainably, TSB Group seeks to ensure that good conduct and an appreciation of the conduct risks the bank faces underpin everything it does. To achieve this, TSB Group is continually investing in the pre-requisites of good conduct. This can be simply translated as: • having the right people, • doing the right things, • in the right way for our customers, and • ensuring that we continually assess that we are achieving this aim. By holding to this approach and having a feedback loop from customers, Partners, regulators and wider industry commentators, TSB can both deliver fair outcomes for its customers and build sustainable value. For historical conduct issues, prior to IPO, TSB Group remains protected through the Conduct Indemnity provided by LBG.
Financial risks; managing the balance sheet for sustainable growth	TSB Group's banking model is based on using customer deposits as its primary source of funding to support lending activities, helping more people to borrow well. To mitigate against potential funding shortfalls, TSB makes use of other funding facilities, such as wholesale term funding, within the limits set in the Board approved risk appetite. TSB Group is funded and capitalised to support its strategy for organic growth, for example through Mortgage Intermediary lending, and inorganic expansion such as the acquisition of £3.0 billion of ex-Northern Rock loans. With continuing growth activities, regular stress testing forms part of the process to ensure TSB Group remains adequately funded.
Lending risks; helping more people to borrow well	TSB Group adopts decision making processes and systems geared to provide affordable lending, based on individual needs and circumstances at the time of application. This approach helps customers borrow well and limit the risks associated with non-repayment. To assist with this, TSB Group's Risk Appetite, which has been set for controlled growth, has measures and limits in place to act as a mechanism to prevent the bank and its customers from overreaching their ability to manage credit. These measures include loan-to-income ratios, limits on interest only mortgage lending and maximum loan-to-value thresholds. Risk appetite metrics apply to all acquisition channels including the new Mortgage Intermediary channel. However, TSB Group understands that occasionally customer circumstances change which could impact on their ability to pay back borrowing. In these situations, TSB Group works with its customers to improve their position by offering various temporary treatment strategies and support.

Risk management in TSB (continued)

A new challenger bank, growing quickly (continued)	
Market risks; managing market risks	Market risk occurs in the form 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 TSB Group's assets and liabilities. TSB Group aims to optimise the value of its business by preserving its margins by managing market risk positions that arise through the natural course of business. TSB Group's primary market risk is interest rate risk arising from its banking activities and as a result it is exposed to the following categories of risk: re-pricing risk, basis risk, optionality risk arising from certain product features, behavioural risk, residual risk and margin compression. TSB Group holds derivative financial instruments in the normal course of its banking business for interest rate risk management and margin stabilisation purposes. The effectiveness of these derivatives is monitored regularly.
Industry risks; regulatory, structural and legislative	As a challenger bank operating in an ever-changing environment it is important for TSB Group to respond to industry developments in a way that doesn't adversely impact on its customers, strategy and Partners. TSB Group regularly reviews and responds to future industry changes including technology advances, regulatory developments, and shifts in political agenda. This includes developments such as the Senior Managers Regime, the implementation of the Financial Services (Banking Reform) Act 2013, enhanced digital services such as Apple Pay, and the recent CMA report on competition in the UK retail banking sector.
Financial and cyber-crime; protecting TSB and its customers	TSB Group and its customers face continued threat from fraud and financial crime, whether from telephone scams, money laundering, or online from hacking or malicious emails. TSB takes seriously its duties to protect customers, Partners and itself from fraud and financial crime, including cyber-crime. Every TSB Partner regularly undertakes an education and awareness programme to ensure an understanding of the threats faced by TSB Group, and its customers, the methods used by criminals and how to report any suspicious activity. TSB Group makes use of robust technology to identify and prevent suspicious activity through the use of transaction monitoring systems and other prevention systems. Reviews are regularly undertaken, along with business line reporting of key risk indicators, to confirm the effectiveness of the controls in place to protect against both financial and cyber-crime. TSB Group is committed to making customers' banking experience as safe as possible. Along with the steps outlined above, TSB Group also provides information and steps that customers can take themselves to stay safe, through an online Security Centre, which is available online at: http://www.tsb.co.uk/security/.
Operational risks; managing the stability, resilience and capability of day-to-day banking activities	TSB Group naturally undertakes activities that create operational risk which could result in a loss for TSB Group. TSB uses a framework for managing its operational risk, with controls to prevent, detect and mitigate against the consequences of operational risk events. Examples of operational risks faced by TSB Group include: • IT systems: risk of cyber attacks, outages or other loss of resilience which leads to a disruption in day-to-day banking activities; • People: TSB faces a number of people risks which could impact on the day-to-day operation of services; • Change: not managing change to maintain a stable working and banking environment and failure to limit the impact on customers and Partners during the change cycle; and • Third party suppliers: risk of service disruption caused by the failure of a third party supplier or service provider. TSB Group regularly reviews its operational risks and any potential impact that they may have and takes action to mitigate and control them.

Risk management in TSB (continued)

Reliant on a competitor for outsourced services	
Supplier risk; managing the contractual relationship with LBG	The main supplier, under the Transitional Services Agreement (TSA), to TSB Group for its IT platform and other banking services is a key competitor, LBG. The relationship between TSB Group and LBG is carefully managed through robust governance arrangements as specified in the TSA contracts.
Part of an international banking group	
Migration risks; becoming an integrated part of Sabadell	As TSB Group begins its journey to assess the feasibility of migrating to Sabadell's banking platform, it is important that there is no overall detrimental impact to our customers and their banking experience with TSB Group. Many Partners in TSB Group and Sabadell are experienced in delivering large scale change and migration projects, most notably for TSB Group Partners involved in the divestment of TSB Group from LBG, and are fully aware of the risks that come with such projects. TSB Group is mindful of the distraction of integrating with a new owner whilst continuing to deliver its growth strategy. To mitigate and monitor these risks, a full cross-entity change and migration project and governance structure is in place, with representatives from every part of TSB Group's business.
Evaluating emerging risks	
Strategic delivery risk	Operating in a competitive UK retail banking sector, with a 'lower for longer' interest rate outlook, could impact TSB Group's growth strategy and objectives. With the support of a prudent risk appetite and governance processes, products and services continue to evolve to drive forward the growth agenda. This includes increased use of digital technology and improved online services.
Changes to UK regulatory, legislative and public policy	Due to the nature of the financial services industry, TSB Group has to comply with a complex legal and regulatory agenda. TSB Group monitors forthcoming legal and regulatory change and continues 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 TSB is managed through an effective governance and oversight framework.
Global trends	Political uncertainty could have an impact on TSB Group's business, customers and shareholder and this is continuously monitored to assess the potential impacts.

Risk management in TSB (continued)

Going concern

The Directors recognise their responsibility to make an assessment of TSB 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. As noted on page 38, the Directors consider that it is appropriate to adopt the going concern basis in preparing the consolidated financial statements.

Viability statement

As more fully explained in the Corporate Governance statement on page 21, the Directors consider that it is appropriate to voluntarily comply with principles of the UK Corporate Governance Code issued by the Financial Reporting Council (FRC) which includes new viability provisions which require the Directors to:

- carry out a robust assessment of the principal risks facing the company;
- explain how they have assessed the prospects of the company, over what period, and why they consider that period to be appropriate; and
- to state whether they have a reasonable expectation that the Company and TSB Group will be able to continue in operation and meet their liabilities, taking account of their current position and principal risks, over this period.

Robust assessment of risks

The Chief Risk Officer presents a regular analysis of the principal risks arising from TSB Group's business model, strategy and the external economic and competitive environment to the Board Risk Committee. The Directors receive a regular report from the Chief Risk Officer to enable them to monitor the principal risks, and changes to them, in the context of the Board approved risk appetite. Further information on the principal risks and uncertainties are set out on pages 9 to 11.

Period of viability assessment

Guidance from the Financial Reporting Council states that the period assessed under the Viability Statement should be significantly longer than 12 months from the date of approval of the financial statements, which is the period over which going concern is assessed.

For TSB Group, the Directors have assessed viability to December 2019. The assessment has been made over this period as it is consistent with the period over which TSB Group's medium term strategic and financial plan is prepared, the period over which key capital and leverage ratios are forecast and the period over which regulatory and internal stress testing of these profit, capital and funding forecasts are carried out. The period is also consistent with guidance at the time of TSB's Initial Public Offering (IPO) in June 2014 that the strategy was designed to support a double digit post tax return on required equity over a five year post IPO horizon.

Approach to assessing viability and going concern

The Directors' assessment of viability is integrated into the existing approach to the going concern assessment. In making the viability assessment, the Directors have considered a wide range of information relating to present and future conditions, including future projections of profitability, capital requirements, capability, resources and funding. In addition, the Directors have assessed the top and emerging risks that could threaten TSB Group's future prospects and business model more broadly and the monitoring and mitigation activities around them.

Viability assessment

The viability assessment is based on TSB Group having sufficient liquidity and capital, and includes consideration of its funding and capital plans and the ILAAP and the ICAAP approved by the Board and submitted to the Prudential Regulatory Authority (PRA).

The Directors confirm that:

- they have carried out a robust assessment of the principal risks facing TSB Group, including those that would threaten its business model, future performance, solvency or liquidity; and
- in light of TSB Group's capital and funding resources (pages 14 and 15) they have a reasonable expectation that TSB Group will be able to continue in operation and meet its liabilities as they fall due during the period to December 2019.

Review of our performance in 2015

Basis of presentation

The presentation of TSB Group's performance is on a statutory basis prepared under IFRS and accounting policies described on page 50.

The presentation of performance in 2015 is structured around the key elements of TSB Group's business model which are explained on page 6. Performance in 2015 is further analysed and explained on a segmental basis, consistent with how TSB Group is organised, managed and reported internally to the Executive Committee as follows:

- *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 TSB Group 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 TSB Group's profitability by over £230 million.
- *Acquired ex-Northern Rock Loans* is a £3.0 billion portfolio of mortgages and unsecured loans for which beneficial interest was acquired from Cerberus Capital Management group with effect from 7 December 2015.

The segmental results, as presented on a management basis, exclude certain volatile and one-off items which enables management to assess TSB Group's underlying financial performance. These items are separately identified in the explanation of TSB Group's statutory financial performance in 2015.

Review of financial performance

Consolidated balance sheet, funding and capital

Business model component	Analysis	2015 £ million	2014 £ million
Funding resources		29,217.4	25,040.4
Shareholder's equity		1,746.3	1,634.4
Sources of funding	Page 14	30,963.7	26,674.8
Other liabilities		654.3	496.6
Total equity and liabilities		31,618.0	27,171.4
Loans and adv to customers	Page 16	26,402.2	21,641.4
Liquidity portfolio	Page 16	3,782.3	4,509.0
Other assets		1,433.5	1,021.0
Total assets		31,618.0	27,171.4
Franchise loan to deposit ratio		81.5%	76.5%
Common Equity Tier 1 Capital ratio		17.8%	23.0%

Total sources of funding increased by £4.3 billion primarily driven by strong customer deposit net inflow and the successful diversification of the funding base which saw the successful launch of TSB Group's first public securitisation and further drawing on the existing Cape facility.

This increased funding was used to fund the majority of the £2.3 billion increase in Franchise customer loan balances, reflecting the successful launch of TSB's new mortgage intermediary channel in January 2015, and the acquisition of the £3.0 billion portfolio of ex-Northern Rock loans.

As a consequence, the Franchise loan to deposit ratio increased to 81.5% from 76.5% at December 2014.

Consolidated income statement and profitability

By Segment		2015 £ million	2014 £ million
Franchise		40.3	62.0
Mortgage Enhancement		63.2	71.7
Acquired ex-Northern Rock Loans		2.2	–
Management profit before tax		105.7	133.7
Non-segmental items		(38.1)	36.5
Statutory profit before tax		67.6	170.2
By business model component	Analysis	2015 £ million	2014 £ million
Income	Page 17	890.7	900.2
Operating expenses	Page 18	(740.8)	(632.4)
Impairment	Page 18	(82.3)	(97.6)
Statutory profit before tax		67.6	170.2
Taxation	Page 18	21.2	(35.7)
Statutory profit for the year		88.8	134.5

Profit before tax, reported on a management basis of £105.7 million, is 20.9% lower than 2014. This reduction was primarily a result of our investment in balance sheet growth, the expected attrition of the Mortgage Enhancement portfolio, lower fee income on bank accounts and the effect of new regulations to reduce interchange rates.

On a statutory basis, 2015 profit before tax decreased by 60.3% to £67.6 million. This decrease primarily reflected higher expenses from £23.9 million of non-recurring and business restructuring costs in 2015 such as those incurred in completing the Sabadell transaction and the non-recurring gain of £63.7 million in 2014 associated with the exit of TSB Group Partners from LBG's defined benefit pension scheme.

Sources of funding

	2015 £ million	2014 £ million	Change %
Customer deposits	25,915.7	24,624.9	5.2
Non-customer funding:			
Debt securities in issue	2,899.6	10.0	
Subordinated liabilities	402.1	405.5	(0.8)
Funding resources	29,217.4	25,040.4	16.7
Shareholder's equity	1,746.3	1,634.4	6.8
Total sources of funding	30,963.7	26,674.8	16.1

Funding resources

A substantial proportion of TSB Group's funding comprises customer bank accounts and savings balances which, although mostly repayable on demand, have historically provided a stable source of funding. During 2015, funding resources increased by 16.7% to £29,217.4 million. Growth in bank account balances of £1,170.8 million was the largest contributor to customer deposit balance growth reflecting the ongoing strength of the 'Classic Plus' bank account proposition which contributed to TSB Group opening 6.8% of all new and switching personal bank accounts in the UK over the last 12 months.

During 2015, funding sources were further diversified with the aim of accessing sources of funding beyond TSB Group's traditional customer deposit base and to support the continued growth of the business. The main funding developments during 2015 were as follows:

- On 8 October 2015, TSB Group established a £1.0 billion unsecured funding facility from Sabadell. As at 31 December 2015, no amounts were drawn against this facility.
- On 9 October 2015, a £750 million 18 month repurchase agreement facility was established which, if drawn, will be collateralised using retained notes issued by Duncan Funding 2015-1 plc. At 31 December 2015, no amounts were drawn against this facility.
- On 12 November 2015, TSB Group completed its first public residential mortgage backed securitisation (Duncan Funding 2015-1 plc) which securitised Franchise mortgages raising £537 million, with £1,362 million of AAA/Aaa rated retained notes available to be used as security against future funding requirements.
- On 17 November 2015, a further £2,339.0 million was drawn on the Cape securitisation facility from Lloyds Bank plc taking the balance at 31 December 2015 to £2,355.3 million.

Cost of funding resources

The cost of customer deposits decreased by 14bps in 2015 to 0.66%, reflecting the repricing of the variable rate savings portfolio, the runoff of historic fixed business at higher pay rates and the change in mix in savings and bank account balances. Average savings deposit costs decreased from 0.88% to 0.72%. Average bank account deposit rates decreased from 0.61% to 0.54% due to growth in non-interest bearing balances and repricing activities.

Capital resources

The capital position of TSB Group remains strong with a Common Equity Tier 1 (CET1) Capital ratio of 17.8% and a leverage ratio of 5.2% providing ongoing support to deliver the growth strategy. The decline in the year primarily reflects the acquisition of the ex-Northern Rock loans, growth in lending, and the migration of the overdraft and credit card portfolios to an internal ratings based method of capital requirements calculation. This was partially offset by retained profits earned during 2015.

Capital resources

	At 31 Dec 2015 £ million	At 31 Dec 2014 £ million
Shareholder's equity	1,746.3	1,634.4
Excess of expected losses over impairment provisions	(72.1)	(41.0)
Cash flow reserve regulatory adjustment	0.9	—
Prudent valuation prudential filter adjustment	(1.6)	—
Intangible assets	(1.0)	(0.4)
Common Equity Tier 1/Total Tier 1 capital	1,672.5	1,593.0
Tier 2 capital	383.5	384.3
Total capital resources	2,056.0	1,977.3
Risk-weighted assets	9,376.2	6,930.2
Common Equity Tier 1/Total Tier 1 capital ratio (fully loaded)	17.8%	23.0%
Total Capital ratio (fully loaded)	21.9%	28.5%

Sources of funding (continued)

The movements in CET 1, Tier 2 and Total Capital in the year are shown below:

	CET 1/ Total Tier 1 £ million	Tier 2 £ million	Total resources £ million
At 31 December 2014	1,593.0	384.3	1,977.3
Profit attributable to ordinary shareholder	88.8	–	88.8
Change in excess of expected losses over impairment provisions	(31.1)	–	(31.1)
Change in excess of default provision over default expected loss	–	(1.1)	(1.1)
Movement in other comprehensive income	15.0	–	15.0
Movement in other reserves	8.1	–	8.1
Change in intangible assets	(0.6)	–	(0.6)
Movement in tier 2 subordinated liabilities	–	0.3	0.3
Cash flow hedging reserve regulatory adjustment	0.9	–	0.9
Movement in prudent valuation prudential filter adjustment	(1.6)	–	(1.6)
At 31 December 2015	1,672.5	383.5	2,056.0

Risk-weighted assets (CRD IV)

	At 31 Dec 2015 £ million	At 31 Dec 2014 £ million
Risk type analysis of risk-weighted assets:		
Franchise standardised approach	828.4	1,300.6
Franchise IRB approach	4,913.4	3,187.3
Total Franchise	5,741.8	4,487.9
Mortgage Enhancement standardised approach	802.4	984.8
Acquired ex-Northern Rock Assets standardised approach	1,363.6	–
Total credit risk	7,907.8	5,472.7
Operational risk	1,416.4	1,451.5
Market and counterparty risk	52.0	6.0
Total risk-weighted assets	9,376.2	6,930.2

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. TSB Group calculates its leverage ratio based on the exposure measure in the revised Basel III leverage ratio framework published in January 2014 and applicable from 1 January 2015, 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. TSB Group continues to monitor Basel III developments and their adoption in the CRD IV framework.

	At 31 Dec 2015 £ million	At 31 Dec 2014 £ million
Total Tier 1 Capital for leverage ratio		
Shareholder's equity per balance sheet	1,746.3	1,634.4
Less: regulatory adjustments	(73.8)	(41.4)
	1,672.5	1,593.0
Exposures for leverage ratio		
Total statutory balance sheet assets	31,618.0	27,171.4
Removal of accounting value for derivatives	(90.5)	(123.1)
Exposure value for derivatives and securities financing transactions	(129.8)	28.5
Off-balance sheet	709.7	405.0
Other regulatory adjustments	(73.8)	(41.4)
Total exposures	32,033.6	27,440.4
Leverage ratio	5.2%	5.8%

The leverage ratio of 5.2% comfortably exceeds the Basel Committee's proposed minimum of 3%, applicable from 2018.

Loans

	2015 £ million	2014 £ million	Change %
Loans and advances to customers			
Franchise - secured	18,909.0	16,561.4	14.2
Franchise - unsecured and business banking	2,214.5	2,277.9	(2.8)
Mortgage Enhancement	2,272.3	2,802.1	(18.9)
Acquired ex-Northern Rock Loans	3,006.4	–	
Total loans and advances to customers	26,402.2	21,641.4	22.0
Liquidity portfolio			
Balances at central banks ⁽¹⁾	2,541.9	4,169.3	(39.0)
Gilts (available-for-sale)	1,240.4	339.7	265.1
Total liquidity portfolio	3,782.3	4,509.0	(16.1)

(1) Balances at central banks are combined with other cash balances and mandatory reserve deposits of £213.7 million (2014: £227.0 million) when shown on TSB Group's consolidated balance sheet on page 52.

Loans and advances to customers

Loans to customers increased by 22.0% compared to December 2014. This reflected a £2.3 billion increase in Franchise loan balances and the acquisition of the £3.0 billion portfolio of ex-Northern Rock loans, partially offset by the ongoing and expected repayment of the Mortgage Enhancement portfolio.

The growth in Franchise mortgage loans reflected the success of the new intermediary channel since its launch in January 2015, culminating in £5.5 billion of mortgage applications and £3.1 billion of mortgage advances by the year end. This combined with £1.7 billion of new mortgage advances through our branch and telephony channels resulted in an aggregate £4.8 billion of new mortgage advances, more than three times the volume achieved in 2014.

Unsecured lending and business banking loan balances, net of impairments, reduced by 2.8% reflecting ongoing competition within this product segment. During H2 2015, TSB Group began to offer personal loans to customers who did not also have a bank account with TSB Group. This capability currently only exists in branches but is expected to be extended to digital customers during 2016.

Liquidity portfolio

TSB Group continues to hold a high quality liquid asset portfolio. The primary liquidity portfolio remained stable through 2015 with the composition reflecting efforts to continue to diversify the range of assets with an increasing proportion held in gilts. This supported TSB Group's liquidity risk management strategy and provided capacity to undertake repurchase agreements, enhancing its ability to access short term funding from the financial markets.

