Price range prospectus

9 June 2014

This prospectus (the "**Prospectus**") comprises a prospectus relating to TSB Banking Group plc (the "**Company**") prepared in accordance with the Prospectus Rules of the Financial Conduct Authority (the "**FCA**") made under section 73A of the Financial Services and Markets Act 2000 (as amended) (the "**FSMA**"). The Prospectus has been filed with the FCA and has been made available to the public in accordance with section 3.2 of the Prospectus Rules.

Application will be made to the FCA acting in its capacity as competent authority for the purpose of Part VI of the FSMA (the "**UK Listing Authority**") for all of the Ordinary Shares of the Company to be admitted to the premium segment of the Official List of the FCA (the "**Official List**") and to trading on the London Stock Exchange plc's (the "**London Stock Exchange**") main market for listed securities (together, "**Admission**"). Admission to trading on the London Stock Exchange's main market for listed securities constitutes admission to trading on a regulated market. Conditional dealings in the Ordinary Shares are expected to commence on the London Stock Exchange on 20 June 2014. It is expected that Admission will become effective, and that unconditional dealings in the Ordinary Shares will commence, on 25 June 2014. **All dealings in Ordinary Shares before the commencement of unconditional dealings will be of no effect if Admission does not take place and such dealings will be on a "when issued" basis and at the sole risk of the parties concerned. No application has been, or is currently intended to be, made for the Ordinary Shares to be admitted to listing or trading on any other exchange.**

The directors of the Company, whose names appear on page 44 of this Prospectus (the "**Directors**"), the Prospective Non-executive Director and the Company accept responsibility for the information contained in this Prospectus. To the best of the knowledge of the Company, the Directors and the Prospective Non-executive Director (who have taken all reasonable care to ensure that such is the case), the information contained in this Prospectus is in accordance with the facts and contains no omission likely to affect the import of such information.

Prospective investors should read the entire document and, in particular, prospective investors are advised to examine all the risks that might be relevant in connection with an investment in the Ordinary Shares. See Part II: "Risk Factors" for a discussion of certain risks and other factors that should be considered prior to any investment in the Ordinary Shares.

TSB BANKING GROUP PLC

(incorporated under the Companies Act 2006 and registered in England and Wales with registered number 8871766)

Prospectus

Offer of Ordinary Shares of one pence each at an Offer Price expected to be between 220 pence and 290 pence per Ordinary Share and admission to the premium listing segment of the Official List and to trading on the London Stock Exchange

Joint Sponsors, Joint Global Co-ordinators and Joint Bookrunners

Citigroup **J.P. Morgan Cazenove**

Joint Bookrunner and Joint Lead Manager

UBS Investment Bank

Joint Lead Managers

Investec Bank plc **Numis Securities** **RBC Capital Markets**

Issued and fully paid Ordinary Share capital immediately following Admission

Number	Nominal Value
500,000,000	**£5,000,000**

Pursuant to the Offer, the Selling Shareholder is currently expected to sell 125,000,000 Ordinary Shares, representing 25 per cent. of the issued Ordinary Share capital of the Company on Admission. The Offer Price Range and the Expected Offer Size are indicative only and may change during the course of the Offer. The Offer Price may be set within, above or below the Offer Price Range and the Offer Size may be set above or, with the approval of the UK Listing Authority, below the Expected Offer Size. The amount to be raised and the number of Ordinary Shares to be sold may be increased or decreased during the course of the Offer. A number of factors will be considered in determining the Offer Price, the Offer Size, the amount raised in the Offer and the basis of allocation, including the level and nature of demand for the Ordinary Shares during the book-building process, prevailing market conditions and the objective of establishing an orderly after-market in the Ordinary Shares. Unless required to do so by law or regulation, the Company does not envisage publishing any supplementary prospectus or a pricing statement, as the case may be, until announcement of the Offer Price and the Offer Size. A pricing statement containing the Offer Price and the Offer Size and certain other information (the "**Pricing Statement**") is expected to be published on or about 20 June 2014.

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The Company consents to the use of this Prospectus by the Intermediaries in connection with the Intermediaries Offer to persons located in the United Kingdom, the Channel Islands and the Isle of Man: (i) in respect of Intermediaries who are appointed prior to the date of this Prospectus, from the date of this Prospectus; and (ii) in respect of Intermediaries who are appointed after the date of this Prospectus, from the date on which they are approved to participate in the Intermediaries Offer, in each case, until the closing of the Intermediaries Offer. **Any Intermediary that uses this Prospectus must state on its website that it uses this Prospectus in accordance with the Company's consent. Intermediaries are required to provide the terms and conditions of the Intermediaries Offer to any prospective investor who has expressed an interest in participating in the Intermediaries Offer to such Intermediary. Any application made by investors to any Intermediary is subject to the terms and conditions imposed by each Intermediary.**

Recipients of this Prospectus are authorised solely to use it for the purpose of considering the acquisition of the Ordinary Shares and may not reproduce or distribute this Prospectus, in whole or in part, and may not disclose any of the contents of this Prospectus or use any information herein for any purpose other than considering an investment in the Ordinary Shares. Such recipients of this Prospectus agree to the foregoing by accepting delivery of this Prospectus.

The Ordinary Shares are subject to selling and transfer restrictions in certain jurisdictions. Prospective purchasers should read the restrictions contained in Part XXI: *"The Offer – Selling restrictions"*. Each purchaser of the Ordinary Shares will be deemed to have made the relevant representations made therein.

This Prospectus does not constitute an offer to sell or an invitation to purchase, or the solicitation of an offer to buy, any Ordinary Shares to any person in any jurisdiction to whom it is unlawful to make such offer or solicitation in such jurisdiction.

Prior to making any decision as to whether to invest in Ordinary Shares, prospective investors should read this Prospectus in its entirety. In making an investment decision, each prospective investor must rely upon his or her own examination, analysis and enquiries of the Company and the terms of this Prospectus, including the merits and risks involved.

Citigroup and J.P. Morgan Cazenove have been appointed as Joint Sponsors, Joint Global Co-ordinators and Joint Bookrunners. UBS has been appointed as Joint Bookrunner (together with Citigroup and J.P. Morgan Cazenove the "**Joint Bookrunners**"). Investec, Numis, RBC and UBS have been appointed as Joint Lead Managers (together, the "**Joint Lead Managers**") and the Joint Bookrunners and the Joint Lead Managers are collectively the Underwriters (the "**Underwriters**").

The distribution of this Prospectus and the offer of the Ordinary Shares in certain jurisdictions may be restricted by law. Apart from in the UK, the Channel Islands and the Isle of Man, no action has been or will be taken by the Company or the Underwriters to permit a public offering of the Ordinary Shares or to permit the possession, issue or distribution of this Prospectus in any jurisdiction where action for that purpose may be required, including the United States, Australia, Canada, Japan or South Africa. Accordingly, neither this Prospectus nor any advertisement nor any other offering material may be distributed or published in any jurisdiction except for in the UK, the Channel Islands and the Isle of Man and under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Prospectus comes should inform themselves about and observe any such restrictions. Any failure to comply with these restrictions may constitute a violation of the securities laws of any such jurisdiction.

The Ordinary Shares have not been, and will not be, registered under the U.S. Securities Act of 1933, as amended (the "**Securities Act**") or under the applicable securities laws or regulations of any State or other jurisdiction of the United States and may not be offered or sold except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and in compliance with any applicable State securities laws. The Underwriters may offer and sell or arrange for the offer and sale of the Ordinary Shares in the United States only to persons reasonably believed to be Qualified Institutional Buyers ("**QIBs**") as defined in and pursuant to Rule 144A under the Securities Act ("**Rule 144A**") or another exemption from, or in a transaction not subject to, the registration requirements of the Securities Act in offshore transactions in reliance on Regulation S under the Securities Act ("**Regulation S**"). None of the U.S. Securities and Exchange Commission, any other U.S. federal or state securities commission or any U.S. regulatory authority has approved or disapproved of the Ordinary Shares nor have any such authorities reviewed or passed upon the accuracy or adequacy of this Prospectus. Any representation to the contrary is a criminal offence.

INTERNAL REVENUE SERVICE CIRCULAR 230 NOTICE: TO ENSURE COMPLIANCE WITH TREASURY DEPARTMENT CIRCULAR 230, PROSPECTIVE INVESTORS ARE HEREBY NOTIFIED THAT: (A) ANY DISCUSSION OF FEDERAL TAX ISSUES IN THIS PROSPECTUS IS NOT INTENDED OR WRITTEN TO BE RELIED UPON, AND CANNOT BE RELIED UPON, BY PROSPECTIVE INVESTORS FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON HOLDERS UNDER THE INTERNAL REVENUE CODE; (B) SUCH DISCUSSION IS INCLUDED HEREIN BY THE COMPANY IN CONNECTION WITH THE PROMOTION OF MARKETING (WITHIN THE MEANING OF CIRCULAR 320) BY THE COMPANY OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) PROSPECTIVE INVESTORS SHOULD SEEK ADVICE BASED ON THEIR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISER.

NOTICE TO NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENCE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES ("RSA-421-B") WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE IN NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER RSA-421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE OF NEW HAMPSHIRE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

Dated 9 June 2014.

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PART I
SUMMARY INFORMATION

Summaries are made up of disclosure requirements known as "Elements". These Elements are numbered in Sections A to E (A.1 to E.7).

This summary contains all the Elements required to be included in a summary for this type of security and issuer. Because some Elements are not required to be addressed, there may be gaps in the numbering sequence of the Elements.

Even though an Element may be required to be inserted in the summary because of the type of security and issuer, it is possible that no relevant information can be given regarding the Element. In this case, a short description of the Element is included in the summary together with the statement "not applicable".

	SECTION A – INTRODUCTION AND WARNINGS
A.1	**Warning to investors** This summary should be read as an introduction to this Prospectus. Any decision to invest in the Ordinary Shares should be based on consideration of this Prospectus as a whole by the investor. Where a claim relating to the information contained in this Prospectus is brought before a court, a plaintiff investor might, under the national legislation of the European Economic Area Member States, have to bear the costs of translating the Prospectus before the legal proceedings are initiated. Civil liability attaches to the Directors, the Prospective Non-executive Director and the Company, who are responsible for this summary including any translation thereof, but only if this summary is misleading, inaccurate or inconsistent when read together with the other parts of this Prospectus or it does not provide, when read together with the other parts of this Prospectus, key information in order to aid investors when considering whether to invest in the Ordinary Shares.
A.2	**Consent for Intermediaries** The Company consents to the use of this Prospectus for subsequent resale or final placement of the Ordinary Shares by the Intermediaries in connection with the Intermediaries Offer to persons located in the United Kingdom, the Channel Islands and the Isle of Man on the following terms: (i) in respect of Intermediaries who are appointed prior to the date of this Prospectus, from the date of this Prospectus; and (ii) in respect of Intermediaries who are appointed after the date of this Prospectus, from the date on which they are approved to participate in the Intermediaries Offer, in each case, until the closing of the Intermediaries Offer. Prospective investors interested in participating in the Intermediaries Offer should apply for Ordinary Shares through the Intermediaries by following their relevant application procedures by no later than 17 June 2014. **Any Intermediary that uses this Prospectus must state on its website that it uses this Prospectus in accordance with the Company's consent. Intermediaries are required to provide the terms and conditions of the Intermediaries Offer to any prospective investor who has expressed an interest in participating in the Intermediaries Offer to such Intermediary. Any applications made by investors to any Intermediary are subject to the terms and conditions approved by each Intermediary.**

	SECTION B – COMPANY
B.1	**Legal and commercial name** The legal and commercial name of the Company is TSB Banking Group plc.
B.2	**Domicile, legal form and country of incorporation of the Company** The Company is domiciled in the United Kingdom and is a public limited company incorporated in England and Wales with its registered office situated in England and Wales. The Company operates under the Companies Act 2006.
B.3	**Current operations and principal activities** The Company, together with its subsidiary undertakings ("**TSB**" or the "**TSB Group**"), is a fully functioning UK retail bank: • As at 31 March 2014, TSB had approximately 4.5 million retail and approximately 113,000 small business banking customers;

	• TSB has a multi-channel, national distribution model, including 631 branches (as at 31 March 2014) with coverage across England, Scotland and Wales and a full digital (internet and mobile) and telephony capability; • TSB's comprehensive product suite includes PCAs, savings products, mortgages, unsecured personal and business lending and certain insurance products; and • TSB's service and sales capability is supported by approximately 8,600 employees. As at 31 March 2014, TSB had customer assets of £19.7 billion and customer deposits of £23.3 billion. In addition, TSB is entitled to the economic benefit of a portfolio of residential mortgages (the "**Additional Mortgages**") of £3.3 billion (in nominal value) as at 31 March 2014, the beneficial title to which was transferred by Bank of Scotland (the transferring entity in Lloyds Banking Group (as defined below)) to the Company's principal subsidiary, TSB Bank plc ("**TSB Bank**") with effect from 28 February 2014 (the "**Mortgage Enhancement**" and TSB's business, excluding the Mortgage Enhancement, the "**TSB Franchise**"). The Mortgage Enhancement has been designed with the aim of enhancing TSB's profit by approximately £220 million in aggregate over the four years from (and including) 2014. The legal title to the Additional Mortgages remains with Bank of Scotland and Bank of Scotland may require TSB Bank to sell its equitable interest in the Additional Mortgages back to Bank of Scotland once certain triggers, based on a determination of the profit deemed to have been earned by TSB Bank from the Additional Mortgages, have been met.
B.4a	**Significant recent trends and regulatory developments** TSB's results, and those of its competitor retail banks, are directly and indirectly affected by a number of trends. In general, TSB and its competitors are affected by the uncertain and unpredictable condition of the UK economy, which experienced a significant degree of turbulence and periods of recession during the global financial crisis that started in mid-2008 and adversely affected, among other things, the state of the housing market, market interest rates, levels of unemployment, the cost and availability of credit and the liquidity of the financial markets. While economic indicators in the UK have been improving recently, the outlook for the UK economy remains somewhat uncertain. As TSB's financial results are derived almost entirely from customers based in the UK, TSB has been particularly impacted by the persistently low interest rates seen over the three years ended 31 December 2013, 2012 and 2011, impacting TSB's net interest margin and income over that period. In addition, TSB and its competitors have been impacted by regulatory developments. TSB and its competitors are subject to a comprehensive and fluid regulatory environment, including (i) prudential regulations, pursuant to which TSB and its competitors are required, among other things, to maintain adequate capital and liquidity resources and to satisfy specified capital and liquidity ratios; (ii) conduct regulations, including those relating to the mis-selling of financial products; and (iii) banking reform initiatives, including a bail-in option under the Banking Act 2009 for resolving failing banks.
B.5	**Group structure** The Company is the parent company of the TSB Group, which carries on a retail banking business which operates in the UK. The Company has one principal subsidiary, TSB Bank, which is incorporated in Scotland. Until Admission, the Company will be a wholly-owned indirect subsidiary of Lloyds Banking Group plc (the "**Parent**" and, together with its subsidiaries and subsidiary undertakings, "**Lloyds Banking Group**"), a large financial services group in the United Kingdom. Lloyds Banking Group's 100 per cent. interest in the Company is held through Lloyds Bank plc ("**Lloyds Bank**" or the "**Selling Shareholder**"). Following Admission, the Company will no longer be wholly owned by the Parent through the Selling Shareholder.