Interest rates earned on loans

In 2015, the average rate earned on Franchise loans reduced from 3.89% to 3.76% as competition continued to weigh on new business and refinance rates. The average rate earned on Franchise mortgages reduced from 2.74% to 2.70%. Lower rates were earned on the fixed rate portion of the portfolio reflecting lower funding costs and increased competition in the market. Yields on unsecured lending decreased from 12.88% to 12.21% reflecting the highly competitive market.

Encumbered assets

Encumbered assets are shown in the table below.

	Assets encumbered with counterparties other than central banks £ million	Assets positioned at central banks (pre-positioned plus encumbered) £ million	Other Assets			Total Assets
			Assets not positioned at central banks			
			Readily available for encumbrance £ million	Capable of being encumbered £ million	Unencumbered-cannot be used £ million	
Cash and balances with central banks	–	2,591.6	–	–	164.0	2,755.6
Loans and advances to banks	302.5 ⁽¹⁾	–	–	–	29.2	331.7
Loans and advances to customers	3,246.7 ⁽²⁾	9,125.6	1,453.7	10,303.9	2,272.3	26,402.2
Available-for-sale financial assets	–	–	1,240.4	–	22.4	1,262.8
Other assets – cash collateral	227.8 ⁽³⁾	–	–	–	637.9	865.7
Total – December 2015	3,777.0⁽⁴⁾	11,717.2	2,694.1	10,303.9	3,125.8	31,618.0
Total – December 2014	230.8	16,159.8	3,171.4	4,019.5	3,589.9	27,171.4

(1) Cash held on deposit by the securitisation subsidiaries, Cape Funding No.1 plc and Duncan Funding 2015-1 plc.

(2) Mortgage loans encumbered in support of external securitisation notes issued by Cape Funding No.1 plc and Duncan Funding 2015-1 plc.

(3) Cash collateral placed with counterparties in respect of TSB Group's derivative financial liabilities.

(4) The increase in amounts encumbered with counterparties other than central banks during 2015 reflects increased funding drawn from TSB Group securitisation programmes.

Income

Net interest income

	2015 £ million	2014 £ million	Change %
Franchise	704.3	707.3	(0.4)
Mortgage Enhancement	73.7	79.8	(7.6)
Acquired ex-Northern Rock Loans	3.3	–	
Management basis net interest income	781.3	787.1	(0.7)
Net interest income on derivatives not in hedge relationships*	(16.0)	(28.9)	44.6
Statutory net interest income	765.3	758.2	0.9

* Included in Management basis net interest income but is recognised in other income for statutory purposes.

	2015 %	2014 %	Change Bps
Segmental margins			
Group banking net interest margin	3.51%	3.56%	(5)bps
Franchise banking net interest margin	3.61%	3.62%	(1)bps
Mortgage Enhancement banking net interest margin	2.90%	3.11%	(21)bps

Management basis net interest income decreased by 0.7% to £781.3 million, primarily reflecting lower earnings from the smaller Mortgage Enhancement book. Franchise net interest margin remained broadly unchanged as the impact of a higher mix of secured lending and pressure on both secured and unsecured lending rates was mostly mitigated by the net impact of harmonising interest rates across the savings portfolio. Mortgage Enhancement net interest income decreased by 7.6% primarily due to the ongoing and expected repayment of balances on this book. This decrease was partially offset by the recognition of a full year of earnings in 2015 as compared to the 10 months recognised in 2014 following the portfolio's transfer which was effective from 28 February 2014.

As guided last year, the end of year Franchise margin is notably lower than the full year average due to the increasing proportion of secured lending on the balance sheet following the launch of the intermediary business.

Other income

	2015 £ million	2014 £ million	Change %
Franchise	129.7	147.8	(12.2)
Mortgage Enhancement	(10.4)	(7.5)	(38.7)
Acquired ex-Northern Rock loans	(1.1)	–	
Management basis other income	118.2	140.3	(15.8)
Net interest income on derivatives not in hedge relationships*	16.0	28.9	(44.6)
Loss on derivatives and hedge accounting	(1.9)	(3.1)	38.7
Derivative fair value unwind	(5.1)	(24.1)	78.8
Volatility related to share schemes – Sabadell shares	(1.8)	–	
Statutory other income	125.4	142.0	(11.7)

* Included in Management basis net interest income but is recognised in other income for statutory purposes.

Other income decreased by 11.7% to £125.4 million reflecting the previously guided effect of market reforms to interchange fee income, lower income from Added Value current accounts which remain available only through the digital channel, and increased current account promotion fees.

Loss on derivatives and hedge accounting

From 1 January 2014, TSB Group established qualifying hedge accounting relationships designed to minimise accounting volatility. These are available as TSB Group applies the accounting policy treatment available in the EU endorsed version of International Accounting Standards (IAS) 39 *Financial Instruments: Recognition and Measurement*, which is not available in the version issued by the International Accounting Standards Board (IASB). The loss on derivatives and hedge accounting of £1.9 million (2014: £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.

Derivative fair value unwind

As the interest rate swaps entered into with LBG on 1 November 2013 were designed to reflect the continuity of the previous economic hedging approach within TSB 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 amounts previously recognised in income, unwinds through the income statement over the remaining life of the interest rate swaps. During 2015, £5.1 million (2014: £24.1 million) of the fair value movement in derivatives was attributable to this factor.

Charges

Operating expenses

	2015 £ million	2014 £ million	Change %
TSB Partner related costs	343.4	331.6	(3.6)
Regulatory and professional costs	36.2	35.0	(3.4)
Operational and IT costs	30.9	29.0	(6.6)
Marketing	54.7	61.1	10.5
Property costs	95.6	87.2	(9.6)
Investment	56.7	43.9	(29.2)
Transitional Service Agreement costs	85.4	97.8	12.7
Other	8.6	10.5	18.1
Management basis operating expenses	711.5	696.1	(2.2)
Sabadell transaction related costs	12.4	–	
Business restructuring costs	11.5	–	
Mortgage Enhancement tax related payment	6.8	–	
Volatility from share scheme liabilities	(1.4)	–	
Defined benefit pension scheme settlement gain	–	(63.7)	
Statutory operating expenses	740.8	632.4	(17.1)
Management basis cost:income ratio	79.1%	75.1%	4.0pp

Management basis operating expenses increased by 2.2% to £711.5 million reflecting increased investment spend, driven by, for example, development costs to enable personal loans to be offered to non-Franchise customers, and costs to support the mortgage intermediary business. These were partially offset by lower TSA costs as more processes were brought in house and lower marketing spend following the increased marketing in 2014 associated with the launch of the Classic Plus current account and the IPO.

Statutory operating expenses increased by 17.1% to £740.8 million reflecting costs related to the Sabadell acquisition of TSB Group and other business restructuring costs, including costs associated with branch co-locations. During 2014, a gain of £63.7 million was recognised, reflecting the derecognition of the defined benefit pension scheme deficit on 31 March 2014. From 1 April 2014, TSB Group has no further liabilities in respect of defined benefit pension schemes.

Impairment charge

	2015 £ million	2014 £ million	Change %
Mortgages	2.0	(0.8)	
Personal unsecured	79.0	95.0	
Business banking	1.2	2.8	
Total Franchise	82.2	97.0	15.3
Mortgage Enhancement	0.1	0.6	
Total impairment charge	82.3	97.6	15.7
Asset quality ratio*	0.37%	0.44%	7bps

*Excludes ex-Northern Rock loans.

The impairment charge decreased by 15.7% to £82.3 million. The personal unsecured portfolio saw a year on year reduction of 16.9% or £16.0 million due in part to sustained favourable economic conditions driving continued improvement in portfolio quality. Impairment charges on the secured portfolio also remained at low levels in 2015. The asset quality ratio decreased to 0.37%, reflecting the decrease in impairment charge.

Taxation

The tax credit of £21.2 million (2014: tax charge of £35.7 million) includes deferred tax credits, which increase the deferred tax asset, as follows:

- £32.3 million arising primarily from changes to UK corporation tax rates (see page 70); and
- £6.8 million in relation to temporary differences that arose following HMRC's determination of the tax transfer value of the Mortgage Enhancement portfolio.

Excluding these items, the effective tax rate was 26.2% which is higher than the average UK corporation tax rate of 20.25% in 2015 reflecting the non deductibility of Sabadell transaction related and other costs.

Profits and returns to the shareholder

Segmental analysis

TSB Group's Executive Committee and Board review the results and consider performance across three segments: Franchise; Mortgage Enhancement; and Acquired ex-Northern Rock Loans.

	Franchise £ million	Mortgage Enhancement £ million	Acquired ex-Northern Rock Loans £ million	Total £ million
Year ended 31 December 2015				
Net interest income	704.3	73.7	3.3	781.3
Other income/(expense)	129.7	(10.4)	(1.1)	118.2
Total income	834.0	63.3	2.2	899.5
Operating expenses	(711.5)	–	–	(711.5)
Impairment	(82.2)	(0.1)	–	(82.3)
Management basis profit before taxation	40.3	63.2	2.2	105.7
Losses on derivatives and hedge accounting				(1.9)
Derivative fair value unwind				(5.1)
Volatility related to share schemes – Sabadell shares				(1.8)
Volatility from share scheme liabilities				1.4
Mortgage Enhancement tax related payment				(6.8)
Sabadell transaction related costs				(12.4)
Business restructuring costs				(11.5)
Statutory profit before taxation				67.6
Year ended 31 December 2014				
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)
Management basis profit before taxation	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
Key balance sheet items at 31 December 2015				
	£ million	£ million	£ million	£ million
Loans and advances to customers	21,123.5	2,272.3	3,006.4	26,402.2
Customer deposits	25,915.7	–	–	25,915.7
Key balance sheet items at 31 December 2014				
	£ million	£ million	£ million	£ million
Loans and advances to customers	18,839.3	2,802.1	–	21,641.4
Customer deposits	24,624.9	–	–	24,624.9

Franchise management basis profit before taxation decreased by 35.0% to £40.3 million during 2015 as a result of investment in business growth and lower fee income on bank accounts partially offset by lower impairment losses as a result of the benign economic environment.

Mortgage Enhancement management basis profit before taxation decreased by 11.9% to £63.2 million due to the expected run-off of this mortgage portfolio.

The Acquired ex-Northern Rock Loans segment has had limited income statement impact following its transfer with effect from 7 December 2015.

By order of the Board



Susan Crichton

Company Secretary, 27 January 2016

Corporate governance statement

21	How the business is managed
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How the business is managed

On 20 March 2015, the Boards of Banco de Sabadell, S.A. (Sabadell) and TSB Banking Group plc (the Company) announced that they had agreed on the terms of a recommended cash offer by Sabadell for the entire issued and to be issued share capital of the Company. The offer was declared unconditional in all respects on 30 June 2015 and the Company delisted from the London Stock Exchange with effect from 28 July 2015.

The design and operation of a robust governance structure appropriate for a bank of TSB's scale and ambition is critical to meeting the needs of all our stakeholders. Although the Company no longer has shares with a premium listing on the London Stock Exchange, the Board of the Company (the Board) has committed to voluntarily adopt the principles of the UK Corporate Governance Code 2014 (the Code), where it is appropriate to do so as a wholly owned subsidiary of a listed Spanish banking group. A copy of the Code is available at www.frc.org.uk.

The following aspects of the Code are not considered appropriate to TSB:

- All Directors should be subject to annual election by shareholders (Code references: B.7.1 and B.7.2).
- Provisions relating to the proportion of independent Non-executive Directors who are members of the Nomination, Audit and Remuneration Committees (B.2.1 / C.3.1 / D.2.1).
- Provisions relating to dialogue with shareholders (E.1) and constructive use of Annual General Meetings (E.2).

In addition, since the resignation of Stuart Sinclair on 27 November 2015, less than half the Board (excluding the Chairman) is comprised of Non-executive Directors considered by the Board to be independent. During the course of 2016 the Board will determine if it is considered appropriate to appoint an additional independent Non-executive Director to the Board.

Change in the structure of TSB Group following acquisition

The Company became a subsidiary of Sabadell on 30 June 2015 and from this date TSB Group has been consolidated in the financial statements of Sabadell. In line with the commitment made by Sabadell prior to the acquisition, work has been undertaken to ensure that any revised governance processes remain fit for purpose and that the Company continues to comply with relevant regulations.

Whilst TSB Bank plc (the Bank) continues to operate as a ring-fenced UK bank it is also now part of a wider group (the Sabadell Group) and is required to adhere to relevant Sabadell Group policies in addition to any relevant obligations imposed by Sabadell's regulators, the Bank of Spain and the European Central Bank.

To assist with this Sabadell has created three information sharing and co-ordination committees to ensure that TSB Group policies and processes are aligned to those of the Sabadell Group where it is appropriate to do so. Certain members of TSB's Bank Executive Committee are also appointed as members of these committees.

The corporate governance framework

The corporate governance framework encompasses the Company, the Bank and any other subsidiaries of the Company from time to time. Each Director of the Company also serves as a Director of the Bank which is also chaired by Will Samuel. The Board as a whole is collectively responsible to the shareholder 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:

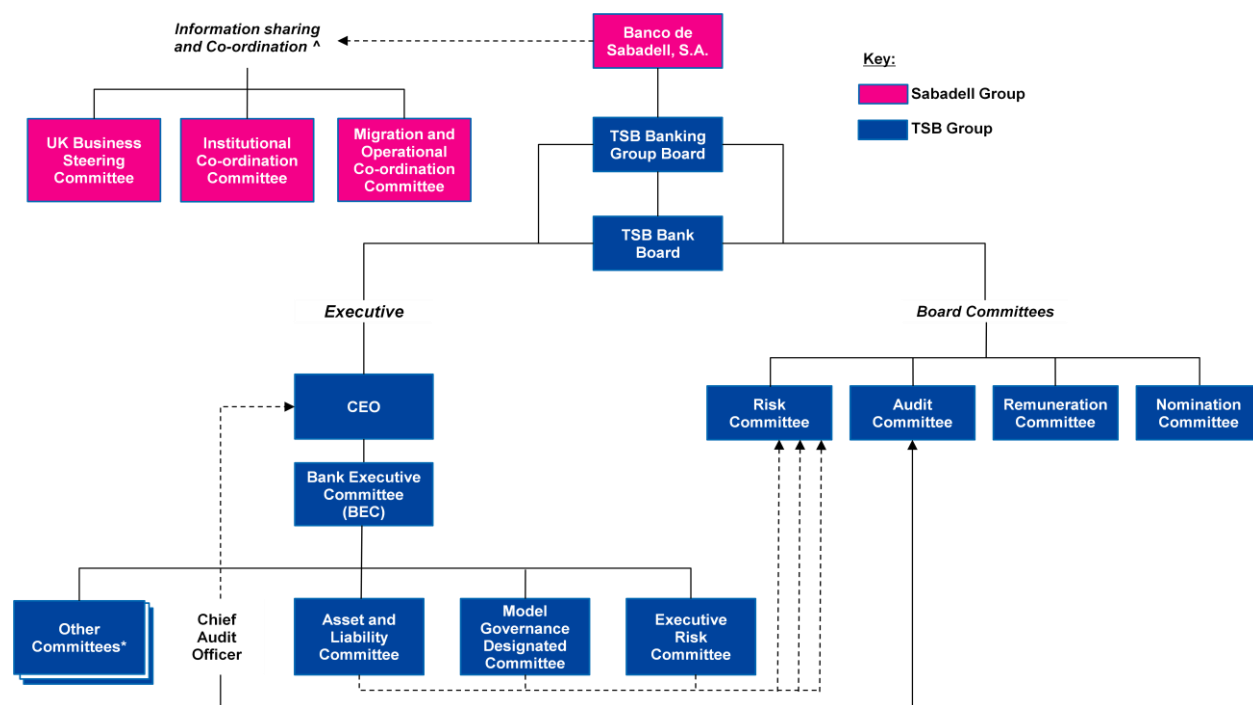
- Board Authorities which set out the basis for delegation of authorities from the Board and the Bank Board to Board Committees and to the Chief Executive Officer; and
- Delegated Executive Authorities through which the Chief Executive Officer delegates aspects of his own authority to the Senior Executives 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 22. 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.

How the business is managed (continued)

The corporate governance framework is reviewed at least annually by the Board to ensure that governance arrangements are and remain effective.

The Company is now a wholly owned subsidiary of Sabadell. The diagram below sets out the framework of Board and Executive Committees.



^ The information sharing and co-ordination committees are Sabadell Group Committees. Membership of these committees includes TSB Group executives.

* Product Pricing Committee, Executive Product and Sales Governance Committee, Spend Wise Committee, Disclosure Committee.

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 TSB Group's strategy and long term objectives and ensuring that rigorous and robust processes are in place to monitor 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 Bank, 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 Bank principles and high level governance policy and noting funding and liquidity and accounting policies;
- Approving TSB Group contracts where the cost impact exceeds £10 million and renewal of existing contracts where the cost impact exceeds £20 million;
- Approving the acquisition or disposal of assets by the Company or any subsidiary of the Company; and
- Approving material changes to TSB Group corporate and organisational structure, including changes to the Company's listing status or its status as a plc.

How the business is managed (continued)

(ii) Risk

- Determining risk appetite, which defines the amount of risk that the Board is prepared to take in pursuit of TSB 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 financial statements and annual report and accounts;
- Approving TSB Group's dividend policy; and
- Approving the resolutions and associated documentation for the shareholder at a general meeting.

In accordance with the new articles of association adopted on 10 December 2015, Sabadell is empowered to determine that certain matters reserved to the Board of the Company also require approval by Sabadell.

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 Board with complementary skills and experience;
- Running the Board and setting its agenda;
- 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 the shareholder;
- Encouraging active engagement by all Board members;
- Holding meetings with the Non-executive Directors without the Executive Directors present;
- Demonstrating effective leadership; and
- Upholding the highest standards of integrity, probity and corporate governance.

(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 TSB Group's strategy;
- Co-ordinating activities to implement strategy and for managing the business in accordance with TSB 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;
- Establishing, maintaining and implementing the risk management and funding and liquidity frameworks in line with Board approved appetite for risk;
- The continuing review of the organisational structure of TSB Group and recommendations for changes to optimise the adequacy and use of resources; and
- Setting the tone at the top in relation to culture, ethos and corporate social responsibility.

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 includes 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.

How the business is managed (continued)

(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 the shareholder if it has 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

As at the date of this report the Board has eight 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:	Dame Sandra Dawson (Senior Independent Director)
	Sandy Kinney
	Polly Williams
Non-executive Directors:	Miquel Montes
	Tomás Varela

Full biographical details including their skills and experience are shown on pages 45 to 47. The letters of appointment for Non-executive Directors are available at the Company's registered office.

On 27 January 2016, TSB announced that Darren Pope intends to step down from the Board on 1 July 2016. It was also announced that Ralph Coates would join the Board as Chief Financial Officer on 1 July 2016, subject to regulatory approval.

Board Committees

Certain responsibilities of the Board and Bank Board are delegated to committees of the Board to assist the Board and Bank Board in carrying out their functions. The Board has established a Risk Committee (chaired by Sandy Kinney) to oversee the management of the risks TSB Group faces, an Audit Committee (chaired by Polly Williams) to oversee financial reporting and internal control, a Nomination Committee (chaired by Will Samuel) to lead the process for appointments to the Board, and a Remuneration Committee (chaired by Dame Sandra Dawson), to formulate TSB Group Remuneration Policy and support the ongoing delivery of sustainable performance. The Audit and Nomination Committees have each prepared reports which include a full discussion on their role, structure and composition. The Committee's terms of reference are available at www.tsb.co.uk.

How the business is managed (continued)

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 (i)	Audit Committee meetings attended	Risk Committee meetings attended	Nomination Committee meetings attended	Remuneration Committee meetings attended
Number of meetings held	22	7	7	3	9
Will Samuel	22 out of 22	-	-	3 out of 3	-
Paul Pester (iv)	21 out of 22	-	-	-	-
Darren Pope (iv)	21 out of 22	-	-	-	-
Philip Augar (ii)(iv)	11 out of 12	-	3 out of 3	1 out of 2	5 out of 5
Norval Bryson (ii)(iv)(vii)	11 out of 12	-	3 out of 3	-	3 out of 5
Dame Sandra Dawson (iv)	21 out of 22	-	-	3 out of 3	8 out of 9
Mark Fisher (ii)(iv)(vii)	11 out of 12	-	3 out of 3	-	-
Sandy Kinney (iv)	21 out of 22	7 out of 7	7 out of 7	-	-
Godfrey Robson (iii)(vii)	8 out of 8	2 out of 2	-	-	-
Stuart Sinclair (iv)(vi)	18 out of 21	6 out of 6	6 out of 6	2 out of 2	-
Polly Williams (iv)	20 out of 22	7 out of 7	7 out of 7	-	9 out of 9
Miquel Montes (v)	10 out of 10	-	-	1 out of 1	4 out of 4
Tomás Varela (v)	10 out of 10	4 out of 4	4 out of 4	-	-

(i) This figure includes the additional Board meetings required due to the acquisition of the Company by Sabadell and the Company's purchase of ex-Northern Rock mortgages and loans from Cerberus Capital Management group.

(ii) Resigned from the Board on 30 June 2015.

(iii) Resigned from the Board on 22 April 2015.

(iv) 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.

(v) Appointed to the Board on 30 June 2015.

(vi) Resigned from the Board on 27 November 2015.

(vii) Norval Bryson was paid a fee for attending the Risk and Remuneration Committees, Godfrey Robson was paid a fee for attending the Audit Committee and Mark Fisher was paid a fee for attending the Risk Committee. Accordingly, although they were not members of these committees, their attendance at such meetings is recorded in the table above. Their attendance and participation at these meetings for a transitional period enhanced discussion and ensured that their experience and knowledge of TSB assisted the committees in discharging their duties effectively.

Board development

Miquel Montes and Tomás Varela completed a comprehensive induction programme following their appointment to the Board as Non-executive Directors. 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. Additionally, Non-executive Directors are given the opportunity to request additional training in order that they are fully comfortable with their role within the Board and to ensure that they are able to contribute to the operation of the Board and the long-term success of the Company in the fullest manner possible.

In addition, '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 2015 and covered topics including the Senior Managers' Regime, conduct risk, interest rate risk in the banking book and a review of liquidity stress scenarios. The Chairman maintains an oversight of the training and development requirements of the Board, supported by the Company Secretarial and Risk functions. The Company Secretarial function maintains a schedule of all external training sessions and conferences attended by the Directors during the year.

How the business is managed (continued)

Board effectiveness

An independent Board effectiveness development programme was undertaken during the period December 2014 to June 2015 led by Dr Elisabeth Marx of Stonehaven International. The programme was 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. Dr Marx observed the December 2014 Board meeting, held one to one meetings and subsequent feedback meetings with each Board member following which she discussed her findings at a Board workshop focusing on the areas of governance, skills and dynamics in the context of enabling growth. The review, as part of the development programme, concluded that the Board's performance was effective whilst identifying areas where it could be developed further. Stonehaven International has no other connection with the Company.

The Board's Audit, Risk and Remuneration Committees have also conducted a review of their effectiveness during 2015. Each committee agreed a questionnaire which was circulated to committee members and other members of the executive team who regularly attend committee meetings. The results were analysed by the Company Secretarial team, discussed with the chair of the relevant committee and actions agreed by the committees for the coming year.

Independence

The Board has considered whether there are any relationships or circumstances which could appear to affect the Directors' judgement. No Independent Non-executive Director, or member of their immediate family, has ever had a material relationship with TSB Group nor receives additional remuneration apart from Director fees. The Independent Non-executive Directors do not participate in TSB Group's pension schemes nor do they participate in TSB Group's share schemes. Miquel Montes and Tomás Varela are members of Sabadell's Executive Committee and for that reason are not considered to be independent. They do not receive any fees from TSB Group. No Directors serve as Directors of any companies or affiliates in which any other Director is a Director.

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 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 Miquel Montes and Tomás Varela, 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.

As Executive members of Sabadell, Miquel Montes and Tomás Varela will have a conflict of interest in circumstances where the interests of TSB Group and the wider Sabadell Group are not, or may not be, aligned. This conflict was authorised by the Board on 22 July 2015.

How the business is managed (continued)

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. As the Company is now part of the Sabadell Group it is no longer considered appropriate for Directors to seek annual re-election. All Directors have, however, been appointed for an initial three year term and their continued appointment thereafter will be considered by the Board at the end of this initial period of office.

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 34.

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 35, resolutions proposing their reappointment for 2016 and to authorise the Directors to determine their remuneration will be proposed at the 2016 Annual General Meeting, as recommended by the Audit Committee.

Principal accountant fees and services

An analysis of fees for professional services provided by PwC, the Company's external auditor is set out in note 16 to TSB Group's consolidated financial statements on page 68.

Liaison with shareholders

Prior to the Company's de-listing on 28 July 2015, the Executive Directors met regularly with investors to discuss the Company's business and financial performance.

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 TSB Group's principal executive committee. The Bank Executive Committee collectively supports the Chief Executive Officer in developing and implementing TSB Group's strategy, monitoring business performance and agreeing any actions that are required to manage issues that affect TSB Group. Consideration is given to the interests of all stakeholders, including customers, the shareholder 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. The Chief Audit Officer also has a reporting line to the Group Chief Audit Officer of Sabadell.

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 TSB Group. The Committee provides oversight to assure the effective operation of governance, risk and control frameworks across TSB 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 TSB Group. This is the Board's designated model governance committee and the Chief Financial Officer is the designated Board member attending.

How the business is managed (continued)

(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 TSB 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 is responsible for the strategic management of TSB 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 TSB Group's expenditure. The Committee ensures that TSB Group spends efficiently and reviews cost budgets and forecasts to ensure that they support the delivery of TSB Group's strategy. The Committee also considers requests for expenditure that are outside of forecast and budgets before they are spent, together with the review of budgeted expenditure over a set limit to ensure such requests represent value for money.

(vi) Disclosure Committee

Chaired by the Chief Financial Officer, the Disclosure Committee is responsible for identifying inside information and determining how and when TSB Group should disclose that information in accordance with its obligations to the Sabadell Group and holders of the listed debt.

(vii) Executive Product and Sales Governance Committee

Chaired by the Chief Risk Officer, the Executive Product and Sales Governance Committee 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, 27 January 2016

Nomination Committee report

Chairman's introduction

All the Nomination Committee members are 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 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 in the future.

The members of the Nomination Committee are as follows:

- Will Samuel (Chairman);
- Dame Sandra Dawson; and
- Miquel Montes (from 30 June 2015).

Philip Augar and Stuart Sinclair served as members of the Nomination Committee until their resignation as Directors of the Company on 30 June 2015 and 27 November 2015, respectively.

The Committee met three times during the year.

Recruitment of Directors

As part of its acquisition of TSB, Sabadell nominated Miquel Montes and Tomás Varela to become Non-executive Directors of TSB. The Nomination Committee met on 25 June 2015 to consider the proposal and subsequently recommended the appointments to the Board pending completion of the acquisition and subject to Miquel and Tomás's applications to the PRA and FCA being confirmed. As Miquel and Tomás were nominated by Sabadell, neither an external search consultancy nor open advertising were used in their appointment.

In late 2015, the Nomination Committee undertook a search for a Chief Financial Officer to replace Darren Pope who had indicated that he was minded to step down should a suitable successor be identified. A thorough search was undertaken using the services of an external search firm and the Committee met to discuss potential candidates. On 26 January 2016 the Committee met and agreed to recommend to the Board the appointment, subject to regulatory approval, of Ralph Coates as Chief Financial Officer and Board Director of TSB Banking Group plc and TSB Bank plc.

Diversity

TSB 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. The Board diversity policy promotes and affirms our aspiration to meet and exceed the target of 25% of Board positions being held by women, as set out by Lord Davies. We currently have 38% women on the Board; although this may change over time as the Board is refreshed and new appointments are made. Additionally, women chair three of the four Board Committees. 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 percentage of women in senior management positions and throughout TSB Group is set out on page 37.

The Chairman's other significant interests

My other significant commitments are as detailed on page 45. There have been no changes to them during the year ended 31 December 2015.



Will Samuel

Chairman, 27 January 2016

Audit Committee report

Chair's introduction

Following TSB Group's delisting from the London Stock Exchange, it is no longer a requirement to include an Audit Committee report in our Annual Report and Accounts. It is, though, a mark of our transparency that we do so voluntarily. As I said in my opening remarks in the 2014 Annual Report and Accounts, and I believe is important to repeat, I have a very clear understanding of the importance placed on the role of the Audit Committee and I will ensure that I and the Committee are held to account and that its activities are reported in a straightforward and transparent manner.

I am a chartered accountant and spent a number of years as an Audit Partner at KPMG. I am a Non-executive Director of Jupiter Fund Management plc, Daiwa Capital Markets Europe Ltd and XP Power Ltd. I have been chair of the Committee throughout 2015, ably supported by my fellow Non-executive Director Sandy Kinney during that period. I thank Godfrey Robson and Stuart Sinclair for their support and service on the Committee up to 22 April 2015 and 27 November 2015 respectively, when they stepped down from the Company's Board. I also welcome Tomás Varela as a member of the Committee following his appointment to the Board as a Non-executive Director on 30 June 2015. Biographies of the members of the Committee can be found on pages 45 to 47. All Non-executive Directors, including the Chairman, of TSB Group have a standing invitation to attend meetings of the Committee.

The report that follows describes the Committee's responsibilities and its activities during 2015. Consistent with last year, it describes the matters reviewed by the Committee in assessing the transparency and integrity of TSB Group's financial reporting, explains the Committee's work in assessing the effectiveness of TSB Group's internal controls and risk management framework and the activities undertaken to monitor the work and priorities of the Internal Audit function.

In discharging its responsibilities during 2015, 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 external auditor during 2015.

The Committee's focus in 2016 will continue to evolve and will take particular interest in:

- maintaining an effective control framework during a period of rapid growth and when management are working to consider a migration to the Sabadell banking platform;
- understanding the consequences for TSB Group's control framework resulting from any migration activity; and
- overseeing TSB Group's readiness for IFRS 9 '*Financial Instruments*' and, in particular, compliance with the new financial asset impairment requirements of this new accounting standard.



Polly Williams

Chair, Audit Committee, 27 January 2016

Audit Committee report (continued)

Membership and operation of the Committee

The Committee currently comprises two independent Non-executive Directors and one Non-executive Director, each with recent, relevant experience in finance or banking. All members of the Committee are also currently members 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 seven times during 2015 and has allocated its time to reflect the priorities of TSB Group.

Audit Committee responsibilities and activity in 2015

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

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

Financial statements and reporting

The Committee is responsible for review and challenge of TSB Group's interim and annual financial statements including the significant financial reporting estimates and judgements which they contain. During 2015, 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 TSB Group's accounting policies. This review included consideration of the nature of TSB Group's activities and industry wide practice.

Specifically the Committee considered and accepted management's proposals to:

- adopt cash flow hedge accounting effective from 1 January 2015 (see page 75);
- change TSB Group's accounting policy for share-based compensation to reflect changes to certain TSB share schemes that previously settled in TSB shares and which now settle in Sabadell shares (see page 67); and
- include an accounting policy for foreign currency translation following the issuance of euro denominated securitisation notes (see page 50).

(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
Duncan Funding 2015-1 plc securitisation transaction	Page 61
Changes to share-based compensation arrangements following the acquisition of TSB by Sabadell	Page 70
Mortgage Enhancement deferred tax assets	Page 71
Acquisition of portfolio of ex-Northern Rock loans	Page 61

Audit Committee report (continued)

(iii) Whether TSB 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 financial statements. Consideration has been given to these estimates and judgements at each of TSB Group's reporting dates throughout 2015. The table below summarises the position reflected in TSB Group's financial statements for the year ended 31 December 2015. After challenge, the Committee supported management's proposals in each of these cases.

Significant accounting judgements and estimates	Audit Committee considerations	Financial statement reference
Impairment provisioning	At 31 December 2015, TSB Group's allowance for impairment losses was £71.2 million. Determining the adequacy of provisions against the loan portfolio requires judgement in assessing the level of incurred losses in the 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 TSB Group's metrics against other banks. At 31 December 2015, the impairment provisions included £18.4 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 63)
Customer remediation provision	Conduct issues are a key focus of the banking industry. Notwithstanding the indemnity given by Lloyds Bank plc, TSB Group retains the primary liability for alleged misconduct to its customers. During 2015, TSB Group recognised provisions of £14.5 million, together with an asset of £14.5 million in respect of indemnity provided by Lloyds Bank plc, primarily in respect of alleged mis-selling of added value current accounts. 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 received by TSB Group. The Committee was satisfied that the provisions, recovery under the indemnity and related disclosures in the financial statements were appropriate.	Note 32 (page 88)
Recoverability of deferred tax assets	At 31 December 2015, TSB Group's deferred tax assets of £121.1 million primarily reflected unutilised temporary differences arising from the transfer in 2013 of customer balances to TSB Group from LBG entities and temporary differences arising from the transfer of the Mortgage Enhancement portfolio in 2014. 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. The Committee agreed with management's judgement that, based on TSB Group's forecast taxable profits, continued recognition in full of the deferred tax asset remained appropriate.	Note 20 (page 71)

Audit Committee report (continued)

Effective interest rate methodology	At 31 December 2015, TSB Group carried an asset of £8.0 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 56)
Acquisition of a portfolio of ex-Northern Rock loans	On 7 December 2015, TSB Group acquired a £3.0 billion portfolio of ex-Northern Rock loans which primarily comprises mortgages with a small balance of unsecured loans. Accounting standards require the portfolio to be recognised at its acquisition date fair value which requires judgement to determine that the consideration paid for the portfolio reflects their acquisition date fair value. The Committee received a report from management setting out the approach undertaken which noted that the sale was undertaken via a public competitive tender process and pricing had considered the extent of a number of risks including credit and conduct. In order to determine the effective interest rate (EIR) to be used to recognise interest income on the portfolio, management judgement was required in assessing the level of incurred losses at the acquisition date such that only losses incurred subsequently are recognised in the income statement. The Committee received a report from management setting out the approach to assessing incurred losses including management's adjustments to modelled outcomes. The recognition of interest income also requires management judgement to estimate the expected repayment profile of the portfolio. The Committee received reports from management summarising their approach. The effect of this judgement was not significant in 2015 but will be monitored by the Committee in future periods in the light of the repayment profile of the portfolio compared to management's original estimates.	Note 7 (page 61)
Valuation of TSB Group's investment in Visa Europe	TSB Bank plc is a principal member and shareholder of Visa Europe. At 31 December 2015, TSB Group's investment in Visa Europe was recognised as an available-for-sale asset at its fair value of £22.4 million. Determining the fair value of this asset requires management judgement and the Committee received a report from management setting out the approach adopted. This noted that in November 2015, Visa Inc. announced the proposed acquisition of Visa Europe. TSB Group's estimated share of the sales proceeds comprise of up-front cash consideration of €30.5 million (£22.4 million) and preferred stock convertible into Visa Inc. common stock (up to £17.4 million based on December 2015 market prices). The conversion of the preferred stock remains subject to potential reduction for certain litigation losses incurred by Visa Europe. A further contingent earn-out is payable dependent upon certain conditions. No amounts will be payable until completion takes place which is currently expected during the first half of 2016. Management concluded that currently no value should be attributable to the preferred stock or earn-out reflecting significant ongoing uncertainties and concluded that the cash consideration was a reliable estimate of the current fair value of the investment. The Committee was satisfied that the fair value recognised was appropriate.	Note 11 (page 63)
Fair value of financial instruments carried at amortised cost	Accounting standards require TSB 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 TSB 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 2015. The Committee concluded that the approach adopted and the fair values disclosed were appropriate.	Notes 6 and 12 (pages 58 and 64)

Audit Committee report (continued)

(iv) Viability and going concern assessments

The Committee considered management's approach to, and the conclusions of, the assessment of TSB Group's ability to remain a going concern. The results of that assessment are set out on page 12 where it is noted that the assessment of going concern is integrated with the Directors' assessment of viability.

The Committee also considered management's approach to, and the conclusions of the assessment of TSB viability. In particular the Committee considered and supported the approach adopted by management in determining the period over which viability was assessed. The results of the viability assessment are set out on page 12.

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 the assessment are set out in the Directors' report (page 38).

Internal controls and risk management systems

The Committee is responsible for reviewing the adequacy and effectiveness of TSB Group's internal controls and risk management systems and reporting on that review. As described in the review of the principal risks and uncertainties, on page 11, TSB Group has a significant dependency on LBG for the provision of banking services and the effective operation of related controls under the TSA. The Committee includes these controls within the scope of its review. In undertaking that review the Committee considered the following specific matters:

- Ongoing monitoring reports of the effectiveness of TSB Group's internal control and risk management systems;
- A review which concluded that TSB Group's internal financial control framework is operating effectively;
- Regular management information on the activity of Internal Audit; and
- The review of matters arising from a Type 2 International Standard on Assurance Engagements (ISAE) 3402 controls report from LBG.

On the basis of this work, the Committee was satisfied that TSB Group's internal controls and risk management systems operated effectively during 2015. The key elements of the management of risk within the business and the effective system for internal controls are set out within the corporate governance statement (see page 21).

Whistleblowing

The Committee oversees the adequacy of TSB Group's whistleblowing arrangements, ensuring that they are proportionate and enable Partners and contractors to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters. In 2015, the Committee considered a report on the whistleblowing arrangements within TSB Group and an overview of instances of whistleblowing. The report concluded that there is awareness of whistleblowing processes and procedures within TSB Group and that there were no matters that would suggest these are not operating effectively. The report further 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 2015, 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 2015 Internal Audit plans and ensuring these had appropriate coverage of the business and were flexible and focused on significant risk activities in 2015;
- Receiving regular reports from the Chief Audit Officer on the range of Internal Audit activities undertaken in 2015 and monitoring activities resulting from Internal Audit reports;
- Reviewing and approving the 2016 Internal Audit plans in line with TSB Group's strategy, ensuring that, as above, it has the flexibility to respond to important events that may arise, e.g. providing assurance over inorganic growth opportunities;
- Approving the Internal Audit budget, including for utilising subject matter expertise where appropriate, to deliver the audit plan;
- Reviewing the interaction between Internal Audit and the Risk function;
- Reviewing the interaction between Internal Audit and the external auditor; and
- Confirming that Internal Audit makes independent assessments of TSB Group's control framework but is fully informed by management's and the Risk function's reporting and views on risks and controls.

Audit Committee report (continued)

Relationship with the external auditor

The Committee is responsible for the effectiveness of TSB Group's relationship with its external auditor and for assessing their independence and objectivity. During 2015 the Committee discharged this responsibility by:

- Agreeing the terms of the audit engagement letter and reviewing and approving the audit fee proposal;
- Reviewing and challenging the external auditor's audit strategy and their consideration of significant and elevated audit risks to ensure TSB Group's circumstances are appropriately reflected;
- 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 potential considerations for TSB Group's audit;
- Considering the approach to obtaining independent assurance over outsourced controls;
- Performing a formal review of the audit service through the use of targeted confidential questionnaires with selected senior members of TSB Group's management team and interviews with the Chair of the Audit Committee, Chief Financial Officer and Chief Risk Officer and a senior Partner from PwC who is independent of the TSB audit engagement; and
- Ensuring compliance with policy governing the use of the external auditor for non-audit services to safeguard their objectivity and independence (see page 68 for fees paid to the external auditor).

The Committee is mindful of its obligations to tender TSB Group's external audit, at a minimum, every 10 years. While the Committee undertook to develop an audit tendering policy in 2015, this was superseded by the acquisition of TSB Group by Sabadell.

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 historic LBG audit relationship. The Committee has taken into account the knowledge and experience that PwC have of TSB Group's business and the need to align with the broader Sabadell Group wide audit arrangements. Consequently, the Committee has recommended to the Board that the re-appointment of PwC for the audit of the 2016 financial statements is put to the shareholder along with a resolution for the Committee to set the remuneration and terms of engagement of the Company's auditor. 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.



Polly Williams

Chair, Audit Committee, 27 January 2016

Directors' report

Introduction

The Directors of TSB Banking Group plc (the Company) present their report for the year ended 31 December 2015, in accordance with section 415 of the Companies Act 2006.

The information set out on pages 3 to 19 and, in particular, the following cross-referenced material, is incorporated into this Directors' report:

- The change in TSB Group's structure (page 21);
- The corporate governance statement (pages 21 to 48);
- Likely future developments in TSB Group's business (page 7); and
- Statement of Directors' responsibilities (page 48).

Results and dividends

The consolidated balance sheet can be found on page 52 and the consolidated statement of comprehensive income is on page 53. 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	<i>(resigned 30 June 2015)</i>
Norval Bryson	<i>(resigned 30 June 2015)</i>
Dame Sandra Dawson	
Mark Fisher	<i>(resigned 30 June 2015)</i>
Sandy Kinney	
Miquel Montes	<i>(appointed 30 June 2015)</i>
Paul Pester	
Darren Pope	
Godfrey Robson	<i>(resigned 22 April 2015)</i>
Stuart Sinclair	<i>(resigned 27 November 2015)</i>
Tomás Varela	<i>(appointed 30 June 2015)</i>
Polly Williams	

The biographies of TSB Group's Directors appear on pages 45 to 47.