B.6 **Major shareholder**

As at the date of this Prospectus, the Parent owns 100 per cent. of the issued ordinary share capital of the Company, through the Selling Shareholder. Pursuant to the Offer, the Selling Shareholder is currently expected to sell 125,000,000 Ordinary Shares, representing 25 per cent. of the issued Ordinary Share capital of the Company. In addition, a number of Ordinary Shares representing up to 10 per cent. of the Offer Size (representing 2.5 per cent. of the issued Ordinary Share capital of the Company on Admission, assuming the Offer Size is set at the Expected Offer Size) may be sold by the Selling Shareholder pursuant to the Over-allotment Option. The Offer Size is expected to be set at the Expected Offer Size but could be set above or, with the approval of the UK Listing Authority, below the Expected Offer Size. At Admission, the Selling Shareholder will, save with the approval of the UK Listing Authority, own no more than 75 per cent. of the issued ordinary share capital of the Company. There is a relationship agreement in place between the Parent and the Company that will take effect from Admission. The Ordinary Shares owned by the Selling Shareholder after Admission will rank *pari passu* with other Ordinary Shares in all respects.

B.7 **Selected historical key financial information**

TSB Bank Group's audited Income Statement data for the three years ended 31 December 2013, 2012 and 2011 (the "**Track Record Period**") and the unaudited Income Statement data for the three months ended 31 March 2014, are presented in this Prospectus on a management basis, which the board of the Company (the "**TSB Board**") believes better reflects the underlying performance of the business by highlighting certain transactions and underlying trends (the "**Management Basis**"). Certain differences exist between the Management Basis and the income statement in the Historical Financial Information included in Part XVI of this Prospectus (the "**HFI**"). These differences resulted in changes to certain line items for the year ended 31 December 2013 and the three months ended 31 March 2014, as set out in the reconciliations presented in Part XII: "*Selected Financial and Other Information*". There were no changes to the line items in the years ended 31 December 2012 or 2011 as a result of the differences between the Management Basis and the HFI.

Income Statement Data

The following tables set out income statement data on a Management Basis for TSB Bank and its subsidiaries (the "**TSB Bank Group**") for the three months ended 31 March 2014 and the years ended 31 December 2013, 2012 and 2011.

	Management Basis		
	TSB Franchise	**Mortgage Enhancement**	**Total**
		(£m)	
Three months ended 31 March 2014 (*unaudited*)			
Net interest income	179	16	195
Total other income (net of fee and commission expense)	37	—	37
Total income	**216**	**16**	**232**
Profit for the period			**60**

	Management Basis		
	TSB Franchise	**Mortgage Enhancement**	**Total**
		(£m)	
Year ended 31 December 2013			
Net interest income	603	32	635
Total other income (net of fee and commission expense)	163	—	163
Total income	**766**	**32**	**798**
Profit for the year			**172**

	Management Basis		
	TSB Franchise	Mortgage Enhancement	Total
		(£m)	
Year ended 31 December 2012			
Net interest income	533	25	558
Total other income (net of fee and commission expense)	179	—	179
Total income	**712**	**25**	**737**
Profit for the year			**28**

	Management Basis		
	TSB Franchise	Mortgage Enhancement	Total
		(£m)	
Year ended 31 December 2011			
Net interest income	634	25	659
Total other income (net of fee and commission expense)	197	—	197
Total income	**831**	**25**	**856**
Profit for the year			**57**

In accordance with IFRS 8, "Operating Segments", the Management Basis is used to present the performance of individual operating segments. This analysis is provided in Note 4 to Part XVI: *"Historical Financial Information"* and Part XVII: *"Condensed Combined Interim Financial Information (Unaudited)"*. Part XII: *"Selected Financial and Other Information"* and Part XIII: *"Operating and Financial Review"* present income statement data on the Management Basis, because the TSB Board believes that it better highlights the underlying performance of the business.

Balance Sheet Data

The following table sets out the TSB Bank Group's balance sheet data as at 31 March 2014 (on an unaudited basis) and as at 31 December 2013, 2012 and 2011.

	As at 31 March	As at 31 December		
	2014	2013	2012	2011
	(unaudited)		*(£m)*	
Total assets	**26,561**	**28,333**	**24,868**	**24,270**
Total liabilities	**25,137**	**23,391**	**23,111**	**21,946**
Net investment from Lloyds Banking Group	1,424	4,942	1,757	2,324
Net investment from Lloyds Banking Group and liabilities	**26,561**	**28,333**	**24,868**	**24,270**

Cash Flow Statement

The following table sets out the TSB Bank Group's consolidated cash flows for the years ended 31 December 2013, 2012 and 2011.

	Year ended 31 December		
	2013	2012	2011
		(£m)	
Profit before taxation	**67**	**39**	**82**
Net cash (used in)/provided by operating activities	(2,976)	564	147
Net cash (used in) investing activities	(48)	(23)	(18)
Net cash (used in)/provided by financing activities	3,017	(532)	(125)
Cash and cash equivalents at end of year	**174**	**181**	**172**

TSB reports its results in two segments: TSB Franchise, which comprises the retail banking business, and the Mortgage Enhancement, which comprises a separate portfolio of mortgage assets now in run-off with no new customer lending. The beneficial interest in the Additional Mortgages that comprise the Mortgage Enhancement has been assigned to TSB, but the Additional Mortgages are not TSB-branded and are managed by the Bank of Scotland.

TSB Franchise – Income Statement

- Net interest income increased 13 per cent. for the year ended 31 December 2013 to £603 million from £533 million in 2012, primarily due to reduced rates paid on customer deposit balances, as well as a 62 per cent. decline in the funds transfer pricing ("**FTP**") charged by Lloyds Banking Group. This was partially offset by a decrease in interest income from mortgage lending. Net interest income decreased 16 per cent. for the year ended 31 December 2012 to £533 million from £634 million in 2011.

- Other income (net of fee and commission income) decreased 9 per cent. for the year ended 31 December 2013 to £163 million from £179 million in 2012, primarily due to a decline in investment and protection income. Other income (net of fee and commission income) decreased 9 per cent. for the year ended 31 December 2012 to £179 million from £197 million in 2011.

- Operating expenses decreased 1 per cent. for the year ended 31 December 2013 to £575 million from £579 million in 2012, primarily due to lower recharges for services provided by Lloyds Banking Group. Operating expenses decreased by 2 per cent. for the year ended 31 December 2012 to £579 million from £590 million in 2011.

TSB Franchise – Balance Sheet

- Total assets as at 31 December 2013 were £24,947 million, a 15 per cent. increase from £21,688 million as at 31 December 2012. The increase was primarily due to the recognition of a deposit of £4.1 billion held with Lloyds Banking Group and classified under loans and advances to banks. This principally represents the excess of customer deposits over loans and advances to customers. The equivalent items as at 31 December 2012 and 2011 were accounted for within net investment from Lloyds Banking Group. Total assets as at 31 December 2012 of £21,688 million were broadly flat compared to £21,616 million as at 31 December 2011.

- Total liabilities as at 31 December 2013 were £23,391 million, a 1 per cent. increase compared to £23,111 million as at 31 December 2012, with growth in personal and business current accounts largely offset by a decline in savings accounts. Total liabilities as at 31 December 2012 were £23,111 million, a 5 per cent. increase over £21,946 million as at 31 December 2011.