On 27 January 2016, TSB announced that Darren Pope intends to step down from the Board on 1 July 2016. It was also announced that Ralph Coates would join the Board as Chief Financial Officer on 1 July 2016, subject to regulatory approval.

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 appointed or removed from office by written notice provided to the Company by Sabadell as the sole shareholder.

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, with the exception of Miquel Montes and Tomás Varela, 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 Articles and the Companies Act 2006. The indemnities were in place throughout 2015 and remain in force at the date of signing these financial statements and are available for inspection at the Company's registered office. Deeds of indemnity for Miquel Montes and Tomás Varela are in the process of being put in place.

Directors' emoluments waiver

Miquel Montes and Tomás Varela do not receive a fee as Non-executive Directors of the Company. None of the other 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 they agreed to waive future emoluments.

TSB Banking Group plc

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Directors' report (continued)

Share capital

At 27 January 2016 the total issued share capital with voting rights consisted of 500,000,000 ordinary shares of £0.01 each. The total share capital is held by Banco de Sabadell, S.A.

Future developments

The development of TSB Group is set out in the context of the Board's strategy on page 7.

Employee information

TSB aims to be an inclusive organisation in which people with disabilities are treated fairly and can compete on equal terms for career progression. TSB's Partners with Disabilities policy is designed to inform Partners of the support available to those with disabilities and how to access this support. This policy, along with a range of supporting initiatives, helps TSB to achieve this important goal. TSB is committed to becoming a disability confident employer and is a member of the Business Disability Forum.

A key enabler in creating an inclusive culture is TSB'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 TSB's approach in this area.

Gender balance of Partners is a key priority to ensure that TSB recruits from the widest resource pool and appoints the best person for each role. There is particular focus on achieving this balance for the more senior roles in the Bank, with 40% of Senior Managers, 33% of the top 150, 38% of the Executive Committee, and 38% of the Board being female.

TSB has policies that enable Partners to work flexibly, including working compressed hours, flexible hours and job sharing to meet personal commitments.

A culture of lifelong learning continues to be embedded within the organisation. Every Partner is encouraged to have a personal development plan which they review regularly with their line manager. Partners who are new to role or to TSB are given an induction, 'Welcome to TSB'. The 'TSB Academy' guides Partners through all of the learning and development that is available, and a mentoring scheme encourages 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.

'The Link', a forum formed of Partners across all levels, gathers and builds on Partner feedback and enables meaningful dialogue between Partners and the Executive leadership. There are five regional Link Groups covering Britain, made up of Partners from every part of the business. The outputs from every meeting are presented to the Executive Committee to help inform TSB's activity and strategic outlook.

Partner feedback is also received through an annual Partner Experience survey. In the most recent survey, 76% of questions were answered positively and action plans are being delivered to address any negative trends identified.

Collaboration is also encouraged through the recognition and celebration of Partner contribution. This is demonstrated in the 'Say Thank You' scheme which gives Partners the opportunity to recognise the contribution of fellow Partners who demonstrate TSB's values.

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 the Managing financial risk section of the financial statements on pages 75 to 83.

Post balance sheet events

There are no significant events affecting TSB Group that have arisen between 31 December 2015 and the date of this report that require disclosure save for the matter disclosed in note 35 to the financial statements on page 89.

Directors' report (continued)

Research and development activities

TSB Group develops new products and services during the ordinary course of business.

Overseas branches

TSB 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 auditors are 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 auditors are aware of that information.

Going concern

The Directors recognise their responsibility to make an assessment of TSB 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. As set out on page 12, 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 TSB 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 the shareholder to assess the Company's position and 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 widely by TSB Partners of varying degrees of seniority and from a broad range of TSB Group functions, TSB Group's Executive Committee and the Audit Committee prior to consideration by the Board.

By order of the Board



Susan Crichton

Company Secretary, 27 January 2016

Registered in England and Wales

Company Number 08871766

Remuneration review

TSB Group's remuneration philosophy and framework remain unchanged from last year. Our approach is designed to be transparent, simple and fair and put customer service at the heart of what we do. As TSB Group no longer has shares listed on the London Stock Exchange, formal reporting requirements have reduced. As a matter of good corporate governance, certain voluntary disclosures are provided in this section to provide transparency and clarity on Directors' remuneration policy and practice.

Overview of remuneration in 2015

The main elements of our remuneration policy are competitive fixed pay, the TSB Award for all Partners and the Sustainable Performance Award (SPA) for our more senior Partners.

The Committee considered some changes to be necessary post acquisition and these were made with the agreement of Sabadell. The key changes are:

- The fixed pay of two senior executives was increased from 1 July 2015. The increases for both executives took account of the changed circumstances and the wider market. In the case of the CEO, this also reflected the wider remit of his role and his additional accountabilities as a member of the Executive Committee of Sabadell. The change to the CEO's fixed pay was partly in the form of a role based allowance. No other role based allowances have been approved.
- An additional incentive arrangement, the Sabadell Integration Award (SIA), has been put in place for a small number of senior Partners. These individuals are now responsible for critical objectives: to achieve the wider integration of TSB into the Sabadell Group and to develop proposals for a migration of TSB Group onto Sabadell IT platforms. Awards will pay out only if demanding corporate and personal performance conditions are met.
- Sabadell's 2:1 cap on variable to fixed pay, approved by its shareholders for use in 'exceptional circumstances,' will apply to TSB Group from 1 July 2015. From 1 January to 30 June 2015, the 1:1 cap applied.

The aim of our remuneration policy remains to provide competitive remuneration aligned to the delivery of our strategic goals; the promotion of TSB values; the generation of sustainable business performance, taking into account the effective management of risk and acceptable conduct; and a focus on the need for successful integration into the Sabadell Group. TSB's remuneration policy meets all applicable regulatory requirements. We maintain a dialogue with our regulators on remuneration matters.

Remuneration review (continued)

TSB Remuneration Policy overview

The table below summarises the key components of TSB's remuneration.

Fixed pay	TSB aims to provide market competitive fixed pay, taking into consideration relevant market benchmarks, complexity of the role and the individual's experience and performance. It includes: • Basic salary: Typically reviewed annually, taking account of general market movements and performance of TSB and the individual. • Pension: Participation in TSB's defined contribution scheme. Senior Partners may receive a cash allowance of equivalent value in lieu of a pension contribution. • Benefits: Benefits include private medical insurance, life assurance, provision of a car (or alternatively a cash based car allowance) and participation in TSB's flexible benefits scheme. Other benefits may be provided where appropriate (e.g. relocation allowances). • Role based allowance: This is only received by the CEO to reflect the change in his role following the acquisition of TSB by Sabadell.
TSB Award	The TSB award is an annual incentive for all Partners on the same terms. It rewards the achievement of annual business and personal performance targets and aligns all Partners to common goals. An 'on-target' award level of 10% of basic salary applies to all. Awards are made only if certain 'gateways', including risk, profitability and individual conduct are satisfied and corporate performance targets are met. Further detail on the performance measures are provided below.
Sustainable Performance Award (SPA)	The SPA is a long term incentive arrangement, designed to reward sustained business performance over time. Awards are funded subject to there being sufficient profit and the pool is determined based on assessment of corporate performance measures. Individual awards are then determined by reference to individual performance and are denominated in a mix of cash and shares (proportions vary depending on seniority). Awards are deferred in line with regulatory requirements and only vest to the extent that vesting conditions are met.
Sabadell Integration Award (SIA)	SIAs will be made to a small number of Partners based on their role in achieving critical integration and potential migration objectives. The SIA will run from 2015 to 2017. Awards will only vest to the extent that stretching performance targets are achieved and will be deferred in line with regulatory requirements.

Given new regulatory requirements any SPA or SIA awards made to our most senior Partners for performance periods from 1 January 2016 will be subject to increased deferral of up to seven years.

Taken as a whole, we believe TSB Group's remuneration package is balanced and competitive, driving sustainable long-term growth.

The Remuneration Committee does not expect any significant changes to the remuneration policy in 2016.

TSB Award

All eligible Partners participate in the TSB Award which is structured to pay the same percentage of basic salary, depending on corporate and individual performance, to those with the same performance rating.

The core TSB Award can vary between 0% and 15% of eligible basic salaries. Outcomes are always subject to the discretion of the Committee based on consideration of results. At 'on target' performance the award is targeted to be 10% of eligible basic salaries. Individuals with an exceptional performance rating of 'Pioneer' could be given a higher award, with a maximum of two times the core award. This means the highest award possible could be 30% of basic salary for a Partner with a 'Pioneer' performance rating. A zero award is possible if either corporate performance and/or individual performance merit that result.

The process for determining the TSB Award is as follows:

- Assess whether profitability and risk management gateways have been satisfied at a corporate level.
- Assess corporate performance against pre-determined Key Performance Indicators (KPIs) to determine the overall award size and funding for the year.
- Assess individual performance to (i) ensure all individuals have met minimum performance criteria to be eligible for the award and (ii) identify any exceptional performance in the year which may warrant an enhanced 'pioneer' award.

Remuneration review (continued)

The pre-determined KPIs to determine the overall award size for 2015 were set under the following strategic priorities:

- **Customer Outcomes** –Targets were set relating to:
 - Customer satisfaction measured by a Net Promoter Score (NPS);
 - Customer advice measured through a sales fair outcomes assessment; and
 - Customer service based on how well we deal with customer complaints.
- **Financial Resilience** - A profit target was set.
- **Strategic Delivery** –Targets were set relating to:
 - Personal Current Account (PCA) market share flow;
 - Digital penetration of new PCA customers; and
 - Gross Asset Flows.

Sustainable Performance Award (SPA)

SPA awards are restricted to more senior Partners, broadly the Bank Executive Committee, their direct reports and some other senior roles.

The face value of a SPA grant may vary between 0% and 100% of basic salary. 'On target' awards vary by seniority, but for BEC members would be 62.5% of basic salary. Exceptional corporate and individual performance may result in a higher award but no grant will exceed 100% of basic salary. A zero award can be made if either corporate and/or individual performance merit that result.

The process for determining the grant level for SPA Awards for participants is as follows:

- Assess whether profitability and risk management gateways have been satisfied at a corporate level.
- Assess corporate performance against pre-determined KPIs to determine the SPA pool size.
- Assess individual performance to determine individual award levels.

The pre-determined KPIs to determine the core award pool size for 2015 were set under the same strategic priorities as for the TSB Award, detailed above. One further target was set for the SPA under the heading of Financial Resilience relating to the management of operating costs.

SPA Awards will be made following the publication of TSB Group's results (i.e. in Q1 2016) and will vest in five annual tranches if the vesting conditions are met, from the first anniversary of the award.

Sustainable performance release conditions

Each tranche is released subject to satisfactory individual conduct and performance, if the sustainable performance conditions have been met at each vesting date. These conditions are as follows:

- Capital and Liquidity: No significant breach of Board risk appetite in the year.
- Regulatory & Compliance: No material regulatory issues and satisfactory internal control environment in the year.
- Sustainable financial performance: Performance against a pre-determined financial target has been achieved.

The testing of the metrics will determine, subject to the Committee's discretion, the extent to which a tranche vests. The vesting may be reduced, ultimately to zero, depending on the testing outcome and Committee discretion.

Remuneration review (continued)

Sabadell Integration Award (SIA)

The SIA is designed to support the delivery of a potential migration and integration plan. Each year up to the end of the 2017 financial year, the Remuneration Committee will consider grants to those eligible to participate in the SIA and the performance targets that need to be met for those awards to vest.

For the SIAs granted in 2015, individual performance objectives had to be met for the awards to vest. However, 2015 awards that vested were deferred. They will be released only if TSB Group achieves profit and operating cost targets and if the Committee is satisfied that the overall integration of TSB Group into the Sabadell Group is being achieved. 50% of the 2015 vested award is subject to these performance criteria for 2016 and 50% for 2017. Testing of corporate objectives will ensure individual objectives have not been met at the expense of TSB Group's sustainable financial performance and its successful integration into the Sabadell Group. The Committee will also ensure any payments under the SIA are affordable.

At an individual level, in respect of the 2015 awards, personal objectives were set relating to key targets for the second half of 2015. Account will also be taken of individual 2015 performance against TSB Group's risk, culture and conduct requirements.

Consideration of risk

In designing the remuneration elements, careful consideration has been given to supporting and promoting sound and effective risk management. For example:

- Risk profile and behaviours are a key gateway that must be satisfied for any of the incentive awards to pay out. Incentive pools and awards may be adjusted, including to zero, in the event of any material breaches.
- All elements of variable remuneration for Material Risk Takers are subject to malus and clawback provisions in line with regulatory requirements.
- Risk based adjustments to variable reward outcomes at a collective and individual level are considered, and where appropriate, applied.
- A significant portion of variable remuneration is deferred. For example, for the CEO at least 60% of variable remuneration is deferred and released over a five year period post award (increasing to seven years for variable remuneration for performance periods from 1 January 2016).

Remuneration review (continued)

Highest paid Director – 2015 remuneration disclosure (audited)

The table below sets out 2015 and 2014 total remuneration for TSB Group's CEO, Paul Pester, the highest paid director.

	2015 £	2014 £ ⁽¹⁾
Basic salary ⁽²⁾	800,000	651,588
Role based allowance ⁽³⁾	100,000	–
Benefits ⁽⁴⁾	43,426	26,232
Pension ⁽⁵⁾	160,000	130,318
Fixed Pay	1,103,426	808,138
TSB Award ⁽⁶⁾	100,000	36,167
2014 Bonus Award for the period to IPO ⁽⁶⁾	–	377,000
2014 SPA – Vesting of Tranche 1 ⁽⁷⁾	124,343	–
Variable remuneration	224,343	413,167
Total	1,327,769	1,221,305

Notes

- (1) The figures set out for 2014 represent relevant remuneration figures for the full year drawn from the disclosures in TSB's 2014 Directors' Remuneration Report (DRR). Since part of 2014 related to service prior to TSB's IPO, the relevant single figure total disclosed related to the period for which qualifying services were provided (25 April 2014 to 31 December 2014). On that basis, the relevant 2014 single figures were £571,542 for fixed pay and £166,167 for variable pay. The 2014 DRR also disclosed details of the legacy LBG LTIP granted in 2012 which vested for the performance period ended 31 December 2014.
- (2) The basic salary figure represents the actual amount paid during 2015, reflecting a basic salary of £700,000 from 1 January to 30 June 2015 and of £900,000 from 1 July to 31 December 2015.
- (3) The role based allowance figure is for payments made for the period from 1 July 2015 to 31 December 2015.
- (4) Benefits include the taxable value of all benefits received. Benefits include a car allowance and a flexible benefits allowance set annually at 4% of basic salary.
- (5) Pension represents the value of the pension allowance provided, which has been paid partly as contributions into TSB's Defined Contribution Pension Scheme with the balance in cash.
- (6) The TSB Award in 2014 was paid for the period from 25 June 2014 (the date of listing) to 31 December 2014. For the period from 1 January to 25 June 2014, TSB Group operated legacy LBG bonus arrangements but payments were based on TSB performance conditions. The amount awarded under this scheme is set out here in the 2014 column.
- (7) The value shown represents the full value of the vesting of the first tranche of the SPA grant made in March 2015 after testing the vesting conditions for the period 1 January – 31 December 2015. Up to 20% of the award made in March 2015 was due to vest, subject to the outcomes against the performance conditions and 100% of this tranche had been approved for vesting. Actual vesting will take place on 9 March 2016. Since the Sabadell share price at that date is not known the value shown has been estimated using the three day average of the Sabadell share price and Euro/Sterling exchange rate up to 31 December 2015. The award was made in a mix of cash and shares, with the cash portion being £37,800.
- (8) Paul Pester has been awarded a 2015 SPA grant with a face value of £760,000 and a 2015 SIA with a face value of £800,000. These awards remain subject to demanding performance conditions and will vest over time only to the extent that those performance conditions are met. Any amounts that do vest will be disclosed at the appropriate point in future reports.
- (9) As disclosed in our DRR for 2014, Paul Pester holds legacy 2013 and 2014 LTIP awards granted by LBG prior to TSB listing. These share-based awards lapsed on a time pro-rated basis at the point when LBG ceased to hold a majority of shares in TSB Group and participants were treated by LBG as 'good leavers'. To reflect the impact of the pro-rating on individuals, TSB Group made broadly equivalent share-based 'substitution awards' such that no individual is either materially advantaged or disadvantaged as a result of the listing. Legacy awards remain under the governance of LBG and its Remuneration Committee. Substitution awards will vest on the same original vesting dates as the LBG awards they replace. Any LBG 2013 LTIP award which vests in the first quarter of 2016 will be purely at the discretion of LBG and its Remuneration Committee. Vesting of the relevant TSB Substitution Award is determined by the TSB Remuneration Committee based on a balanced scorecard of TSB performance measures.
- (10) As disclosed in our 2014 DRR, LBG determined that Paul Pester would be eligible to receive a Verde Completion Award following listing subject to satisfactory personal performance up to listing, the achievement of key corporate milestones and continued employment to the payment date. This legacy payment remained subject to the discretion of the LBG Remuneration Committee and LBG decided that a payment of £405,000 should be made by LBG, at its sole cost, to Paul Pester in June 2015.
- (11) Paul Pester received shares under long term incentive schemes in 2015, as was the case in 2014 and exercised Sharesave options in 2015.

Remuneration review (continued)

Consideration by the Directors of matters relating to Directors' remuneration

The Board entrusts the Remuneration Committee with responsibility for remuneration policy and its ongoing appropriateness and relevance. Policy is considered regularly by the Committee, taking account of changes in regulation and the wider market. In formulating and reviewing policy independent advice is sought and considered. In particular, the sustainability of the policies and their risk impact are carefully reviewed. The Bank's Remuneration Policy is formally reviewed at least annually and, once approved by the Committee, is reviewed and approved by the Board. The effectiveness of the remuneration policy and its application are reviewed formally by the Risk function annually. The Committee considers the Risk function's report following that review and tracks and monitors any recommended actions.

The Committee's full terms of reference, as revised following the acquisition of TSB by Sabadell, were approved by the Board in December 2015 and will be kept under regular review. This can be found on our corporate website at <http://www.tsb.co.uk/investors/people/>.

The Committee is chaired by Dame Sandra Dawson and committee members are Polly Williams, who also chairs the Audit Committee, and, from his appointment on 30 June 2015, Miquel Montes. Philip Augar was previously a member of the Committee in 2015 until his resignation on 30 June 2015. Sandy Kinney, Chair of the Risk Committee, attends meetings of the Remuneration Committee from time to time to ensure alignment between the work of the Remuneration Committee and the Risk Committee. Committee meetings are also attended by the Company Chairman, the CEO, the CFO, the HR Director, the Chief Risk Officer, and the Director of Performance & Reward to provide input on their specialist areas. The Company Secretary acts as the secretary to the Committee. None of these additional attendees participates in the discussion of issues directly affecting their own remuneration.

The Committee appointed Deloitte LLP (Deloitte) to provide independent advice on remuneration matters following a presentation to the Committee members in 2014. The Committee reviewed Deloitte's work during 2015 and decided to continue with Deloitte's appointment. 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 in the UK. Deloitte has provided independent advice on matters under consideration by the Committee including compliance with regulations, advice on market trends and data, remuneration policy and implementation of remuneration arrangements. The Committee is satisfied the advice it has received has been objective and independent.

Deloitte also provided advice on share plans, wider remuneration matters, 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 to consider Directors' remuneration.

Directors' biographies

Will Samuel

Chairman

Skills and background

Will was appointed as Non-executive Chairman on 7 March 2014 and having worked for over 35 years in merchant banking and corporate finance, he brings a wealth of expertise of the banking sector and regulatory environment to his role.

Will began his career at Coopers & Lybrand where he qualified as a Chartered Accountant. In 1977, Will joined Schroders in the Investment Management Division and worked in a variety of roles. In 1986, he was appointed a Director of Schroders plc as the Group Managing Director of Investment Banking. Schroders subsequently sold its investment banking business to become Schroder Salomon Smith Barney (SSSB) in 2000 and Will served as Co-Chief Executive Officer at SSSB until 2003, when he was appointed Vice Chairman, European Investment Bank of Citigroup Inc.

Will joined Lazard & Co in 2004 as Vice Chairman and was appointed a Senior Advisor from 2011. In January 2012, Will was appointed Senior Advisor to the Financial Services Authority and, subsequently, Senior Advisor to the Prudential Regulation Authority, stepping down prior to his appointment as Non-executive Chairman of TSB.

Will is a Fellow of the Institute of Chartered Accountants in England and Wales and has a First Class Honours Degree in Chemistry from Durham University and a Degree in Mathematics from the Open University.

Will has held other Non-executive Directorships including Chairman of H P Bulmer plc, Deputy Chairman of Inchcape plc, and Non-executive Director of the Edinburgh Investment Trust plc. Will was Trustee and Honorary Treasurer of International Alert, a charitable peace building non-governmental organisation, from 2009 to 2014.

Current external appointments

- Chairman of Howden Joinery Group plc
- Chairman of Ecclesiastical Insurance Group plc

Committee membership

Nomination Committee (Chair)

Professor Dame Sandra Dawson

Independent Non-executive Director, Senior Independent Director

Skills and background

Dame Sandra joined the Board on 16 May 2014 and 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 and Non-executive Director, Institute for Government
- Chairman of Executive Committee and Trustee, Social Science Research Council USA
- Trustee, American University of Sharjah

Committee membership

- Remuneration Committee (Chair)
- Nomination Committee

Directors' biographies (continued)

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, MBNA Limited

Committee membership

- Risk Committee (Chair)
- Audit Committee

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 since then has held a number of Non-executive Directorship roles, including at Worldspreads Group plc, APS Financial Limited, Z Group plc, National Counties Building Society (as Chairman) and Scotiabank Ireland Limited.

Current external appointments

- Non-executive Director, Jupiter Fund Management plc
- Non-executive Director, Daiwa Capital Markets Europe Ltd
- Non-executive Director, XP Power Ltd
- Trustee of the Guide Dogs for the Blind Association

Committee membership

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

Miquel Montes

Non-executive Director

Skills and background

Miquel was appointed to the Board on 30 June 2015. He is General Manager and Chief Operations and Corporate Development Officer of Sabadell, which he joined in 2001. He has extensive retail banking experience having held senior positions at Deutsche Bank, Banco Atlántico and Banca Catalana in the 21 years prior to joining Sabadell.

Currently, Miquel leads Sabadell's technology, innovation, operations, organisation and efficiency functions. In addition, he is responsible for Sabadell's corporate development function and is a member of Sabadell's Management Committee. He is an academic adviser at ESADE Business School and holds a Global Executive MBA from ESADE and an MBA from Georgetown University (McDonough School of Business - School of Foreign Services).

Current external appointments

- Chairman of Solvia Real Estate
- Chairman of Sabadell Business Services (IT/Ops servicing company)
- Member of the Board of Directors of Banco Sabadell, SA IBM (Mexico)
- Member of the Board of Directors of Sabadell Capital SOFOM (Mexico)

Committee membership

- Remuneration Committee
- Nomination Committee

Directors' biographies (continued)

Tomás Varela

Non-executive Director

Skills and background

Tomás was appointed to the Board on 30 June 2015. He is General Manager and Chief Financial Officer of Sabadell, which he joined in 1992. Over 23 years he has developed his career at Sabadell, having previously held different managerial positions in the insurance sector at Allianz (Spain) and as an auditor at Price Waterhouse (a legacy firm of PWC) over a 10 year period.

In his current role, Tomás's responsibilities include financial reporting, asset and liability management, funding structure, economic analysis, accounting and financial management, capital management, short, medium and long term financial planning, cost management, M&A financial structure and investor relations. He is a member of Sabadell's Management Committee. Tomás is a Certified Public Accountant and Certified Insurance Broker. He holds a B.Sc. in Economics from the University of Barcelona and an MBA in International Business from the European University (Barcelona).

Committee membership

- Audit Committee
- Risk Committee

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. More recently, in June 2015, TSB was acquired by Sabadell Group and Paul became a member of its Global Management Committee. Previously, 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.

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 IPO in 2000.

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual 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 TSB Group and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of TSB Group and the Company and of the profit or loss of the group for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company and TSB Group will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and TSB Group and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and TSB Group and hence for taking reasonable steps for the prevention and detection of 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.

Financial statements

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Alignment with TSB Group's business model

The presentation of TSB Group's consolidated financial statements aligns with the execution of its 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 TSB Group's business model as explained on page 6.

Basis of preparation

These consolidated financial statements of TSB Banking Group plc (TSB Group) comprise the results of TSB Banking Group plc consolidated with those of its subsidiaries, including TSB Bank plc. 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 IFRS Interpretations Committee (IFRS IC) and its predecessor body. TSB 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 financial assets and financial liabilities, including 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 TSB Group's business model and are therefore included in the relevant sections of the consolidated financial statements. In addition, the following accounting policies relate to the consolidated financial statements taken as a whole.

Consolidation - Subsidiaries are all entities (including special purpose entities) over which TSB Group has control. TSB 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 TSB Group and are deconsolidated from the date that control ceases. Inter-company transactions, balances and unrealised gains and losses on transactions between TSB Group companies are eliminated.

Foreign currency translation - Foreign currency transactions are translated using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are translated at the rate prevailing at the balance sheet date. Foreign exchange gains and losses resulting from the restatement and settlement of such transactions are recognised in other operating income/expenses in the income statement.

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 TSB Group's business model as shown in the table below. These areas are discussed in detail by the Audit Committee as set out on pages 32 and 33 of the corporate governance statement.

Critical accounting estimates and judgements	Note
Effective interest rate methodology	1
Acquisition of a portfolio of ex-Northern Rock loans	7
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Impairment provisioning	10
Valuation of TSB Group's investment in Visa Europe	11
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Customer remediation provision	32

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TSB Group's primary consolidated financial statements are presented on pages 52 to 55. The notes to these consolidated financial statements are structured to follow TSB Group's business model as set out on page 6 and are listed below.

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Consolidated balance sheet

as at 31 December 2015

	Note	2015 £ million	2014 £ million
Assets			
Cash and balances at central banks		2,755.6	4,396.3
Loans and receivables:			
Loans and advances to customers	7	26,402.2	21,641.4
Loans and advances to banks	9	331.7	134.5
Available-for-sale financial assets	11	1,262.8	339.7
Items in course of collection from banks		163.0	135.7
Deferred tax assets	20	121.1	108.1
Property, plant and equipment	30	161.1	149.2
Other assets	31	330.0	143.4
Derivative financial assets	27	90.5	123.1
Total assets		31,618.0	27,171.4
Liabilities			
Customer deposits	1	25,915.7	24,624.9
Deposits from banks	2	0.8	32.5
Debt securities in issue	3	2,899.6	10.0
Subordinated liabilities	4	402.1	405.5
Items in course of transmission to banks		152.3	144.6
Other liabilities	32	217.9	202.8
Derivative financial liabilities	27	283.3	116.7
Total liabilities		29,871.7	25,537.0
Equity			
Share capital	22	5.0	5.0
Share premium	22	965.1	965.1
Merger reserve	22	616.5	616.5
Available-for-sale reserve	22	16.3	0.4
Cash flow hedging reserve	22	(0.9)	—
Capital reorganisation reserve	22	(1,311.6)	(1,311.6)
Capital reserve	22	410.0	410.0
Retained profits	22	1,045.9	949.0
Shareholder's equity		1,746.3	1,634.4
Total equity and liabilities		31,618.0	27,171.4

The accompanying notes are an integral part of the consolidated financial statements.

The consolidated financial statements on pages 50 to 89 were approved by the Board of Directors on 27 January 2016 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 2015

	Note	2015 £ million	2014 £ million
Income statement:			
Interest and similar income	13	967.2	979.1
Interest and similar expense	13	(201.9)	(220.9)
Net interest income	13	765.3	758.2
Fee and commission income	14	198.8	208.6
Fee and commission expense	14	(81.8)	(70.4)
Net fee and commission income	14	117.0	138.2
Other operating income	15	8.4	3.8
Other income		125.4	142.0
Total income		890.7	900.2
Operating expenses:			
Other operating expenses		(740.8)	(696.1)
Defined benefit pension scheme settlement gain		–	63.7
Total operating expenses	16	(740.8)	(632.4)
Operating profit before impairment losses and taxation		149.9	267.8
Impairment losses on loans and advances to customers	10	(82.3)	(97.6)
Profit before taxation		67.6	170.2
Taxation	19	21.2	(35.7)
Profit for the year	22	88.8	134.5
Other comprehensive income/(expense):			
Items that may be subsequently reclassified to profit or loss:			
<i>Change in available-for-sale reserve</i>			
Change in fair value		22.1	0.5
Taxation thereon	20	(6.2)	(0.1)
	22	15.9	0.4
<i>Change in cash flow hedging reserve</i>			
Change in the fair value of derivatives in cash flow hedges		14.4	–
Transfers to the income statement		(15.1)	–
Taxation thereon	20	(0.2)	–
	22	(0.9)	–
Other comprehensive income for the year, net of taxation		15.0	0.4
Total comprehensive income for the year		103.8	134.9

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated statement of changes in equity

for the year ended 31 December 2015

	Share capital £ million	Share premium £ million	Merger reserve £ million	Capital reorg- anisation reserve £ million	Capital reserve £ million	Available- for-sale reserve £ million	Cash flow hedging reserve £ million	Retained profit £ million	Total equity £ million
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 parent company	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
Balance at 1 January 2015	5.0	965.1	616.5	(1,311.6)	410.0	0.4	–	949.0	1,634.4
Comprehensive income/(expense):									
Profit for the year	–	–	–	–	–	–	–	88.8	88.8
Other comprehensive income/(expense)	–	–	–	–	–	15.9	(0.9)	–	15.0
Total comprehensive income	–	–	–	–	–	15.9	(0.9)	88.8	103.8
Transactions with owners:									
Movement in shares held by trusts	–	–	–	–	–	–	–	9.1	9.1
Reclassification of equity settled share schemes to cash settled	–	–	–	–	–	–	–	(3.1)	(3.1)
Value of Partner services	–	–	–	–	–	–	–	2.1	2.1
Total transactions with owners	–	–	–	–	–	–	–	8.1	8.1
Balance at 31 December 2015	5.0	965.1	616.5	(1,311.6)	410.0	16.3	(0.9)	1,045.9	1,746.3

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated cash flow statement

for the year ended 31 December 2015

	Note	2015 £ million	2014 £ million
Profit before taxation		67.6	170.2
Adjustments for:			
Change in operating assets	33	(2,270.5)	5,697.6
Change in operating liabilities	33	1,478.1	1,568.5
Non-cash and other items	33	142.1	41.1
Taxation paid		(8.5)	(3.7)
Net cash (used in)/provided by operating activities		(591.2)	7,473.7
Cash flows from investing activities			
Purchase of property, plant and equipment		(39.7)	(85.8)
Purchase of financial assets		(3,969.6)	(3,682.1)
Interest received on financial assets		32.8	–
Issue of reverse repurchase agreement	9	(20.3)	–
Purchase of Sabadell shares		(7.1)	–
Disposal/(Purchase) of shares held by trusts		7.6	(9.1)
Net cash used in investing activities		(3,996.3)	(3,777.0)
Cash flows from financing activities			
Proceeds from debt securities issued		2,873.7	10.0
Interest paid on debt securities		(0.3)	(0.6)
Repurchase of debt securities		–	(0.8)
Proceeds from subordinated liabilities issued		–	383.0
Interest paid on subordinated liabilities		(22.1)	(11.4)
Proceeds from shares issued		–	200.0
(Repayments of)/Proceeds from repurchase agreements	5	(32.5)	32.5
Interest paid on repurchase agreements		(0.4)	–
Net cash provided by financing activities		2,818.4	612.7
Change in cash and cash equivalents		(1,769.1)	4,309.4
Cash and cash equivalents at beginning of year		4,483.8	174.4
Cash and cash equivalents at end of year	33	2,714.7	4,483.8

The accompanying notes are an integral part of the consolidated financial statements.

Notes to the consolidated financial statements

Sources of funding

Money deposited by customers into their bank and savings accounts provides the majority of the funds we use to support lending to customers. We also raise funds from other sources that diversify our funding profile and our shareholder also provides 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 TSB Group's deposits and funding. It includes customer deposits, deposits from banks, debt securities in issue, subordinated liabilities, items in the course of transmission to banks and derivative financial liabilities (see accounting policy (j) 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 TSB 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

	2015 £ million	2014 £ million
Non-interest bearing bank accounts	5,315.8	4,777.3
Interest bearing bank accounts	3,423.9	2,791.6
Savings accounts	17,176.0	17,056.0
Total customer deposits	25,915.7	24,624.9

At 31 December 2015 £1,338.4 million (2014: £1,937.1 million) of customer deposits had a residual maturity of greater than one year.

Significant judgements and estimates – effective interest rate methodology

TSB Group uses the effective interest rate (EIR) method to determine the recognition of interest expense on customer deposits. At 31 December 2015, TSB Group had deferred for accounting purposes £8.0 million of interest expense in respect of bonus interest on certain savings products (2014: £16.6 million). 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

	2015 £ million	2014 £ million
Repurchase agreements (note 5)	–	32.5
Other deposits from banks	0.8	–
Total deposits from banks	0.8	32.5

No balances have a contractual residual maturity of greater than one year (2014: £nil).

Notes to the consolidated financial statements

Sources of funding (continued)

3. Debt securities in issue

	2015 £ million	2014 £ million
Securitisation notes	2,899.6	10.0
Total debt securities in issue	2,899.6	10.0

The balance at 31 December 2015 represents debt securities issued by Cape Funding No. 1 plc and Duncan Funding 2015-1 plc (see note 7).

4. Subordinated liabilities

	2015 £ million	2014 £ million
Fixed/floating rate reset callable subordinated Tier 2 notes due May 2026	383.5	383.2
Accrued interest	3.4	3.5
Fair value hedge accounting adjustments	15.2	18.8
Total subordinated liabilities	402.1	405.5

On 1 May 2014, TSB Banking Group plc (the Company) 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. 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 3 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.

5. Repurchase agreements

During 2014, TSB Group 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 TSB 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 TSB 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 TSB Group's obligation to repurchase the transferred assets.

	Carrying amount of transferred assets 2015 £ million	Carrying amount of associated liabilities 2015 £ million	Carrying amount of transferred assets 2014 £ million	Carrying amount of associated liabilities 2014 £ million
Available-for-sale financial assets (note 11)	–	–	32.9	(32.5)
Repurchase agreements	–	–	32.9	(32.5)

Notes to the consolidated financial statements

Sources of funding (continued)

6. Fair value of financial liabilities

The following table summarises the carrying values of financial liabilities presented on TSB 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.

		2015		2014	
		Carrying value	Fair value	Carrying value	Fair value
	Note	£ million	£ million	£ million	£ million
Financial liabilities					
Customer deposits	1	25,915.7	25,954.8	24,624.9	24,679.7
Debt securities in issue	3	2,899.6	3,031.4	10.0	10.0
Subordinated liabilities	4	402.1	412.4	405.5	404.9
Derivative financial liabilities	27	283.3	283.3	116.7	116.7

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 (or sell an asset) in an orderly transaction between market participants at the measurement date. As quoted market prices are not available for TSB 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 TSB Group.

Valuation hierarchy of financial liabilities

Financial 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 financial liabilities of TSB 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.

The table below analyses the fair values of TSB Group's financial liabilities.

	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total fair value £ million	Total carrying value £ million
At 31 December 2015					
Customer deposits	–	25,954.8	–	25,954.8	25,915.7
Debt securities in issue	625.4	2,406.0	–	3,031.4	2,899.6
Subordinated liabilities	–	412.4	–	412.4	402.1
Derivative financial liabilities	–	283.3	–	283.3	283.3
At 31 December 2014					
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

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. TSB 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 TSB Group.

Notes to the consolidated financial statements

Loans

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

Accounting policies relevant to loans

(b) Financial assets

'Financial assets' is the term used to describe TSB 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 (j) 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 TSB 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 TSB 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
- TSB 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 TSB 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 TSB Group together with a corresponding liability for the funding where TSB Group retains control of the structured entity.

(ii) Available-for-sale financial assets

TSB 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 TSB 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.

Notes to the consolidated financial statements

Loans (continued)

(c) Impairment of financial assets

(i) Accounted for at amortised cost

At each balance sheet date TSB 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.

The criteria that TSB 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 TSB 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 TSB 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.

Notes to the consolidated financial statements

Loans (continued)

7. Loans and advances to customers

	2015 £ million	2014 £ million
Mortgages – Franchise	18,927.4	16,580.7
Mortgages – Mortgage Enhancement	2,273.1	2,802.7
Unsecured lending and business banking	2,266.5	2,344.1
Acquired ex-Northern Rock loans	3,006.4	–
Gross lending	26,473.4	21,727.5
Allowance for impairment losses on loans and advances to customers (note 10)	(71.2)	(86.1)
Total loans and advances to customers	26,402.2	21,641.4

At 31 December 2015 £23,992.2 million of loans and advances to customers (2014: £19,422.2 million) had a contractual residual maturity of greater than one year.

Loans and advances to customers include loans securitised under TSB Group's securitisation programmes, the majority of which have been sold to bankruptcy remote structured entities. As the structured entities are funded by the issue of debt on terms whereby the majority of the risks and rewards of the portfolio are retained by TSB Group, the structured entities are consolidated fully and all of these loans are retained on TSB Group's balance sheet, with the related notes in issue included within debt securities in issue.

TSB Group's securitisation programmes, together with the balances of the advances subject to these arrangements and the carrying value of the notes in issue at 31 December, are listed below.

	31 December 2015		31 December 2014	
	Loans and advances securitised ⁽¹⁾ £ million	Liability £ million	Loans and advances securitised ⁽¹⁾ £ million	Liability £ million
Cape Funding No. 1 plc	2,701.2	2,805.1	2,876.3	2,925.0
Duncan Funding 2015-1 plc	2,026.5	2,086.1	–	–
	4,727.7	4,891.2	2,876.3	2,925.0
Less held by TSB Group		(1,991.6)		(2,915.0)
Total securitisation notes (note 3)		2,899.6		10.0

(1) Due to the nature of the securitisation programmes, cash arising from mortgage repayments will be retained for periods of time before being invested in replacement mortgage assets or being distributed to note holders.

Cash deposits of £302.5 million (2014: £179.1 million) held by the Group are restricted in use to repayment of the debt securities issued by the structured entities and other legal obligations.

TSB Group recognises the full liabilities associated with its securitisation programmes within debt securities in issue, although the obligations of TSB Group are limited to the cash flows generated from the underlying assets. TSB Group could be required to provide additional support to the Cape Funding securitisation programme for the credit ratings of the debt securities issued in the form of increased cash reserves and the holding of subordinated notes. Further, the Cape Funding programme contains contractual obligations that require TSB Group to repurchase assets should they become credit impaired. TSB Group has voluntarily offered to repurchase £3.4 million of assets from its public securitisation programmes during 2015 (2014: £nil).

Significant judgements and estimates – acquisition of an ex-Northern Rock loan portfolio

On 7 December 2015, TSB Group acquired a £3.0 billion portfolio of ex-Northern Rock loans which primarily comprises mortgages with a small balance of unsecured loans. Accounting standards require the portfolio to be recognised at its acquisition date fair value which requires judgement to determine that the consideration paid for the portfolio reflects its acquisition date fair value. Management concluded that fair value was represented by the £3,041 million consideration payable, taking into account that the sale was undertaken via a public competitive tender process and pricing had considered the extent of a number of risks including credit and conduct.

Notes to the consolidated financial statements

Loans (continued)

8. Commitments arising from the banking business

In the normal course of business, TSB Group provides commitments to lend to its customers as presented below.

	2015 £ million	2014 £ million
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Mortgage offers made	1,740.0	247.3
Credit cards	2,760.2	2,655.0
Other	806.3	789.3
Total commitments	5,306.5	3,691.6

Of the amounts shown above, £1,740.0 million (2014: £254.7 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

	2015 £ million	2014 £ million
Loans and advances to banks	331.7	134.5
Total loans and advances to banks	331.7	134.5

At 31 December 2015 £137.6 million of loans and advances to banks (2014: £nil) had a contractual residual maturity of greater than one year.

Loans and advances to banks includes cash deposits of £302.5 million (2014: £nil) held by securitisation entities Cape Funding No.1 plc and Duncan Funding 2015-1 plc and £20.3 million (2014: £nil) of reverse repurchase agreements.

10. Allowance for impairment losses on loans and receivables

	Mortgages £ million	Unsecured retail and small business £ million	Total £ million
At 1 January 2014	24.0	72.8	96.8
Charge/(credit) to the income statement	(0.2)	97.8	97.6
Advances written off	(3.9)	(118.2)	(122.1)
Recoveries of advances written off in previous years	–	13.8	13.8
At 31 December 2014	19.9	66.2	86.1
Charge to the income statement	2.1	80.2	82.3
Advances written off	(2.9)	(111.4)	(114.3)
Recoveries of advances written off in previous years	–	17.1	17.1
At 31 December 2015	19.1	52.1	71.2

Included in total allowance for loans and advances to customers is £53.7 million (2014: £63.0 million) relating to lending that was determined to be impaired.