- In the year ended 31 December 2013, the TSB Bank Group recognised a deferred tax asset of £142 million in respect of the transfer of customers and their related deposits and assets from Lloyds Banking Group (recorded as £122 million as at 31 December 2013). This was the primary driver of the overall tax credit of £105 million in the year ended 31 December 2013 compared to tax charges of £11 million and £25 million for the years ended 31 December 2012 and 2011, respectively.

Mortgage Enhancement

- Net interest income from the Additional Mortgages comprising the Mortgage Enhancement increased 28 per cent. for the year ended 31 December 2013 to £32 million from £25 million in 2012, primarily resulting from an increase in both the Additional Mortgages portfolio and the average gross customer asset margin. Net interest income was flat for the year ended 31 December 2012 as compared to 2011.

TSB Bank Group – Results for the three months ended 31 March 2014

- Net interest income for the three months ended 31 March 2014 on a Management Basis was £195 million, reflecting stable mortgage yields on a slightly declining mortgage book from 31 December 2013 and static unsecured lending yields on a broadly flat book size over the quarter. Other income (net of fee and commission income) for the three months ended 31 March 2014 on a Management Basis was £37 million, reflecting reduced investment and protection income partially offset by an increase in household insurance commission income. Operating expenses for the three months ended 31 March 2014 were £121 million. These expenses include recharges to TSB by Lloyds Bank using the service charges schedule agreed under the Transitional Services Agreement ("**TSA**") and Long Term Services Agreement ("**LTSA**") (such agreements governing the provision of a number of services by Lloyds Bank to TSB) as if the TSA had been in place from 1 January 2014. In addition, staff costs increased as TSB continued to expand resource capacity in preparation for becoming a fully standalone and listed organisation. Total assets as at 31 March 2014 were £26,561 million. Total liabilities as at 31 March 2014 were £25,137 million.

Current Trading

- Trading performance since 31 March 2014 has progressed largely in line with the trends seen in the three months ended 31 March 2014. The Classic Plus PCA product continues to attract new customers to TSB above trend levels with corresponding increases in the level of customer interest payments.

B.8 **Selected key pro forma financial information**

The unaudited pro forma net assets statement as at 31 March 2014 of the TSB Group has been prepared to illustrate the effect of certain capital, liquidity, and other funding actions undertaken between 31 March 2014 and Admission as if each of the foregoing had taken place on 31 March 2014. The unaudited pro forma income statement of the TSB Group for the three months ended 31 March 2014 has been prepared to illustrate the effect of those actions as if each had taken place on 1 January 2014, the start of the financial period.

The unaudited pro forma net assets statement and the unaudited pro forma income statement and footnotes thereto (together "**unaudited pro forma financial information**") have been prepared for illustrative purposes only and, because of their nature, address a hypothetical situation and, therefore, do not represent the TSB Group's actual financial position or results. The unaudited pro forma financial information does not constitute financial statements within the meaning of section 434 of the Companies Act.

Summarised unaudited pro forma net assets statement at 31 March 2014

	TSB Group as at 31 March 2014[1]	Issue of share capital and Tier 2 Securities[2]	Establish standalone liquid assets[3]	Recognition of RMBS Funding Facility[4]	Pro forma net assets as at 31 March 2014
			(£m, except where indicated)		
Total assets	26,561	583	—	(1,285)	25,859
Total liabilities	(25,137)	(383)	—	1,285	(24,235)
Net assets	**1,424**	**200**	**—**	**—**	**1,624**
Key capital and liquidity measures					
Risk-weighted assets[5]	7,401	117	(390)	(257)	6,871
Common Equity Tier 1 Capital Ratio[5]	17.3%				21.6%
Total Capital Ratio[5]	17.3%				27.1%
Leverage Ratio[6]	4.7%				5.6%
Liquidity Coverage Ratio[7]	—				146%

Summarised unaudited pro forma income statement for the three months ended 31 March 2014

	TSB Group Income Statement for the three months ended 31 March 2014[8]	Issue of share capital and Tier 2 Securities[2]	Recognition of RMBS Funding Facility[4]	Pro forma Income Statement for the three months ended 31 March 2014[9]
		(£m, except where indicated)		
Net interest income	186	(3)	10	193
Net fee and commission income	37	—	—	37
Profit before taxation	76	(3)	10	83
Taxation	(16)	1	(2)	(17)
Profit for the period	60	(2)	8	66

Notes:

(1) The net assets position of TSB Bank Group as at 31 March 2014 is extracted from the condensed combined interim financial information (unaudited) set out in Part XVII: *"Condensed Combined Interim Financial Information (Unaudited)"*. The Company was incorporated on 31 January 2014 with a share capital of £50,000. The net asset statement of TSB Group as at 31 March 2014 is, therefore, equivalent to the aggregated net asset statements of TSB Bank Group and the Company at 31 March 2014.

(2) On 19 May 2014, share capital of £200 million was issued to Lloyds Bank for cash consideration. On 1 May 2014, Tier 2 Securities were settled by Lloyds Bank for net proceeds of £383 million. After taking into account the impact of an interest rate swap entered into on the same date, the Tier 2 Securities incur interest at 354 bps over three-month LIBOR. The proceeds were placed on deposit earning interest at three-month LIBOR. The impact on the net interest income for the period, had this occurred on 1 January 2014, is to decrease net interest income by £3 million.

(3) On 1 May 2014, TSB Bank Group left the defined liquidity group headed by Lloyds Banking Group and liquid assets of £1,950 million were transferred by the business to the Bank of England. Cash held at the Bank of England is assumed to earn interest at base rate. Had it occurred on 1 January 2014, the impact on the net interest income for the period would have been less than £1 million.

(4) On 20 May 2014, TSB Bank Group entered into the £2.5 billion RMBS Funding Facility. On 20 May 2014, £10 million of the facility was drawn down from Lloyds Bank. A further £240 million was drawn down from Lloyds Bank on 2 June 2014. On 2 June 2014, TSB Bank Group repaid the unsecured funding facility of £1,535 million that had been put in place on 4 March 2014, after the execution of the Mortgage Enhancement Agreements, in part through the £250 million drawn down from Lloyds Bank under the RMBS Funding Facility. The remainder of the repayment, equal to £1,285 million, was funded by liquid cash resources. The terms of the RMBS Funding Facility include a commitment fee of 30 bps on undrawn amounts and a charge of LIBOR plus 60 bps on amounts drawn as well as certain increased margins payable in certain circumstances, which may be beyond TSB's control. The increase to net interest income of £10 million is based on the assumption that the Mortgage Enhancement purchase had been funded by TSB Bank Group throughout the three months ended 31 March 2014, rather than by allocation of FTP costs from Lloyds Banking Group. The unsecured funding facility of £1,535 million at 31 March 2014 is assumed to have been replaced by £250 million of the RMBS Funding Facility and cash funding for the entire period.

(5) Key balance sheet measures include regulatory capital resources and ratios of the TSB Bank Group. These measures are presented immediately before and after the transactions described in footnotes (2), (3) and (4), as if these transactions had occurred at 31 March 2014.

Risk weighted assets, Common Equity Tier 1 Capital, Common Equity Tier 1 Capital Ratio, Total Capital and Total Capital Ratio are calculated based on TSB Bank Group's interpretation of the final CRD IV text and PRA Policy Statement, PS 7/13, which outlines the approach to implementing CRD IV in the UK. The final impact of CRD IV is dependent on technical standards to be finalised by the European Banking Authority and on the final UK implementation of those rules.