Notes to the consolidated financial statements

Loans (continued)

Significant judgements and estimates – impairment provisioning

The allowance for impairment losses is management's best estimate of losses incurred in the portfolio at the balance sheet date. At 31 December 2015 TSB Group recognised an impairment allowance against loans and advances to customers of £71.2 million (2014: £86.1 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 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 2015, the allowance for impairment losses would have been approximately £2.9 million higher (2014: £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 2015, the impairment allowance included £18.4 million of post model adjustments (2014: £21.0 million), the largest component reflecting the effect of the current historical low interest rates environment on customer behaviour.

11. Available-for-sale financial assets

	2015 £ million	2014 £ million
Gilts	1,240.4	339.7
Investment in Visa Europe	22.4	–
Total available-for-sale financial assets	1,262.8	339.7

At 31 December 2015 gilts with a carrying value of £nil (2014: £32.9 million) were subject to repurchase agreements (note 5). At 31 December 2015 and 2014 all of the gilts had a contractual maturity of greater than one year.

Significant judgements and estimates – valuation of investment in Visa Europe

On 2 November 2015, Visa Inc. announced the proposed acquisition of Visa Europe. TSB Bank plc is a principal member and shareholder of Visa Europe. TSB Group's share of the sales proceeds will comprise up-front consideration of cash of €30.5 million (£22.4 million) and preferred stock convertible into Visa Inc. common stock (up to £17.4 million based on December 2015 market prices). The conversion of the preferred stock remains subject to potential reduction for certain litigation losses incurred by Visa Europe. A further contingent earn-out is payable on the achievement by Visa Europe of certain net revenue targets in the four years following the completion of the acquisition, TSB Group remaining a principal member and TSB Group's relative contribution in that period. No amounts will be payable until completion takes place which is expected to be during the first half of 2016. Members' share of the up-front consideration remains subject to member appeal and final confirmation from Visa Europe. Following notification from Visa Europe of TSB Group's indicative share of the up-front consideration, TSB Group revalued its investment to reflect the estimated cash element of the up-front consideration. The potential consideration arising from the convertible preferred stock and the contingent earn-out are not reflected in the fair value of the investment as a result of the inherent uncertainties referred to above.

The most significant unobservable input to the valuation is the discount applied to the fair value of the convertible preferred stock to reflect the risk of reduction in conversion into Visa Inc. common stock from certain litigation losses and restrictions on transferability. The potential fair value of the investment in Visa Europe could be up to £17.4 million greater (calculated in line with the initial notification from Visa Europe and as at the Balance Sheet date) if no reductions were assumed in the conversion of the preferred stock and there were no restrictions on transferability.

Notes to the consolidated financial statements

Loans (continued)

12. Fair value of financial assets

The following table summarises the carrying values of financial assets presented on TSB 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 received on the maturity or settlement date.

	Note	2015		2014	
		Carrying value £ million	Fair value £ million	Carrying value £ million	Fair value £ million
Financial assets					
Loans and advances to customers	7	26,402.2	26,380.9	21,641.4	21,451.6
Available-for-sale financial assets	11	1,262.8	1,262.8	339.7	339.7
Derivative financial assets	27	90.5	90.5	123.1	123.1

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.

Valuation hierarchy of financial assets carried at amortised cost

The table below analyses the fair values of financial assets carried at amortised cost and for which fair value is disclosed.

	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total fair value £ million	Total carrying value £ million
Loans and advances to customers	–	–	26,380.9	26,380.9	26,402.2
At 31 December 2015	–	–	26,380.9	26,380.9	26,402.2
At 31 December 2014	–	–	21,451.6	21,451.6	21,641.4

TSB Group provides loans 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 TSB 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.

Valuation hierarchy of financial assets carried at fair value

The table below analyses the fair values of the financial assets of TSB Group which are carried at fair value.

	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total fair value £ million	Total carrying value £ million
At 31 December 2015					
Available-for-sale financial assets	1,240.4	–	22.4	1,262.8	1,262.8
Derivative financial assets	–	90.5	–	90.5	90.5
Total	1,240.4	90.5	22.4	1,353.3	1,353.3
At 31 December 2014					
Available-for-sale financial assets	339.7	–	–	339.7	339.7
Derivative financial assets	–	123.1	–	123.1	123.1
Total	339.7	123.1	–	462.8	462.8

	2015 £ million	2014 £ million
Level 3 financial assets		
Balance at 1 January	–	–
Gains recognised in 'changes in fair value' in other comprehensive income	22.4	–
Balance at 31 December	22.4	–

Available-for-sale gilts are valued using quoted market prices and are therefore classified as a Level 1 asset. The only Level 3 financial asset carried at fair value is the available-for-sale investment in Visa Europe. A description of the valuation approach and the key unobservable inputs to the valuation are explained on page 63. 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.

Notes to the consolidated financial statements

Income

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 and to providers of other forms of funding. 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 income

(d) Interest income and expense

Interest income and expense are recognised in the income statement for all interest-bearing financial instruments using the EIR 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 TSB 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

	2015 £ million	2014 £ million
Interest and similar income		
Loans and advances to banks	19.3	16.9
Loans and advances to customers	947.9	962.2
Total interest and similar income	967.2	979.1
Interest and similar expense		
Deposits from banks	(0.1)	(1.9)
Customer deposits	(201.8)	(219.0)
Total interest and similar expense	(201.9)	(220.9)
Net interest income	765.3	758.2

Included within interest and similar income is £8.7 million (2014: £10.4 million) in respect of impaired financial assets.

Notes to the consolidated financial statements

Income (continued)

14. Net fee and commission income

	2015 £ million	2014 £ million
Fee and commission income		
Bank accounts	93.9	98.6
Credit and debit card fee income	61.6	65.6
Insurance commission income	21.9	22.9
Other	21.4	21.5
Total fee and commission income	198.8	208.6
Fee and commission expense		
Bank accounts	(62.4)	(55.4)
Credit and debit card fee expense	(6.5)	(6.0)
Other	(12.9)	(9.0)
Total fee and commission expense	(81.8)	(70.4)
Net fee and commission income	117.0	138.2

Fees and commissions which are an integral part of the EIR are recognised in net interest income.

15. Other operating income

	2015 £ million	2014 £ million
Fair value movement on instruments held at fair value through profit or loss	7.2	1.7
Gain on repurchase of preference shares	–	0.6
Rent receivable	1.2	1.3
Other income	–	0.2
Total other operating income	8.4	3.8

Notes to the consolidated financial statements

Charges

Running a bank comes with overheads. Charges we incur include the costs of paying our 8,600 TSB Partners, running our branches, investing in our business 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, TSB Group pays tax to HMRC on the profits we earn.

Accounting policies relevant to recognising charges

(f) Pensions and other post-retirement benefits

TSB Group operates defined contribution pension plans under which fixed contributions are paid. The costs of TSB 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

TSB Group operates a number of cash settled share-based compensation plans, in respect of services received from certain of its Partners. 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 as a liability. In addition, in some circumstances employees may provide services in advance of the grant date and therefore liability 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 fair value of the liability is measured with any changes in fair value recognised in operating expenses.

(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.

Notes to the consolidated financial statements

Charges (continued)

16. Operating expenses

	2015 £ million	2014 £ million
Staff costs		
Wages and salaries	243.1	231.7
Social security costs	28.0	25.6
Defined benefit pension scheme settlement gain	–	(63.7)
Other pension costs	31.7	31.8
Share-based payments	8.4	9.3
Other staff costs	50.4	43.4
Total staff costs	361.6	278.1
Premises and equipment expenses		
Rent	34.5	31.0
Rates	15.6	14.5
Other	32.8	29.0
Total premises and equipment expenses	82.9	74.5
Other expenses		
Transitional Services Agreement costs	85.4	97.8
Professional fees	35.3	34.2
Advertising and promotion	57.4	68.5
Financial Services Compensation Scheme levy	14.2	16.0
Other	83.4	46.1
Total other expenses	275.7	262.6
Depreciation (note 30)	20.6	17.2
Total operating expenses	740.8	632.4

The average monthly number of persons on a headcount basis employed by TSB Group during the year was 8,620 (2014: 8,427), all of whom were employed in the UK.

Included in staff costs is remuneration paid to key management personnel as set out in note 29(i) on page 85.

Included in other expenses are fees paid to TSB Group's auditors in respect of work carried out for TSB Group of £1.2 million (2014: £1.2 million). Of this amount, £1.1 million (2014: £1.0 million) was in respect of the audit of TSB Group's financial statements and £0.1 million (2014: £0.2 million) was in respect of non-audit services. Also included in other expenses was £0.3 million (2014: £0.2 million) paid to LBG in respect of a review by their auditors of controls undertaken on TSB Group's behalf by LBG under the TSA.

17. Directors' emoluments

The remuneration of the Directors during the year was as follows:

	2015 £ 000	2014 £ 000
Aggregate remuneration paid to Directors in respect of qualifying services	2,871	2,840
Aggregate cash received under long-term incentive arrangements	715	–
Total	3,586	2,840

Details of the highest paid director are set out on page 43 in the Remuneration review. The table below shows the number of Directors who:

	2015 Number	2014 Number
Exercised share options	3	–
Received shares under long term incentive schemes	2	2
Accrued pension benefits under defined contribution pension schemes	1	–

Notes to the consolidated financial statements

Charges (continued)

18. Share-based payments

During the year, a number of share-based compensation schemes were operated as part of TSB Group's overall remuneration policy. These TSB share schemes comprised both a share option scheme and certain share award schemes.

A Sharesave scheme and Share Incentive Plan (including Free Share award) were available to all Partners. A Sustainable Performance Award (SPA) scheme and Substitution Award scheme were available to senior Partners. Prior to the acquisition of TSB Group by Sabadell on 30 June 2015, these schemes were accounted for as equity settled.

On 30 June 2015, the Sharesave scheme and Share Incentive Plan (SIP) vested. The SPA and Substitution Award continued with unchanged performance conditions. However as these schemes will now vest in Sabadell shares and not TSB shares, they have been reclassified from equity settled to cash settled. Consequently, the fair value of Partners' services up to the date of reclassification was transferred from equity to liability (see note 22). Operating expenses include the following:

	2015 £ million	2014 £ million
Equity settled	2.4	1.9
Cash settled	6.7	–
	9.1	1.9

Equity settled schemes

Sharesave scheme

Eligible employees chose 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, had the option to use these savings within six months to acquire shares in TSB Group at £2.2548, being a 20% discount to the market price on the date of the Sharesave invitation.

Following the acquisition by Sabadell, the Sharesave scheme terminated. Partners were able to use savings accumulated to the date of termination to exercise their options. All other options were forfeited. Movements in the number of Sharesave options outstanding are set out below:

	2015 Number of options (000's)	2014 Number of options (000's)	Weighted average exercise price (pence)
Outstanding at 1 January	6,301	–	–
Granted	–	6,585	225.48
Exercised	(1,830)	–	–
Forfeited	(4,360)	(70)	225.48
Cancelled	(111)	(214)	225.48
Outstanding at 31 December	–	6,301	225.48
Exercisable at 31 December	–	–	–

The weighted average TSB share price at the date of exercise was £3.40.

Share incentive plan (SIP) – free shares and matching shares

In June 2014, an award of £100 of free shares was made to each TSB Partner. The shares awarded were held in trust for a mandatory period of three years on the Partner's behalf. The award was subject to a non-market based condition whereby if a Partner left TSB Group within the three year holding period for other than 'good' leaver reasons (such as retirement or redundancy) all of the shares awarded would be forfeited.

In October 2014, Sharematch commenced. TSB Group undertook to match shares purchased by Partners, up to the value of £30 per month, which were held in trust for a mandatory period of three years on the TSB Partners' behalf. As with free shares, if a Partner left TSB Group within the three year holding period under anything other than 'good' leaver status, all of the matching shares were forfeited. Similarly, if Partners sold their purchased shares within three years, their matching shares were forfeited. Following the acquisition by Sabadell the SIP scheme, including Free Share award, vested early and terminated. Partners matching and free shares were released from the trust and transferred to the Partner.

A credit of £0.7 million (2014: charge of £1.7 million) related to LBG schemes is included in operating expenses.

Notes to the consolidated financial statements

Charges (continued)

18. Share-based payments (continued)

Cash settled

During 2014, TSB Group announced a change to its 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. TSB 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.

Following the acquisition by Sabadell, the share element of these schemes was modified such that the award was payable in Sabadell shares. There was no incremental fair value as a result of these modifications. At 31 December 2015, a liability of £9.6 million (2014: £nil) is recognised in respect of share-based payments transactions.

At 31 December 2015 £5.3 million (2014: £nil) of equity shares of Sabadell were held for the purpose of TSB Group's share-based payment schemes (see note 31).

19. Taxation

	2015 £ million	2014 £ million
UK corporation tax		
Current tax on profit for the year	(0.1)	(7.6)
Adjustments in respect of prior year	1.9	1.7
Current tax credit/(charge)	1.8	(5.9)
Deferred tax (note 20)		
Origination and reversal of temporary differences:		
Deferred tax on business transfers	(10.9)	(16.3)
Deferred tax on pension	(0.2)	(14.0)
Accelerated capital allowances	(1.1)	(1.1)
Other	(0.7)	(0.6)
Change in UK corporation tax rates	32.3	2.2
Deferred tax credit/(charge)	19.4	(29.8)
Taxation credit/(charge)	21.2	(35.7)

The change in UK corporation rates primarily reflects the effect of the enactment of the Finance (No. 2) Act 2015 which included legislation introducing a corporation tax bank surcharge of 8% effective from 1 January 2016, applicable to taxable profits in excess of £25 million per annum. It also included legislation to reduce the main rate of corporation tax from 20% to 19% from 1 April 2017 and to 18% from 1 April 2020. The net effect of these changes resulted in the recognition of a deferred tax credit of £32.1 million and corresponding increase in the deferred tax asset at 31 December 2015. A further £0.2 million (2014: £2.2 million) reflects the application of the average corporation tax rate for the year to temporary differences reversing during the year.

A reconciliation of the credit/(charge) that would result from applying the average UK corporation tax rate to profit before taxation to the actual taxation credit/(charge) for the year is presented below:

	2015 £ million	2014 £ million
Profit before taxation	67.6	170.2
Taxation charge at average UK corporation tax rate of 20.25% (2014: 21.5%)	(13.7)	(36.6)
Factors affecting charge:		
UK corporation tax rate changes	32.3	2.2
Deferred tax asset arising from business transfers	6.8	–
Disallowed and non-taxable items	(6.1)	(3.0)
Adjustments in respect of prior years	1.9	1.7
Taxation credit/(charge)	21.2	(35.7)

Notes to the consolidated financial statements

Charges (continued)

20. Deferred tax assets

The movement in deferred tax assets is as follows:

	2015 £ million	2014 £ million
At 1 January	108.1	138.0
Income statement charge (note 19)	19.4	(29.8)
Amount charged to shareholder's equity:		
Movements in cash flow hedging reserve	(0.2)	–
Movements in available-for-sale reserve	(6.2)	(0.1)
At 31 December	121.1	108.1

Deferred tax assets are comprised as follows:

	2015 £ million	2014 £ million
Deferred tax impact of business transfers	127.8	106.4
Pension and other post-retirement benefits	(0.2)	0.1
Revaluations of available-for-sale financial assets	(6.2)	(0.1)
Cash flow hedging reserve	(0.2)	–
Other temporary differences	(0.1)	1.7
Total deferred tax assets	121.1	108.1

Significant judgements and estimates - recoverability of deferred tax assets

At 31 December 2015, TSB Group recognised deferred tax assets of £121.1 million (2014: £108.1 million), primarily comprising £122.4 million in respect of temporary differences arising from the transfer of customer accounts during 2013 and £5.4 million in respect of temporary differences arising from the Mortgage Enhancement portfolio, offset by £6.3 million (2014: £nil) of deferred tax liability arising from the revaluation of the investment in Visa Europe (see note 11).

The valuation and assessment of recovery of the deferred tax asset requires judgement as to the amount and timing of future taxable profits. TSB Group's expectations of the level of future taxable profits takes into account the Board approved medium term plan and associated risk factors including future economic outlook and regulatory change. Based on this, management have concluded it remains appropriate to recognise the deferred tax asset in full.

Notes to the consolidated financial statements

Profits and returns to the shareholder

The Board reviews TSB Group's performance. It decides whether profits are put aside for future investment in the business, for protection against the uncertainties that TSB Group faces, or returned to the shareholder in the form of dividends. Currently all returns are being reinvested in the business.

Accounting policies relevant to profits and returns to the shareholder

(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.

21. Segmental analysis

The presentation of segmental information 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. TSB Group's reportable segments have been identified as Franchise, Mortgage Enhancement and ex-Northern Rock Loans 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 TSB Group 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 which is designed to enhance TSB Group's profitability by over £230 million.
- *Acquired ex-Northern Rock Loans* is a £3.0 billion portfolio of mortgages and unsecured loans for which beneficial interest was acquired with effect from 7 December 2015.

The Executive Committee's review includes 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.

	Franchise £ million	Mortgage Enhancement £ million	Acquired ex-Northern Rock Loans £ million	Total £ million
Year ended 31 December 2015				
Net interest income	704.3	73.7	3.3	781.3
Other income	129.7	(10.4)	(1.1)	118.2
Total income	834.0	63.3	2.2	899.5
Operating expenses	(711.5)	–	–	(711.5)
Impairment	(82.2)	(0.1)	–	(82.3)
Management basis profit before taxation	40.3	63.2	2.2	105.7
Losses on derivatives and hedge accounting				(1.9)
Derivative fair value unwind				(5.1)
Mortgage enhancement tax related payment				(6.8)
Sabadell transaction and other business restructuring costs				(23.9)
Volatility from share schemes				(0.4)
Statutory profit before taxation				67.6
At 31 December 2015				
Segment loans and advances to customers	21,123.5	2,272.3	3,006.4	26,402.2
Segment customer deposits	25,915.7	–	–	25,915.7

Notes to the consolidated financial statements

Profits and returns to the shareholder (continued)

21. Segmental analysis (continued)

	Franchise £ million	Mortgage Enhancement £ million	Acquired ex-Northern Rock Loans £ million	Total £ million
Year ended 31 December 2014				
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)
Management basis profit before taxation	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				
Segment loans and advances to customers	18,839.3	2,802.1	–	21,641.4
Segment customer deposits	24,624.9	–	–	24,624.9

The table below presents a reconciliation from the management basis profit to the statutory results.

	Management basis £ million	Loss on derivatives and hedge accounting £ million	Derivative fair value unwind £ million	Volatility from share schemes £ million	Sabadell transaction and other business restructuring costs £ million	Mortgage enhancement tax related payment £ million	Defined benefit pension scheme settlement gain £ million	Statutory basis £ million
Year ended 31 December 2015								
Net interest income	781.3	(16.0)	–	–	–	–	–	765.3
Other income	118.2	14.1	(5.1)	(1.8)	–	–	–	125.4
Total income	899.5	(1.9)	(5.1)	(1.8)	–	–	–	890.7
Operating expenses	(711.5)	–	–	1.4	(23.9)	(6.8)	–	(740.8)
Impairment	(82.3)	–	–	–	–	–	–	(82.3)
Profit before taxation	105.7	(1.9)	(5.1)	(0.4)	(23.9)	(6.8)	–	67.6
Year ended 31 December 2014								
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

Notes to the consolidated financial statements

Profits and returns to the shareholder (continued)

22. Shareholder's equity

	Share capital £ million	Share premium £ million	Merger reserve £ million	Capital reorg- anisation reserve £ million	Capital reserve £ million	Available- for-sale reserve £ million	Cash flow hedging reserve £ million	Retained profits £ million
Balance at 1 January 2014	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
Balance at 1 January 2015	5.0	965.1	616.5	(1,311.6)	410.0	0.4	—	949.0
Movement in shares held by trusts	—	—	—	—	—	—	—	9.1
Reclassification of equity settled share schemes to cash settled	—	—	—	—	—	—	—	(3.1)
Value of Partner services	—	—	—	—	—	—	—	2.1
Net movement in available-for-sale reserve	—	—	—	—	—	15.9	—	—
Net movement in cash flow hedging reserve	—	—	—	—	—	—	(0.9)	—
Profit for the year	—	—	—	—	—	—	—	88.8
At 31 December 2015	5.0	965.1	616.5	(1,311.6)	410.0	16.3	(0.9)	1,045.9

In 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, in the capital reorganisation reserve, 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.

The capital reserve represents a capital contribution received in 2013 from a then parent company.