RWAs have been calculated on the basis expected to be adopted by TSB Bank Group at Admission. A standardised approach is applied to all banking assets, with the exception of the TSB Franchise mortgages, which will continue to apply an IRB waiver methodology. RWAs for loans and advances to banks are calculated on the basis that cash is held with external banks, receiving a 20 per cent. risk weight. Note that this method differs from the actual capital position of TSB Bank Group as at 31 March 2014, which treats cash held with Lloyds Banking Group as an intragroup asset.

	TSB Bank Group's Common Equity Tier 1 Capital and Tier 2 Capital at 31 March 2014 are calculated as follows: **Capital resources** / **Issue of share capital and Tier 2 Securities(2)** / **Pro forma capital resources** Share capital and premium: 75 / 200 / 275 Reserves: 1,220 / — / 1,220 **Shareholders' equity**: 1,295 / 200 / 1,495 Excess expected loss adjustments: (14) / — / (14) **Common Equity Tier 1 Capital**: 1,281 / 200 / 1,481 Debt securities in issue: — / 383 / 383 Excess default provisions: — / 1 / 1 **Tier 2 Capital**: — / 384 / 384 **Total Capital**: 1,281 / 584 / 1,865 Shareholders' equity for use in calculation of the Common Equity Tier 1 Capital represents the statutory equity and reserves of TSB Bank Group at 31 March 2014, but is adjusted to exclude unverified profits for the three months ended 31 March 2014. Were these profits to be verified and included, the total shareholders' equity on a pro forma basis would be £1,577 million. A difference of £47 million exists between this balance and the pro forma net assets of £1,624 million and is described in note 11 of the condensed combined interim financial information (unaudited) as set out in Part XVII of this Prospectus. (6) TSB Bank Group's Leverage Ratio is calculated in accordance with TSB Bank Group's interpretation of the final CRD IV text and is defined as the ratio of Common Equity Tier 1 Capital, described in footnote (5), to the total of assets, off balance sheet exposures and excess expected loss, as defined by the CRD IV text, totalling £27,249 million on an unadjusted basis and £26,547 million on a pro forma basis. The decrease of £702 million is identical to the decrease in total assets of £702 million set out in the unaudited pro forma net assets statement. (7) TSB Bank Group's Liquidity Coverage Ratio is calculated in accordance with TSB Bank Group's interpretation of the Basel III guidance issued in January 2013 and is calculated as the stock of high quality liquid assets (£1,950 million on a pro forma basis) expressed as a percentage of net cash outflows over a 30-day period (£1,337 million). Liquidity Coverage Ratio is not presented on an adjusted basis as at 31 March 2014, because it is not a meaningful figure prior to TSB's exit from the Lloyds Banking Group defined liquidity group, described in note (3). (8) The income statement of TSB Bank Group for the three months ended 31 March 2014 is the condensed combined interim financial information (unaudited) set out in Part XVII *"Condensed Combined Interim Financial Information (Unaudited)"*. The Company has not traded since incorporation and, therefore, the income statement of TSB Group for the three months ended 31 March 2014 is equivalent to the aggregated income statements of TSB Bank Group and the Company for the same period. (9) All of the adjustments which impact the pro forma Income Statement are continuing. No account has been made of any trading activity post 31 March 2014.
B.9	**Profit forecast or estimate** Not applicable. No profit forecast remains outstanding as at the date of this Prospectus.
B.10	**A description of the nature of any qualifications in the report on the historical financial information** Not applicable. There are no qualifications to PricewaterhouseCoopers LLP's report on the historical financial information.
B.11	**Working capital – insufficiency** Not applicable. The Company has sufficient working capital for its present requirements.

	SECTION C – SHARES
C.1	**Type and class of securities** When admitted to trading, the Ordinary Shares will be registered with ISIN number GB00BMQX2Q65 and SEDOL number BMQX2Q6. It is expected that the Ordinary Shares will be traded on the London Stock Exchange under the ticker symbol "TSB". The Ordinary Shares will, on Admission, comprise the entire issued Ordinary Share capital of the Company.

C.2	**Currency of the issue of securities** The currency of the Ordinary Shares is pounds sterling.
C.3	**Number of issued and fully paid Ordinary Shares** The nominal value of the issued Ordinary Share capital of the Company is £5 million divided into 500,000,000 Ordinary Shares of one pence each, which are issued fully paid.
C.4	**Description of the rights attaching to the securities** The Offer Shares being sold pursuant to the Offer will, on Admission, rank *pari passu* in all respects with the other Ordinary Shares in issue, including for voting purposes, and will rank in full for all dividends and other distributions thereafter declared, made or paid on the Ordinary Share capital of the Company. Subject to the provisions of the Companies Act, any equity securities issued by the Company for cash must first be offered to Shareholders in proportion to their holdings of Ordinary Shares. The Companies Act and Listing Rules allow for the disapplication of pre-emption rights which may be waived by a special resolution of the Shareholders, whether generally or specifically, for a maximum period not exceeding five years. Except in relation to dividends which have been declared and rights on a liquidation of the Company, the Shareholders have no rights to share in the profits of the Company. The Ordinary Shares are not redeemable. However, the Company may purchase or contract to purchase any of the Ordinary Shares on- or off-market, subject to the Companies Act and the requirements of the Listing Rules.
C.5	**Restrictions on the free transferability of the Ordinary Shares** Save as described in the paragraph below, there are no restrictions on the free transferability of the Ordinary Shares. *Transfer restrictions under the Companies Act* The Company may, under the Companies Act, send out statutory notices to those it knows or has reasonable cause to believe have an interest in its Ordinary Shares, asking for details of those who have an interest and the extent of their interest in a particular holding of shares. When a person receives a statutory notice and fails to provide any information required by the notice within the time specified in it, the Company can apply to the court for an order directing, among other things, that any transfer of shares which are the subject of the statutory notice is void. *Transfer restrictions under the Articles* The TSB Board can decline to register any transfer of any share which is not a fully paid share. The TSB Board may also decline to register a transfer of a certificated share unless the instrument of transfer: • is lodged at the transfer office, duly stamped if required and accompanied by the relevant share certificate(s) or such other evidence of the right to transfer as the TSB Board may reasonably require; • is in respect of only one class of share; and • if to joint transferees, is in favour of not more than four such transferees. Registration of a transfer of an uncertificated share may be refused in the circumstances set out in the CREST regulations (as defined in the Articles) and where, in the case of a transfer to joint holders, the number of joint holders to whom the uncertificated share is to be transferred exceeds four. The TSB Board may decline to register a transfer of any of the Company's certificated shares by a person with an interest of 0.25 per cent. or more of the existing Ordinary Shares (exclusive of any shares held in treasury) if such a person has been served with a direction notice (as defined in the Articles) after failure to provide the Company with information concerning interests in those shares required to be provided under the Companies Act, unless the transfer is shown to the TSB Board to be pursuant to an arm's length sale (as defined in the Articles).

C.6	**Admission** Application will be made to the FCA for all of the Ordinary Shares to be admitted to the premium listing segment of the Official List and to the London Stock Exchange for such Ordinary Shares to be admitted to trading on the London Stock Exchange's main market for listed securities. No application has been made or is currently intended to be made for the Ordinary Shares to be admitted to listing or trading on any other exchange.
C.7	**Dividend policy** The TSB Board believes that the Company will, in time, be able to support a dividend distribution of 40 to 60 per cent. of underlying earnings, reflecting the strength of the capital position and franchise of the Company. In the near term, however, as TSB grows its earnings and balance sheet, the TSB Board will have particular regard to the low level of profitability of the underlying business and the need to preserve capital to support TSB's growth strategy. Taking this into account, it is the TSB Board's current expectation that the Company's inaugural dividend would be in respect of the financial year ending 31 December 2017. The TSB Board intends to review, on an ongoing basis, the expected timing and quantum of any dividend payments in the context of progress on delivery of TSB's strategy and the broader operating environment.

	SECTION D – RISKS
D.1	**Key information on the key risks that are specific to the Company or its industry** Risks relating to the macro-economic environment in which TSB operates • TSB's business is subject to inherent risks arising from general macro-economic conditions in the UK, the Eurozone and the state of the global financial markets. As TSB's customer revenue is derived almost entirely from customers based in the UK, TSB is particularly exposed to the condition of the UK economy, including house prices, interest rates, levels of unemployment and consequential fluctuations in consumers' disposable income. Higher unemployment rates and the resultant decrease in customer income can also have a negative impact on TSB's results, including through an increase in mortgage arrears, impairment provisions and defaults, and on its ability to grow its business. • A decline in house prices could have a material adverse effect on TSB's business. A significant portion of TSB's revenue is derived from interest and fees paid on its mortgage portfolio. • Interest rates affect the cost and availability of TSB's funding, TSB's net interest margin and revenue and TSB's mortgage impairment levels and customer affordability. A sustained period of low interest rates could result in smaller margins being realised between the rate TSB pays on customer deposits and that received on its loans, reducing TSB's revenue and net interest margin. A rise in interest rates could lead to an increase in default rates, in turn leading to increased impairment charges and lower profitability for TSB. Risks relating to the operation of TSB's business • TSB faces risks associated with its operations' compliance with a wide range of laws and regulations. TSB may also be subject to other penalties and injunctive relief, civil or private litigation arising out of a regulatory investigation, the potential for criminal prosecution in certain circumstances and regulatory restrictions on TSB's business, all of which can have a negative effect on TSB's reputation. • TSB faces risks associated with the implementation of its strategy, which relies significantly on the appeal of TSB's brand. The TSB brand as applied to the current stand-alone business is relatively new and there can be no assurance that TSB will be successful in further developing its brand. The implementation of its strategy is subject to execution risks, including those relating to the provision of a number of services by Lloyds Bank to TSB under the TSA and the LTSA, TSB's management of its cost base and limitations in its management or operational capacity.

	• TSB's competitors include established providers of financial services, including banks and building societies, some of which have greater scale and financial resources, broader product offerings or appeal and more extensive distribution networks than TSB, and other challenger banks. In addition, customers whose accounts have migrated to TSB as part of the separation from Lloyds Banking Group may retain loyalty to Lloyds Banking Group brands and choose, at some point, to move their business back to Lloyds Banking Group. Any failure to manage the competitive dynamics to which it is exposed could have a material adverse impact on TSB. • TSB's business is subject to risks relating to the cost and availability of liquidity and funding, including the risk that TSB's funding needs will increase and/or its funding structure may not continue to be efficient, giving rise, in both cases, to a requirement to raise wholesale funding. While TSB does not currently rely heavily on wholesale funding, if the wholesale funding markets were to be partially or fully closed, it is likely that wholesale funding would prove more difficult to obtain on commercial terms. This could constrain TSB's ability to deliver its growth strategy. • TSB faces potential risks associated with the planned referendum on Scottish independence. The outcome of the referendum could have a material impact on the regulatory, currency and tax regime to which TSB's operations are currently subject and could also result in TSB becoming subject to a new regulatory, currency or tax regime in Scotland. In addition, the outcome of the referendum could contribute to prolonged uncertainty around certain aspects of the Scottish economy, Scottish companies and UK consumers' confidence in businesses with significant operations in Scotland, which could, among other things, increase the cost of TSB's funding and create customer uncertainty. • TSB has exposures to many different products, counterparties and obligors whose credit quality can have a significant adverse impact on TSB's earnings and the value of assets on TSB's balance sheet. In addition, TSB faces risks associated with the concentration of its credit risk, geographically and relating to its interest-only mortgage portfolio, which amounts to approximately 45 per cent. of TSB's residential mortgage lending as at 31 March 2014. As these mortgages near maturity, TSB may face greater repayment and asset quality risks than competitors with a lower proportion of interest-only mortgages. • While the Mortgage Enhancement structure has been constructed in a manner that aims to enhance TSB's profitability by approximately £220 million in aggregate in the first four years, it does not represent a guaranteed stream of income. Bank of Scotland has agreed not to treat the Additional Mortgages in a manner that is different to the way it treats the rest of its mortgage portfolio. However, it does retain the ability to make changes (including re-pricing) across its whole portfolio, including the Additional Mortgages. Any such changes could lead to a decrease in the income that TSB will receive. Risks relating to the regulatory environment in which TSB operates • TSB faces risks associated with an uncertain and rapidly evolving prudential regulatory environment, increased competition scrutiny in the areas in which it operates and substantial and changing conduct regulations. Certain aspects of TSB's business may be determined by its regulators, including the FCA, the Prudential Regulation Authority (the "**PRA**"), the Competition and Markets Authority (the "**CMA**"), HM Treasury, the Financial Ombudsman Service (the "**FOS**") or the courts as not being conducted in accordance with applicable local or, potentially, overseas laws or regulations. If TSB fails to comply with any relevant regulations, there is a risk of an adverse impact on its business due to sanctions, fines or other actions imposed by the regulatory authorities and the possibility of redress or compensation being required to be paid to customers. Risks relating to TSB's relationship with Lloyds Banking Group • TSB's reliance on service arrangements with Lloyds Bank raises a range of potential operational and regulatory risks. TSB will be heavily reliant on Lloyds Bank under the TSA and LTSA for the provision of a broad range of IT and related services that are critical to TSB's business. The systems and infrastructure may not operate as expected, may not fulfil their intended purpose or may be damaged or interrupted by unanticipated increases in usage, human error, unauthorised access, natural hazards or disasters or similarly disruptive events. Lloyds Bank has no experience of providing services of a comparable breadth and scale to a third party financial institution.

	• The LTSA does not provide for TSB to continue to use the LTSA services beyond 2024. TSB may only be able to procure alternative services at a materially higher price than that paid to Lloyds Bank pursuant to the LTSA, leading to a material increase in TSB's cost base in a relatively short period of time. Irrespective of the quality of a new service provider or platform and support received from Lloyds Bank, there may be disruptions during the exit process which could adversely impact TSB's business operations and its customers and could cause TSB to incur higher administrative and other costs both for the processing of business and the potential remediation of disputes. • While the financial performance of Lloyds Banking Group does not have a direct impact on the performance of TSB, any catastrophic deterioration in Lloyds Banking Group's business, financial condition or results of operations, such that it required resolution or other Government intervention, could jeopardise TSB's ability to continue to operate. In addition, as part of its separation from Lloyds Banking Group, TSB established its own functions and processes in a wide range of areas, which may not continue to operate as intended. TSB could suffer operational difficulties which, either directly or as a result of the need for further investment in these new services and functions, could have a material adverse effect on TSB.
D.3	**Key information on the key risks that are specific to the Ordinary Shares** • TSB may be subject to the provisions of the Banking Act 2009, which enable HM Treasury, the Bank of England and the FCA to engage with and stabilise certain UK-incorporated institutions that are failing or are likely to fail. Use of any such powers in the case of a resolution of TSB would impact Shareholders' ongoing holding of Ordinary Shares, including, but not limited to, potential substantial reductions in the value of such holdings. • The value of the Ordinary Shares may be affected by future sales of Ordinary Shares by Lloyds Banking Group. The Company has no control over the timing or nature of such sales, and how much of Lloyds Banking Group's interest may be sold at any given time or in a given period. • Prior to the Offer, there has been no public trading market for the Ordinary Shares. The Company can give no assurance that an active trading market for the Ordinary Shares will develop or, if developed, can be sustained following the closing of the Offer.