The available-for-sale reserve represents the unrealised change in the fair value of available-for-sale investments since initial recognition.

The cash flow hedging reserve represents the cumulative gains and losses on effective cash flow hedging instruments that will be recycled to the income statement when the hedged transactions affect profit or loss.

At 31 December 2015, TSB Banking Group plc had in issue 500.0 million (2014: 500.0 million) one pence ordinary shares authorised, allotted and fully paid up.

Notes to the consolidated financial statements

Managing financial risk

Financial instruments are fundamental to TSB Group's activities and, as a consequence, the risks associated with financial instruments represent a significant component of the risks faced by TSB. The primary risks affecting TSB Group through its use of financial instruments are: credit risk; funding and liquidity risk; and market risk. A summary of TSB Group's use of financial instruments and information about the management of these risks is presented below.

Accounting policies relevant to managing financial risk

(j) 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 in 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.

The method of recognising the movements in the fair value of derivatives depends on whether they are designated as hedging instruments and, if so, the nature of the item being hedged.

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, TSB 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. TSB Group designates certain derivatives as either hedges of the fair value of recognised assets or liabilities (fair value hedges) or hedges of highly probable future cash flows attributable to recognised assets or liabilities (cash flow hedges).

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.

Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income in the cash flow hedging reserve. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are reclassified to the income statement in the periods in which the hedged item affects profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the income statement when the previously hedged cash flow is ultimately recognised in the income statement.

Notes to the consolidated financial statements

Managing financial risk (continued)

23. Measurement basis of financial instruments

The following tables analyse the carrying amounts of financial instruments by category.

At 31 December 2015	Derivatives designated as hedging instruments £ million	At fair value through profit or loss – held for trading £ million	Loans and receivables £ million	Held at amortised cost £ million	Available-for-sale £ million	Total £ million
Financial liabilities						
Customer deposits	–	–	–	25,915.7	–	25,915.7
Deposits from banks	–	–	–	0.8	–	0.8
Debt securities in issue	–	–	–	2,899.6	–	2,899.6
Subordinated liabilities	–	–	–	402.1	–	402.1
Items in course of transmission to banks	–	–	–	152.3	–	152.3
Derivative financial liabilities	239.8	43.5	–	–	–	283.3
Total financial liabilities	239.8	43.5	–	29,370.5	–	29,653.8

Financial assets						
Cash and balances at central banks	–	–	–	2,755.6	–	2,755.6
Loans and advances to customers	–	–	26,402.2	–	–	26,402.2
Loans and advances to banks	–	–	331.7	–	–	331.7
Available-for-sale financial assets	–	–	–	–	1,262.8	1,262.8
Items in course of collection from banks	–	–	–	163.0	–	163.0
Derivative financial assets	42.6	47.9	–	–	–	90.5
Total financial assets	42.6	47.9	26,733.9	2,918.6	1,262.8	31,005.8

At 31 December 2014	Derivatives designated as hedging instruments £ million	At fair value through profit or loss – held for trading £ million	Loans and receivables £ 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	73.9	42.8	–	–	–	116.7
Total financial liabilities	73.9	42.8	–	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	66.3	56.8	–	–	–	123.1
Total financial assets	66.3	56.8	21,775.9	4,532.0	339.7	26,770.7

Notes to the consolidated financial statements

Managing financial risk (continued)

24. 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, and includes the use of various credit risk rating systems to 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 TSB Group derives the exposure at default; and (iii) the likely loss ratio on the defaulted obligations, the loss given default. TSB 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. TSB 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 in the event of other parties failing to perform their obligations is presented 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.

	2015 £ million	2014 £ million
Loans and advances to customers *	26,402.2	21,641.4
Loans and advances to banks	331.7	134.5
Available-for-sale financial assets - gilts	1,240.4	339.7
Items in course of collection from banks	163.0	135.7
Derivative financial assets	90.5	123.1
	28,227.8	22,374.4
Lending commitments - revocable	3,566.5	3,436.9
Lending commitments - irrevocable	1,740.0	254.7
Maximum credit risk exposure	33,534.3	26,066.0

* Amounts shown are net of related impairment allowances.

(ii) Credit quality of assets

Loans and receivables

The analysis of lending between mortgages and other loans and advances to customers has been presented based upon the type of exposure.

	Loans and advances to customers			Loans and advances to banks
	Mortgages	Unsecured lending and business banking	Total	
	£ million	£ million	£ million	£ million
31 December 2015				
Neither past due nor impaired	23,530.0	2,256.2	25,786.2	331.7
Past due but not impaired	485.3	42.9	528.2	–
Impaired – no provision required	57.7	–	57.7	–
Provision held	41.3	60.0	101.3	–
Gross	24,114.3	2,359.1	26,473.4	331.7
Allowance for impairment losses (note 10)	(19.1)	(52.1)	(71.2)	–
Net	24,095.2	2,307.0	26,402.2	331.7
31 December 2014				
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

Notes to the consolidated financial statements

Managing financial risk (continued)

24. Credit risk (continued)

Loans and advances which are neither past due nor impaired

	Loans and advances to customers			Loans and advances to banks
	Mortgages	Unsecured lending and business banking	Total	
	£ million	£ million	£ million	£ million
31 December 2015				
Good quality	23,464.3	1,909.0	25,373.3	331.7
Satisfactory quality	57.7	284.6	342.3	–
Lower quality	3.6	31.5	35.1	–
Below standard, but not impaired	4.4	31.1	35.5	–
Total loans and advances which are neither past due nor impaired	23,530.0	2,256.2	25,786.2	331.7
31 December 2014				
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

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.

Available-for-sale financial assets include gilts, all of which are issued in sterling and are rated AA+.

Loans and advances which are past due but not impaired

	Loans and advances to customers			Loans and advances to banks
	Mortgages	Unsecured lending and business banking	Total	
	£ million	£ million	£ million	£ million
31 December 2015				
0-30 days	202.3	15.2	217.5	–
30-60 days	92.6	17.0	109.6	–
60-90 days	56.7	0.4	57.1	–
90-180 days	83.2	0.9	84.1	–
Over 180 days	50.5	9.4	59.9	–
Total loans and advances which are past due but not impaired	485.3	42.9	528.2	–
31 December 2014				
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	–

A financial asset is past due if a counterparty has failed to make a payment when contractually due.

An analysis of derivative assets is presented in note 27.

Notes to the consolidated financial statements

Managing financial risk (continued)

24. Credit risk (continued)

(iii) Collateral held as security for financial assets

TSB 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 TSB 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.

	Neither past due nor impaired £ million	Past due but not impaired £ million	Impaired £ million	Gross £ million
31 December 2015				
Less than 70%	17,719.3	276.6	64.5	18,060.4
70% to 80%	3,261.4	86.5	13.1	3,361.0
80% to 90%	1,798.5	68.6	8.3	1,875.4
90% to 100%	638.7	36.1	8.4	683.2
Greater than 100%	112.1	17.5	4.7	134.3
Total	23,530.0	485.3	99.0	24,114.3
31 December 2014				
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

Unsecured lending and business banking

At 31 December 2015, unimpaired unsecured and business banking lending amounted to £2,299.1 million (2014: £2,266.9 million). At 31 December 2015, impaired unsecured and business banking lending amounted to £23.0 million (2014: £30.9 million), net of an impairment allowance of £37.0 million (2014: £46.3 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 2015, credit risk is mitigated by collateral held totalling £158.1 million (2014: £182.8 million).

(iv) Collateral repossessed

	2015 £ million	2014 £ million
Residential property	4.4	15.6
Total collateral repossessed	4.4	15.6

TSB 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) Forbearance

TSB 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. At 31 December 2015, total Franchise mortgages which are currently or recently forborne were £93.8 million (2014: £134.9 million), of which £4.8 million (2014: £19.0 million) were impaired. The allowance for loan losses at 31 December 2015 was £0.7 million (2014: £2.6 million). Total unsecured loans which are currently or recently forborne were £31.5 million (2014: £39.4 million), of which £23.2 million (2014: £31.8 million) were impaired. The allowance for loan losses at 31 December 2015 was £9.1 million (2014: £13.9 million).

TSB Banking Group plc

Notes to the consolidated financial statements

Managing financial risk (continued)

25. Funding and liquidity risk

Definition and exposure

Liquidity risk is the risk that TSB Group, although solvent, does not have available sufficient financial resources to enable it to meet its obligations as they fall due. Funding risk is the risk that TSB does not have stable sources of funding in the medium and long term to enable it to meet its financial obligations, such as payments or collateral calls, as they fall due, either at all or only at excessive cost. 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

TSB Group's funding and liquidity position is underpinned by its significant customer deposit base. The deposit base is made up of customer current and savings accounts which, although mostly repayable on demand, have historically provided a stable source of funding. TSB has also diversified its funding base by raising wholesale term funding during 2015. Further information regarding sources of funding is available on page 14. At 31 December 2015, TSB Group's primary liquidity portfolio totalled £3,782.3 million (2014: £4,509.0 million) of which £2,541.9 million (2014: £4,169.3 million) was held on deposit with the Bank of England, and £1,240.4 million (2014: £339.7 million) was held in a portfolio of UK gilts. TSB Group also uses wholesale facilities to enable additional funding to be raised if required.

Risk appetite

The funding and liquidity risk appetite for TSB Group is set and approved annually by the Board. Risk is reported against this appetite through various metrics to enable TSB Group to manage the funding and liquidity position. The risk appetite is established under a liquidity risk management framework that ensures that TSB Group has sufficient financial resources of appropriate quality for its funding profile.

Measurement and monitoring

A series of measures are used across TSB 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 monitored, supplemented by early warning indicators and a Liquidity Contingency Plan. Monthly reporting procedures are in place to update and inform senior management. All liquidity policies and procedures are subject to periodic independent internal oversight.

Contractual maturities for financial liabilities form an important source of information for the management of liquidity risk. The table below analyses financial liabilities by relevant contractual maturity grouping on an undiscounted future cash flow basis based on the remaining period at the balance sheet date.

	Up to 1 month £ million	1-3 months £ million	3-12 months £ million	1-5 years £ million	Over 5 years £ million	Total £ million
At 31 December 2015						
Financial liabilities						
Customer deposits	22,648.2	451.1	1,482.5	1,379.7	–	25,961.5
Deposits from banks	0.8	–	–	–	–	0.8
Debt securities in issue	–	107.8	489.8	2,376.8	–	2,974.4
Subordinated liabilities	–	–	22.1	88.6	396.1	506.8
Items in course of transmission to banks	152.3	–	–	–	–	152.3
Total non-derivative financial liabilities	22,801.3	558.9	1,994.4	3,845.1	396.1	29,595.8
Gross settled derivative - outflows	6.6	21.1	102.7	563.3	374.7	1,068.4
Gross settled derivative - inflows	(4.3)	(12.4)	(52.5)	(452.2)	(230.7)	(752.1)
Total	22,803.6	567.6	2,044.6	3,956.2	540.1	29,912.1

At 31 December 2014

Financial liabilities						
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
Total non-derivative financial liabilities	22,032.4	290.6	731.4	1,966.9	428.2	25,449.5
Gross settled derivative - outflows	3.5	14.9	56.7	153.7	96.2	325.0
Gross settled derivative - 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

Notes to the consolidated financial statements

Managing financial risk (continued)

26. Capital resources

TSB 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 TSB Group's regulatory capital resources.

	2015 £ million	2014 £ million
Shareholder's equity	1,746.3	1,634.4
Regulatory deductions	(73.8)	(41.4)
Common Equity Tier 1/Total Tier 1 capital	1,672.5	1,593.0
Tier 2 capital	383.5	384.3
Total capital resources	2,056.0	1,977.3

Further information on capital resources is available on pages 14 and 15 in the review of our performance in 2015.

27. 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 TSB Group's assets and liabilities. TSB Group's market risk consists primarily 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.

Management and measurement

Risk exposure across TSB Group 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 positions or from changes in assumptions about customer behaviour remain within TSB Group's risk appetite. Treasury centralises and then hedges the Group's market risk within appetite. Treasury's residual market risk position is measured and reported daily.

A 12 month view of the sensitivity of net interest income is calculated on the basis of TSB Group's current balance sheet with re-pricing dates adjusted according to behavioural assumptions. At 31 December 2015, 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 £4.6 million (2014: £0.7 million) from a 25bps increase in rates, and a decrease of £10.5 million (2014: £8.2 million) from a 25bps decrease. The measure, however, is relatively simplistic in that it assumes all interest rates, for all currencies and maturities, move at the same time and by the same amount.

Derivative financial instruments

TSB Group holds derivative financial instruments in the normal course of its banking business for interest rate risk management and margin stabilisation purposes. Derivatives are recognised at fair value on TSB Group's balance sheet. The fair values and notional amounts of derivative instruments are presented in the following table:

	31 December 2015			31 December 2014		
	Contract/ notional amount £ million	Assets fair value £ million	Liabilities fair value £ million	Contract/ notional amount £ million	Assets fair value £ million	Liabilities fair value £ million
At 31 December 2015						
Interest rate swaps	14,180.4	47.9	(43.5)	10,874.0	56.8	(42.8)
Fair value through profit/loss – held for trading	14,180.4	47.9	(43.5)	10,874.0	56.8	(42.8)
Designated as micro fair value hedges	737.0	16.3	(0.2)	385.0	18.3	–
Designated as macro fair value hedges	3,355.5	15.2	(238.6)	4,861.8	48.0	(73.9)
Designated as cash flow hedges	2,003.0	11.1	(1.0)	–	–	–
Designated as hedging instruments	6,095.5	42.6	(239.8)	5,246.8	66.3	(73.9)
Total	20,275.9	90.5	(283.3)	16,120.8	123.1	(116.7)

Derivative assets of £78.3 million (2014: £108.9 million) are expected to be recovered after more than one year. Derivative liabilities of £277.1 million (2014: £112.3 million) are expected to be settled after more than one year.

Notes to the consolidated financial statements

Managing financial risk (continued)

27. Market risk (continued)

Fair value hedges

TSB Group designates certain of its fixed rate customer loans, debt securities available-for-sale, customer deposits and subordinated debt in fair value hedge accounting relationships. Losses of £7.9 million (2014: gains of £74.2 million) were recognised on derivatives in hedge accounting relationships. Gains of £7.2 million (2014: losses of £74.6 million) were recognised on the hedged items attributable to the hedged interest rate risk.

Cash flow hedges

From 1 January 2015, TSB Group established cash flow hedge accounting relationships for interest rate and foreign exchange risk. TSB Group designated certain of its base rate mortgages and debt securities in issue in qualifying cash flow hedge accounting relationships. The following tables present the periods when TSB Group's hedged cash flows are expected to occur and when they will affect income for designated cash flow hedges.

At 31 December 2015	Less than 1 year £ million	1-2 years £ million	2-3 years £ million	3-4 years £ million	4-5 years £ million	5-10 years £ million	Total £ million
Hedged forecast cash flows expected to occur:							
Forecast receivable cash flows	4.6	5.5	–	–	–	–	10.1
Forecast payable cash flows	(0.9)	(0.8)	(1.3)	(2.0)	(223.1)	–	(228.1)
Hedged forecast cash flows affect profit or loss:							
Forecast receivable cash flows	4.6	4.9	–	–	–	–	9.5
Forecast payable cash flows	(0.8)	(0.8)	(1.3)	(2.1)	(1.9)	–	(6.9)

During the year, gains of £15.1 million (2014: £nil) were transferred from the cash flow hedging reserve to other operating income (£9.3 million) and to net interest income (£5.8 million). Losses of £3.5 million (2014: £nil) were recognised in other operating income in respect of ineffectiveness arising from cash flow hedges. There were no transactions for which cash flow hedge accounting had to be ceased during the year as a result of the highly probable cash flows no longer being expected to occur.

Notes to the consolidated financial statements

Managing financial risk (continued)

27. Market risk (continued)

Offsetting financial assets and financial liabilities

The following information relates to financial assets and liabilities which have not been set off but for which TSB Group has enforceable master netting agreements in place with counterparties.

				Related amounts where set off in the balance sheet is not permitted		
	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
At 31 December 2015						
Derivative financial assets	90.5	–	90.5	(83.0)	–	7.5
Total	90.5	–	90.5	(83.0)	–	7.5
Derivative financial liabilities	(283.3)	–	(283.3)	83.0	200.3	–
Total	(283.3)	–	(283.3)	83.0	200.3	–
At 31 December 2014						
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	–

Notes to the consolidated financial statements

Other important disclosures

Accounting policies relevant to this section

(k) 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 TSB 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.

(l) 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 10 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.

(m) Operating leases

The leases entered into by TSB 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.

Notes to the consolidated financial statements

Other important disclosures (continued)

28. Contingent liabilities

(i) The Financial Services Compensation Scheme (FSCS)

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 is expected to 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. During 2015, the FSCS invoiced a third annual levy in respect of expected shortfalls in the repayment of the principal balance of the loan. The remaining loan balance is expected to be repaid from the realised funds from the defaulted deposit takers.

During 2015, TSB Group has paid, as required, its share of the 2014/15 interest and the 2015/16 capital elements of the levy and accrued for its share of the 2015/16 interest element, payable in September 2016.

The amount of future compensation costs levies payable by TSB 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 and any shortfall in the repayment of the loan from HM Treasury.

(ii) Legal and regulatory matters

During the ordinary course of business, TSB Group is subject to other 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 TSB 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, TSB 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.

29. Related party transactions

TSB Group's related parties include key management personnel, Sabadell and other Sabadell Group companies. LBG was a related party prior to the Sabadell acquisition of TSB Group in June 2015.

(i) Key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of TSB Group which is the Board and Executive Committee. The compensation paid or payable to key management personnel is shown in the table below.

	2015 £ 000	2014 £ 000
Short term employee benefits	6,581	6,900
Post-employment benefits	907	734
Other long term benefits	1,127	–
Share-based payments	2,113	1,257
Payments for loss of office	143	–
Total	10,871	8,891

Notes to the consolidated financial statements

Other important disclosures (continued)

29. Related party transactions (continued)

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.

	2015 £ 000	2014 £ 000
Loans		
At 1 January	247	63
Advanced during the year (includes key management personnel appointed during the year)	112	244
Interest charged during the year	8	4
Repayments made during the year	(105)	(64)
At 31 December	262	247

The loans attracted interest at customer rates and were made in the ordinary course of business. No provisions have been recognised in respect of loans given to key management personnel (2014: £nil).

	2015 £ 000	2014 £ 000
Deposits		
At 1 January	736	404
Received during the year (includes key management personnel appointed during the year)	8,578	2,192
Interest expense on deposits (includes former key management personnel)	6	5
Repaid during the year	(8,159)	(1,865)
At 31 December	1,161	736

All deposits placed by key management personnel are at customer rates and were made in the ordinary course of business.

(ii) Transactions and balances with Sabadell Group companies

On 8 October 2015, TSB Group established a £1.0 billion unsecured funding facility from Sabadell. At 31 December 2015, no amounts were drawn against this facility. Fee expenses of £0.4 million were recognised in respect of non-utilisation fees payable on this facility to Sabadell of which £0.2 million is payable at 31 December 2015. At 31 December 2015, TSB Group recognised an asset of £4.2 million in respect of certain costs incurred on behalf of, and recharged to, Sabadell Group. On 10 November 2015, Sabadell was appointed Joint Lead Manager in relation to TSB Group's first public residential mortgage backed securitisation (Duncan Funding 2015-1 plc). Sabadell received no fee for the services provided to TSB Group.

(iii) Transactions with Lloyds Banking Group companies

In respect of transactions with LBG companies during the period, to 30 June 2015, that LBG was a related party, TSB recognised net interest income of £0.3 million (2014: net interest expense of £10.7 million), net fee and commission income of £5.7 million (2014: £15.6 million), and incurred expenses of £43.1 million under the TSA (2014: £97.8 million) and interest expense on subordinated liabilities of £11.2 million (2014: £nil).

Notes to the consolidated financial statements

Other important disclosures (continued)

30. Property, plant and equipment

	Premises £ million	Equipment £ million	Total £ million
Cost			
At 1 January 2014	134.1	72.7	206.8
Additions	32.6	11.2	43.8
At 31 December 2014	166.7	83.9	250.6
Additions	26.4	8.1	34.5
Write-offs	(3.8)	(1.4)	(5.2)
At 31 December 2015	189.3	90.6	279.9
Accumulated depreciation			
At 1 January 2014	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
Depreciation charge for the year (note 16)	13.0	7.6	20.6
Write-offs	(2.3)	(0.9)	(3.2)
At 31 December 2015	66.9	51.9	118.8
Carrying amount			
At 31 December 2015	122.4	38.7	161.1
At 31 December 2014	110.5	38.7	149.2

At 31 December 2015, capital expenditure of £0.5 million was authorised and contracted for but not provided and incurred (2014: £1.9 million).