	SECTION E – OFFER
E.1	**Net proceeds and expenses of the Offer** The Company will not receive any proceeds in respect of the sale of the Offer Shares sold by the Selling Shareholder or the proceeds from the sale of Over-allotment Shares by the Selling Shareholder pursuant to the Over-allotment Option. The Company will bear one-off fees and expenses of an amount of approximately £3 million (inclusive of amounts in respect of VAT) in connection with the Offer and Admission, and will receive no Offer proceeds. The Selling Shareholder will bear approximately £33.2 million of fees and expenses in connection with the Offer and Admission, including commissions payable (excluding any discretionary commissions), other estimated fees and expenses in connection with the Offer and Admission (excluding any fees and expenses in relation to the transfer of any Bonus Shares pursuant to the Bonus Share Scheme) and amounts in respect of VAT and United Kingdom stamp duty and SDRT (assuming the Offer Size is set at 125,000,000 Ordinary Shares, representing 25 per cent. of the issued Ordinary Share capital of the Company at Admission (the "**Expected Offer Size**"), no exercise of the Over-allotment Option and that the Offer Price is set at the mid-point of the Offer Price Range) and will receive all of the net Offer proceeds. No expenses will be directly charged to investors in connection with Admission or the Offer by the Company or the Selling Shareholder.
E.2a	**Reasons for the Offer and use of proceeds** HM Treasury's financial support of Lloyds Banking Group in 2008-2009 was deemed by the European Commission to have constituted State aid. As a result of the European Commission decision in relation to the same, Lloyds Banking Group was required to dispose of a significant UK retail banking business that met certain criteria. Lloyds Banking Group intends to meet this commitment through the divestment of TSB, which has been created to meet the agreed criteria. The original deadline for Lloyds Banking Group to complete such disposal was

	November 2013. The European Commission has agreed to an amendment to the perimeter of the divesting business, as well as to a revised deadline of 31 December 2015 for full divestment of Lloyds Banking Group's interest in TSB, which may be extendable to 30 June 2016 or 31 December 2016 (depending on the proportion of Lloyds Banking Group's interest in TSB that has already been divested) in the event of Disorderly Markets. To comply with this requirement, Lloyds Banking Group must have divested its entire interest by 31 December 2015 unless the deadline is extended. The reason for the Offer is that Lloyds Banking Group has determined that its preferred strategy to satisfy the commitment to the European Commission was a divestment by way of an initial public offering ("**IPO**") of the Company (together with subsequent sales of its residual post-Admission interest in the Company). No proceeds of the Offer will be received by the Company.
E.3	**Terms and conditions of the Offer** Under the Offer, all Offer Shares will be sold at the Offer Price, which will be determined by the Parent and the Selling Shareholder in consultation with the Joint Global Co-ordinators and the Company. It is currently expected that the Offer Price will be within the Offer Price Range and that the Offer Size will be set at the Expected Offer Size. A number of factors will be considered in deciding the Offer Price, the Offer Size and the bases of allocation under the Offer, including the level and nature of demand for Ordinary Shares in the book-building process, the level of demand in the Intermediaries Offer, prevailing market conditions and the objective of encouraging the development of an orderly and liquid after-market in the Ordinary Shares. In particular, in the event the Parent and the Selling Shareholder determine that the level and nature of demand for Ordinary Shares warrants it, the Offer Size may be set above the Expected Offer Size, up to a maximum of 175,000,000 Ordinary Shares, representing 35 per cent. of the issued Ordinary Share capital of the Company at Admission (the "**Maximum Offer Size**"). The Offer Price and Offer Size are expected to be announced on or around 20 June 2014. The Pricing Statement, which will contain, among other things, the Offer Price and Offer Size, will (subject to certain restrictions) be published online at tsbshareoffer.equiniti.com and be available in printed form at the Company's registered office, 20 Gresham Street, London EC2V 7JE, until 14 days after Admission. If the Offer Price is set above the Offer Price Range and/or the Offer Size is set below the Expected Offer Size or above the Maximum Offer Size, then an announcement will be made via a Regulatory Information Service and prospective investors will have a statutory right to withdraw their offer to purchase Ordinary Shares in the Offer pursuant to section 87Q of FSMA. The arrangements for withdrawing offers to purchase Ordinary Shares will be made clear in the announcement. The Offer comprises the Institutional Offer and the Intermediaries Offer. Under the Institutional Offer, the Offer Shares are being offered to certain institutional and professional investors in the United Kingdom and elsewhere outside the United States in reliance on Regulation S and to QIBs in the United States in reliance on Rule 144A or another exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Under the Intermediaries Offer, the Offer Shares are being offered to intermediaries in the United Kingdom, the Channel Islands and the Isle of Man who will facilitate the participation of their retail investor clients located in the United Kingdom, the Channel Islands and the Isle of Man. The terms of the Intermediaries Offer provide for a Bonus Share Scheme pursuant to which investors who acquire Ordinary Shares in the Intermediaries Offer and continue to hold such Ordinary Shares for a continuous period of one year following Admission will, as at the date falling at the end of that one-year period (the "**Bonus Share Record Date**"), be entitled to receive one free and fully paid-up Bonus Share from the Selling Shareholder for every 20 Ordinary Shares so acquired and continuously held with the same Intermediary, subject to certain conditions (as set out below) and solely in respect of amounts up to £2,000 invested in Ordinary Shares in the Intermediaries Offer (meaning that a maximum of £100 of Ordinary Shares (determined on the basis of the Offer Price) will be transferred to any investor as Bonus Shares). In addition, Over-allotment Shares (representing up to 10 per cent. of the number of Offer Shares) will be made available by the Selling Shareholder pursuant to the Over-allotment Option. Admission is expected to become effective, and unconditional dealings in the Ordinary Shares are expected to commence on the London Stock Exchange, at 8:00 a.m. on 25 June 2014. It is

	expected that dealings in the Ordinary Shares will commence on a conditional basis on the London Stock Exchange on 20 June 2014. The earliest date for settlement of such dealings will be 25 June 2014. All dealings in Ordinary Shares prior to the commencement of unconditional dealings will be on a "when issued basis", will be of no effect if Admission does not take place and will be at the sole risk of the parties concerned. The Offer is subject to the satisfaction of conditions which are customary for transactions of this type contained in the Underwriting Agreement, including Admission becoming effective by no later than 8:00 a.m. on 25 June 2014, determination of the Offer Price, the Underwriting Agreement not having been terminated prior to Admission and the Parent and the Selling Shareholder deciding to proceed with the Offer. None of the Ordinary Shares may be offered for sale or purchase or be sold or delivered, and this Prospectus and any other offering material in relation to the Ordinary Shares may not be circulated, in any jurisdiction where to do so would breach any securities laws or regulations of any such jurisdiction or give rise to an obligation to obtain any consent, approval or permission, or to make any application, filing or registration.
E.4	**Material interests to the Offer** The Company considers that the Selling Shareholder has interests that are material to the Offer by virtue of the size of its existing shareholding in the Company. The Company does not consider that there is a conflicting interest or that there are other interests, including conflicts of interest, that are material to the Offer.
E.5	**Selling Shareholder and lock-ups** 125,000,000 Ordinary Shares are currently expected to be sold by the Selling Shareholder pursuant to the Offer. In addition, a number of Ordinary Shares representing up to 10 per cent. of the Offer Size are being made available by the Selling Shareholder pursuant to the Over-allotment Option. The Selling Shareholder has agreed to a 90-day lock-up period following Admission, during which time it may not dispose of any interest in its Ordinary Shares. For a 365-day lock-up period, the Company will not issue or dispose of any new Ordinary Shares. The Directors and the Prospective Non-executive Director are also subject to a 365-day lock-up period during which they will not sell any Ordinary Shares they own in the Company. All lock-up arrangements are subject to certain customary exceptions.
E.6	**Dilution resulting from the Offer** Not applicable. No new Ordinary Shares are to be issued under the Offer.
E.7	**Estimated expenses charged to the investor** Not applicable; there are no commissions, fees or expenses to be charged to investors by the Company or the Selling Shareholder under the Institutional Offer. All expenses incurred by any Intermediary are for its own account. Investors should confirm separately with any Intermediary whether there are any commissions, fees or expenses that will be applied by such Intermediary in connection with any application made through that Intermediary pursuant to the Intermediaries Offer. The Intermediaries Terms and Conditions restricts the level of commission that Intermediaries are able to charge retail investors.