Operating lease commitments

Where TSB Group is the lessee, the future minimum lease payments under non-cancellable premises operating leases are as follows:

	2015 £ million	2014 £ million
Not later than 1 year	29.4	29.5
Later than 1 year and no later than 5 years	100.0	97.6
Later than 5 years	66.3	72.5
Total operating lease commitments	195.7	199.6

Operating lease payments represent rental payable by TSB 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.

31. Other assets

	2015 £ million	2014 £ million
Other assets and prepayments	77.3	67.6
Collateral placed with central clearing houses	227.8	53.6
Amounts recoverable under customer remediation indemnity (note 32)	14.5	22.2
Equity securities	5.3	–
Current tax assets	5.1	–
Total other assets	330.0	143.4

Notes to the consolidated financial statements

Other important disclosures (continued)

32. Other liabilities

	2015 £ million	2014 £ million
Accruals and deferred income	130.9	116.4
Other creditors	72.5	49.5
Customer remediation provision	14.5	22.2
Collateral deposited by central clearing houses	–	8.9
Current tax liabilities	–	5.8
Total other liabilities	217.9	202.8

Significant judgements and estimates – customer remediation provision

TSB Group is protected from losses arising from historic misconduct under an indemnity provided by Lloyds Bank plc. However, TSB Group retains the primary liability for the alleged misconduct to its customers and a provision for customer remediation of £14.5 million (2014: £22.2 million) has been recognised. An equivalent recoverable has therefore been recognised under the indemnity provided by Lloyds Bank plc (note 31). The size of the liability follows an assessment of emerging themes in customer complaints, an assessment of broader industry commentary 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.

33. Notes to the consolidated cash flow statement

The following table presents further analysis of balances in the consolidated cash flow statement:

	2015 £ million	2014 £ million
Change in loans and advances to banks	(332.6)	4,084.0
Change in loans and advances to customers	(1,794.3)	1,726.4
Change in derivative assets	32.6	(23.7)
Change in other operating assets	(176.2)	(89.1)
Change in operating assets	(2,270.5)	5,697.6
Change in deposits from banks	8.5	(105.8)
Change in customer deposits	1,282.2	1,540.3
Change in derivative liabilities	166.6	31.1
Change in other operating liabilities	20.8	102.9
Change in operating liabilities	1,478.1	1,568.5
Depreciation and amortisation	20.6	17.2
Allowance for loan losses	82.3	97.6
Other non-cash items	39.2	(73.7)
Non-cash and other items	142.1	41.1
Analysis of cash and cash equivalents as shown in the balance sheet		
Cash and balances with central banks	2,755.6	4,396.3
Less: mandatory reserve deposits *	(49.7)	(47.0)
	2,705.9	4,349.3
Loans and advances to banks with maturity less than three months	8.8	134.5
Total cash and cash equivalents	2,714.7	4,483.8

* Mandatory reserve deposits are held with local central banks in accordance with statutory requirements; these deposits are not available to finance TSB Group's day-to-day operations.

Notes to the consolidated financial statements

Other important disclosures (continued)

34. Future accounting developments

The following pronouncements may impact TSB Group's consolidated financial statements but are not applicable for the year ended 31 December 2015 and have not been applied in preparing these consolidated financial statements. The full impact of these accounting changes is being assessed by TSB Group.

Pronouncement	Nature of Change	IASB effective date
IFRS 9: <i>Financial Instruments</i> ⁽¹⁾	Replaces IAS 39 <i>Financial Instruments: Recognition and Measurement</i> . 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 adoption of IFRS 9 is likely to have a significant impact on TSB Group. Due to the complexities of the new requirements, the impact on TSB Group is still being assessed.	Annual periods beginning on or after 1 January 2018
IFRS 15 <i>Revenue from Contracts with Customers</i> ⁽¹⁾	Replaces IAS 18 <i>Revenue</i> 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 on TSB Group is still being assessed.	Annual periods beginning on or after 1 January 2018
IFRS 16 <i>Leases</i> ⁽¹⁾	Replaces IAS 17 <i>Leases</i> and brings most leases on-balance sheet for lessees under a single model, eliminating the distinction between operating and finance leases. The Standard requires a lessee to recognise a 'right-of-use' asset and a lease liability. Lessor accounting remains largely unchanged. The impact of IFRS 16 on TSB Group is still being assessed.	Annual periods beginning on or after 1 January 2019

(1) As at 27 January 2016, this pronouncement is awaiting EU endorsement.

35. Post balance sheet event

On 27 January 2016, TSB announced that Darren Pope intends to step down from the Board on 1 July 2016. It was also announced that Ralph Coates would join the Board as Chief Financial Officer on 1 July 2016, subject to regulatory approval.

36. Approval of the consolidated financial statements

These consolidated financial statements were approved by the Directors of TSB Banking Group plc on 27 January 2016.

The Company's ultimate parent company and ultimate controlling party is Banco de Sabadell S.A. (incorporated in Spain), which is also the parent undertaking of the largest group of undertakings for which group financial statements are drawn up and of which the Company is a member. Banco de Sabadell S.A. is the parent undertaking of the smallest such group of undertakings for which group financial statements are drawn up and of which the Company is a member. Copies of the consolidated annual report and accounts of Banco Sabadell S.A. is expected to be available in due course from www.grupbancsabadell.com/en/.

Independent auditors' report to the members of TSB Banking Group plc

Report on the Group financial statements

Our opinion

In our opinion, TSB Banking Group plc's group financial statements (the "financial statements"):

- give a true and fair view of the state of the group's affairs as at 31 December 2015 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

The financial statements, included within the Annual Report and Accounts (the "Annual Report"), comprise:

- the consolidated balance sheet as at 31 December 2015;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated cash flow statement for the year then ended;
- the consolidated statement of changes in equity for the year then ended; and
- the notes to the 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, 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.

In applying the financial reporting framework, the Directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Opinion on other matter prescribed by the Companies Act 2006

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.

Other matters on which we are required to report by exception

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 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 set out on page 48, 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 International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Independent auditors' report to the members of TSB Banking Group plc (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 & 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 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 matter

We have reported separately on the company financial statements of TSB Banking Group plc for the year ended 31 December 2015.

Allan McGrath (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
27 January 2016

Company balance sheet

As at 31 December 2015

	Note	2015 £ million	2014 £ million
Assets			
Non-current assets:			
Investments in subsidiaries	4	1,589.4	1,588.4
Loans to subsidiaries	4	386.9	386.7
		1,976.3	1,975.1
Current assets:			
Amounts due from subsidiaries		0.2	0.1
Total assets		1,976.5	1,975.2
Liabilities			
Non-current liabilities:			
Subordinated liabilities	2	386.9	386.7
Current liabilities:			
Amounts due to subsidiaries		12.7	1.7
Total liabilities		399.6	388.4
Equity			
Share capital	3	5.0	5.0
Share premium	3	965.1	965.1
Merger reserve	3	616.5	616.5
Retained (losses)/profits		(9.7)	0.2
Shareholder's equity		1,576.9	1,586.8
Total equity and liabilities		1,976.5	1,975.2

The accompanying notes are an integral part of the financial statements.

The Company financial statements on pages 92 to 97 were approved by the Board of Directors on 27 January 2016 and signed on its behalf by:



Paul Pester
Chief Executive Officer



Darren Pope
Chief Financial Officer

Company statement of changes in equity

for the year ended 31 December 2015

	Share capital £ million	Share premium £ million	Merger reserve £ million	Retained profits/ (losses) £ million	Total equity £ 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
Balance at 1 January 2015	5.0	965.1	616.5	0.2	1,586.8
Comprehensive income					
Total comprehensive loss for the year	–	–	–	(10.1)	(10.1)
Transactions with owners					
Movement in shares held by trusts	–	–	–	1.2	1.2
Movement in share-based compensation reserve	–	–	–	(1.0)	(1.0)
Total transactions with owners	–	–	–	0.2	0.2
Balance at 31 December 2015	5.0	965.1	616.5	(9.7)	1,576.9

Total comprehensive loss for the year comprises only the loss for the year. No statement of comprehensive income has been shown for the Company, as permitted by section 408 of the Companies Act 2006.

Company cash flow statement

for the year ended 31 December 2015

	2015 £ million	2014 £ million
Loss before taxation	(10.1)	(0.6)
Adjustments for:		
Change in current liabilities	11.0	1.7
Change in current assets	(0.1)	-
Other non-cash and other items	(0.8)	-
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	22.1	11.0
Purchase of shares held by trusts	-	(1.2)
Net cash provided by investing activities	22.1	(573.2)
Cash flows from financing activities		
Proceeds from subordinated liabilities issued	-	383.0
Interest paid on subordinated liabilities	(22.1)	(11.0)
Proceeds from share issue	-	200.1
Net cash provided by financing activities	(22.1)	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 Company financial statements

1. Basis of preparation

The financial statements of TSB Banking Group plc (the Company), a public limited company, are prepared on a going concern basis and in accordance with IFRS as adopted by the 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 IFRS Interpretations Committee. 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 TSB Group accounting policies and the following policy is also applicable.

Investments 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

	2015 £ million	2014 £ million
Fixed/floating rate reset callable subordinated Tier 2 notes due May 2026	383.5	383.2
Accrued interest	3.4	3.5
Total other assets	386.9	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 3 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.

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 22 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 TSB Group and the Company are the same. The relevant disclosures are set out in note 29 to the consolidated financial statements. The Company has no employees.

(ii) Investment in subsidiaries

	2015 £ million	2014 £ million
At 1 January	1,588.4	–
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	4.1	1.9
Reclassification of equity settled share schemes to cash settled	(3.1)	1.9
At 31 December	1,589.4	1,588.4

Details of the share for share exchange and subscription for new shares in TSB Bank plc are set out in note 22 to the consolidated financial statements.

Notes to the Company financial statements

4. Related party transactions (continued)

The Company's legal subsidiary undertakings, all of which prepare financial statements to 31 December, are as follows:

At 31 December 2015	Share class	Country of registration/ incorporation	Percentage of equity share capital and voting rights held	Nature of business
TSB Bank plc	Ordinary	Scotland	100%	Banking
TSB Scotland Nominees Limited*	Ordinary	Scotland	100%	Dormant
TSB Scotland (Investment) Nominees Limited*	Ordinary	Scotland	100%	Dormant

*Subsidiary companies of TSB Bank plc.

In addition, TSB Banking Group plc Employee Share Trust is accounted for as a subsidiary of the Company. Cape Funding Holdings No. 1 Ltd (and its subsidiary Cape Funding No.1 plc) and Duncan Funding Holdings 2015-1 Ltd (and its subsidiary Duncan Funding 2015-1 plc) are accounted for as subsidiary companies of TSB Bank plc as it has control over these special purpose entities under IFRS 10 *Consolidated Financial Statements*.

(iii) Loans to subsidiaries

	2015 £ million	2014 £ million
Loans to subsidiaries	386.9	386.7
Total loans to subsidiaries	386.9	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.

(iv) Other related party transactions

Details of other related party transactions is given in note 29 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 2015	Fair value £ million	Loans and receivables £ million	Held at amortised cost £ million	Total £ million
Financial assets				
Loans to subsidiaries	–	386.9	–	386.9
Total financial assets	–	386.9	–	386.9
Financial liabilities				
Subordinated liabilities	–	–	386.9	386.9
Total financial liabilities	–	–	386.9	386.9
At 31 December 2014				
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

Notes to the Company financial statements

5. Financial instruments (continued)

(ii) Fair value of financial assets and liabilities

	2015		2014	
	Carrying value £ million	Fair value £ million	Carrying value £ million	Fair value £ million
At 31 December 2015				
Financial assets				
Loans to subsidiaries	386.9	412.4	386.7	404.9
Financial liabilities				
Subordinated liabilities	386.9	412.4	386.7	404.9

The valuation techniques for the Company's financial assets and liabilities is set out in note 6 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.

	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total fair value £ million	Total carrying value £ million
At 31 December 2015					
Financial assets					
Loans to subsidiaries	–	412.4	–	412.4	386.9
Financial liabilities					
Subordinated liabilities	–	412.4	–	412.4	386.9
At 31 December 2014					
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.

	Up to 1 month £ million	1-3 months £ million	3-12 months £ million	1-5 years £ million	Over 5 years £ million	Total £ million
At 31 December 2015						
Subordinated liabilities	–	–	22.1	88.6	396.1	506.8
Total	–	–	22.1	88.6	396.1	506.8
At 31 December 2014						
Subordinated liabilities	–	–	22.1	88.6	418.2	528.9
Total	–	–	22.1	88.6	418.2	528.9

6. Post balance sheet events

On 27 January 2016, TSB announced that Darren Pope intends to step down from the Board on 1 July 2016. It was also announced that Ralph Coates would join the Board as Chief Financial Officer on 1 July 2016, subject to regulatory approval.

Independent auditors' report to the members of TSB Banking Group plc

Report on the Company financial statements

Our opinion

In our opinion, TSB Banking Group plc's company financial statements (the "financial statements"):

- give a true and fair view of the state of the company's affairs as at 31 December 2015 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 European Union 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

The financial statements, included within the Annual Report and Accounts (the "Annual Report"), comprise:

- the company balance sheet as at 31 December 2015;
- the company cash flow statement for the year then ended;
- the company statement of changes in equity for the year then ended; and
- the notes to the 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, 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.

In applying the financial reporting framework, the Directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Opinion on other matter prescribed by the Companies Act 2006

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.

Other matters on which we are required to report by exception

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 company, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

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 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 set out on page 48, 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 International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Independent auditors' report to the members of TSB Banking Group plc (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 & 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 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 2015.

Allan McGrath (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
27 January 2016

EDTF Recommendations

The Enhanced Disclosure Task Force (EDTF), formed by the Financial Stability Board to develop principles for enhanced risk disclosures, issued a report in October 2012 setting out 32 recommendations across seven risk areas. These are primarily aimed at large international banks. However, aligned to TSB's commitment to transparency, the table below provides an overview of how TSB has responded to the recommendations, where relevant to its business model and risk profile.

Type of risk	EDTF Ref	Description	TSB Group's approach
General	1	Risks to which TSB Group is exposed	A summary of TSB Group's principal risks and uncertainties is disclosed on pages 8 to 12.
	2	Definition of risk terminology, principles and appetite	
	3	Top and emerging risks and changes during the reporting period	
	4	Analysis of future regulatory developments affecting the business model and profitability	
Risk governance & management	5	TSB Group's risk management organisation, process and key functions	Described in the Risk management in TSB section on page 8 and 9 and in the Corporate Governance statement on pages 21 to 24.
	6	Risk culture and risk governance and ownership	
	7	Description of the key risks that arise from the business model, risk appetite, and how TSB Group manages such risks.	TSB Group's principal risks and uncertainties that arise from the business model are explained on pages 8 to 12. Further explanation of financial risks is provided in the notes to the financial statements on pages 75 to 83.
	8	Stress testing and the underlying assumptions	
Capital adequacy	9	Minimum Pillar 3 disclosures requirements	Disclosed in the Sabadell Pillar 3 report*.
	10	Reconciliation of accounting balance sheet to regulatory balance sheet	Disclosed on page 14.
	11	Flow statement of movements in regulatory capital	Disclosed on page 15.
	12	Discussion of targeted level of capital and how this will be established	A description of TSB Group's capital composition and changes is provided on pages 14 and 15.
	13	Analysis of risk weighted assets and how they relate to business activities	An analysis of risk weighted assets is disclosed on page 15.
	14	Analysis of capital requirements for each Basel asset class	
	15	Analysis of credit risk for each Basel asset class	Disclosed in the Sabadell Pillar 3 report*.
	16	Flow statements reconciling movements in Risk Weighted Assets for each Risk Weighted Asset type	
	17	Discussion of Basel credit risk model performance	
Liquidity & funding	18	Analysis of TSB Group's liquid asset buffer	Details of the liquidity portfolio and encumbered assets are disclosed in the 'Review of our performance in 2015' section on pages 15 and 16.
	19	Encumbered and unencumbered assets analysed by balance sheet category	
	20	TSB Group assets, liabilities and off balance sheet commitments analysed by remaining contractual maturity	An analysis of the contractual maturity of TSB Group's liabilities is disclosed in Note 25 to the consolidated financial statements.
	21	Analysis of TSB Group's sources of funding	TSB Group's sources of funding are set out in Notes 1 to 5 of the consolidated financial statements.
Market risk	22	Relationship between market risk measures for trading and non trading portfolios and the balance sheet	A summary of the sources, measurement and monitoring of market risk, including sources and sensitivity of net interest income to non-trading market risk is disclosed on Note 27. TSB Group has no trading market risk.
	23	Discussion of significant trading and non trading market risk factors	
	24	VaR assumptions, limitations and validation	
	25	Description of the primary risk management techniques employed by TSB Group	
Credit risk	26	Analysis of the aggregate credit risk exposures	A table showing the maximum exposure to credit risk is disclosed in Note 24 to the consolidated financial statements.
	27	Description of the policies for identifying impaired or non-performing loans including forbearance	TSB Group policy for identifying impaired loans is disclosed on page 60. A summary of forborne loans is set out on page 79.
	28	Reconciliation of the opening and closing balances of non-performing or impaired loans and the allowance for loan losses.	Disclosure of the movement in the allowance for loan losses is disclosed in note 10 to the consolidated financial statements.
	29	Analysis of counterparty credit risk that arises from derivative transactions	TSB Group's derivatives are set out in note 27 to the consolidated financial statements.
	30	Discussion of credit risk mitigation, including collateral held for all sources of risk	Credit risk mitigation and analysis of collateral held is disclosed in Note 24 to the consolidated financial statements.
Other risks	31	Description of other risks	A description of principal and emerging risks is disclosed in the 'Risk Management in TSB' section on pages 8 to 12.
	32	Discussion of publicly known risks	

* As at the date of this report, the 2015 Sabadell Pillar 3 report has not been approved and is expected to be available in due course from www.grupbancsabadell.com/en/.

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, gross of impairment allowance.
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 due to be phased in, through CRD IV, from 1 January 2014 onward.
Basis point	One hundredth of a per cent (0.01 per cent). 100 basis points is 1 per cent. 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 homogeneous 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 capital 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.
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 TSB Group.
Delinquency	See Arrears.
Encumbrance	The use of assets to secure liabilities, such as by way of a lien or charge.
Expected loss	Expected loss (EL) 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 PD%, LGD% and EAD together and assumes a 12 month time horizon.

Glossary (continued)

Exposure at default	Exposure at default (EAD) 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.
Impaired loans	Impaired loans are loans where TSB 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 Capital Adequacy Assessment Process (ICAAP)	TSB Group's own assessment, based on CRD IV 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. There are two approaches to IRB: Foundation IRB and Advanced IRB.
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	Loss given default (LGD) 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.

Glossary (continued)

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.
Net interest income	The difference between revenues generated by interest-bearing assets and the cost of servicing (interest-burdened) liabilities.
Net interest margin	Net interest margin is net interest income as a percentage of average interest-earning assets.
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.
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	Probability of default (PD) represents an estimate of the likelihood that a customer will default on their obligation within a 12 month time horizon.
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 the Basel Capital Accord as implemented by the PRA.
Securities financing transactions	Securities financing transactions are repurchase and reverse repurchase agreements, buy/sell backs and securities lending. For the lender (seller) of the securities it is usually a way to raise funds to finance the securities positions. For the borrower (buyer) of the securities it is a way to invest short-term funds or to cover short (bond) positions.
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 external credit assessment institutions to assign risk weights to exposures. Standardised approaches, following prescribed methodologies, also exist for calculating market risk and operational risk capital 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 the CRD IV. It captures core tier 1 capital plus other tier 1 securities in issue, but is subject to a deduction in respect of material holdings in financial companies.
Tier 1 capital ratio	Tier 1 capital as a percentage of risk-weighted assets.
Tier 2 capital	A component of regulatory capital defined by the CRD IV, mainly comprising qualifying subordinated loan capital and eligible collective impairment allowances.

Abbreviations

AQR	Asset quality ratio
BPS	Basis points
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 & Customs
IAS	International Accounting Standard
ICAAP	Individual Capital Adequacy Assessment Process
IFRS IC	International Financial Reporting Standards Interpretations Committee
IFRS	International Financial Reporting Standards
ILAAP	Individual Liquidity Adequacy Assessment Process
IPO	Initial public offering
ISAE	International Standard on Assurance Engagements
LBG	Lloyds Banking Group
LTIP	Long Term Incentive Plan
LTV	Loan to value
NPS	Net promoter score
PBT	Profit before taxation
PCA	Personal current account
PP	Percentage points
PRA	Prudential Regulatory Authority
SPA	Sustainable Performance Award
TSA	Transitional Services Agreement

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