PART II
RISK FACTORS

Any investment in the Ordinary Shares is subject to a number of risks. Prior to investing in the Ordinary Shares, prospective investors should consider carefully the factors and risks associated with any investment in the Ordinary Shares, TSB's business and the industry in which it operates, together with all other information contained in this Prospectus, including, in particular, the risk factors described below. Prospective investors should note that the risks relating to TSB, its industry and the Ordinary Shares summarised in Part I: "Summary Information" are the risks that the TSB Board believes to be the most essential to an assessment by a prospective investor of whether to consider an investment in the Ordinary Shares. However, as the risks which TSB faces relate to events and depend on circumstances that may or may not occur in the future, prospective investors should consider not only the information on the key risks summarised in the section of this document headed "Summary Information" but also, among other things, the risks and uncertainties described below.

The following is not an exhaustive list or explanation of all risks which investors may face when making an investment in the Ordinary Shares and should be used as guidance only. Additional risks and uncertainties relating to TSB that are not currently known to TSB, or that it currently deems immaterial, may individually or cumulatively also have a material adverse effect on TSB's business, prospects, results of operations and financial position and, if any such risk should occur, the price of the Ordinary Shares may decline and investors could lose all or part of their investment. Investors should consider carefully whether an investment in the Ordinary Shares is suitable for them in the light of the information in this Prospectus and their personal circumstances.

The order in which the following risk factors are presented does not necessarily reflect the likelihood of their occurrence or the relative magnitude of their potential material adverse effect on TSB's business, results of operations, financial condition and prospects or the market price of the Ordinary Shares.

RISKS RELATING TO THE MACRO-ECONOMIC ENVIRONMENT IN WHICH TSB OPERATES

1 TSB is subject to inherent risks arising from general macro-economic conditions in the UK, the Eurozone and globally.

TSB's business is subject to inherent risks arising from general macro-economic conditions in the UK, the Eurozone and the state of the global financial markets both generally and as they specifically affect financial institutions. During the global financial crisis that started in mid-2008, the UK economy experienced a significant degree of turbulence and periods of recession, adversely affecting, among other things, the state of the housing market, market interest rates, levels of unemployment, the cost and availability of credit and the liquidity of the financial markets.

While economic indicators in the UK have been improving recently, the outlook for the UK economy remains somewhat uncertain, with some forecasts predicting the fragile recovery to continue as such, with modest levels of GDP growth and continued low interest rates over the near to medium term. As TSB's customer revenue is derived almost entirely from customers based in the UK, TSB is particularly exposed to the condition of the UK economy, including house prices, interest rates, levels of unemployment and consequential fluctuations in consumers' disposable income. If these economic indicators and UK economic conditions weaken, or if financial markets exhibit uncertainty and/or volatility, TSB's impairment losses may increase and its ability to grow its business could be materially adversely impacted.

In addition, a deterioration in economic conditions in the Eurozone, including a return to macro-economic or financial market instability, may pose a risk to TSB's business, despite the fact that TSB has no direct financial exposure to the Eurozone. Further, in recent years, the UK financial markets have been at times negatively impacted by ongoing fears surrounding the large sovereign debts and/or fiscal deficits of several countries in Europe. These impacts were felt in the UK economy generally and by UK financial institutions in particular and have placed strains on funding markets at times when many financial institutions had material ongoing funding needs. While TSB is not currently heavily reliant on the Eurozone markets, market volatility has an adverse impact on consumer confidence, spending and demand for credit, which could have an adverse impact on TSB's business, financial condition and results of operations.

2 TSB faces risks related to volatility in UK house prices.

The value of TSB's residential mortgage portfolio is influenced by UK house prices. A significant portion of TSB's revenue is derived from interest and fees paid on its mortgage portfolio. The interest

includes the economic benefit of the Mortgage Enhancement, a portfolio of £3.3 billion of residential mortgages as at 31 March 2014, beneficial title to which was transferred by the Bank of Scotland to TSB Bank with effect from 28 February 2014. A significant decline in house prices in the UK would lead to a reduction in the recovery value of TSB's assets in the event of a customer default, and could lead to higher impairment charges and lower profitability. Higher impairment provisions could reduce TSB's capital and its ability to engage in lending and other income-generating activities. As a result, a decline in house prices could have a material adverse effect on TSB's business and potentially on its ability to implement its strategy. A significant increase in house prices over a short period of time could also have a negative impact on TSB by reducing customer affordability, which could lead to higher impairments or, if it resulted in a decrease in the number of customers that can afford a house, a reduction in demand for new mortgages. Sustained volatility in house prices could also discourage potential homebuyers from committing to a purchase, thereby limiting TSB's ability to grow its mortgage portfolio.

The UK Government's intervention into the housing market, both directly through its "Help to Buy" programme and indirectly through provision of liquidity to the banking sector under the "Funding for Lending" Scheme, may also contribute to volatility in house prices. This could occur, for example, as a result of the sudden end to the "Help to Buy" programme, which could lead to a decrease in house prices, or due to the continuation of the "Help to Buy" programme, which could lead to an inflation of house prices and a resultant "bubble" in the housing market. HM Treasury and the Bank of England announced a number of changes to the "Funding for Lending" Scheme in late 2013, including that the "Funding for Lending" scheme will no longer be available for household lending in the form of mortgages or other loans. The future impact of these changes and other Government programmes is difficult to predict and plan for. Volatility in the UK housing market occurring as a result of these changes, or for any other reason, could have an adverse impact on TSB's business, financial condition and results of operations.

3 TSB faces risks associated with interest rate levels and volatility.

Interest rates, which are impacted by factors outside of TSB's control, including the fiscal and monetary policies of governments and central banks, as well as UK and international political and economic conditions, affect TSB's results, profitability and consequential return on capital in three principal areas: cost and availability of funding, margins and revenues and impairment levels.

First, interest rates affect the cost and availability of the principal sources of TSB's funding, which is largely provided by customer deposits (in the form of personal current accounts ("**PCAs**") and savings accounts). A sustained low interest rate environment keeps TSB's costs of funding low by reducing the interest payable on customer deposits, but also reduces incentives for consumers to save and, therefore, constrains TSB's ability to earn revenue through the interest rates it receives by lending these funds to customers.

Secondly, interest rates affect TSB's net interest margin and revenue. The low interest rate environment seen in the UK since early 2009 has put some pressure on deposit net interest margins throughout the industry. Consequently, a sustained period of low interest rates can result in smaller margins realised between the rate TSB pays on customer deposits and that received on its loans and the structural hedges that TSB enters into with respect to its non-dated, rate insensitive liabilities, reducing TSB's revenue and overall net interest margin.

TSB is subject to a contractual cap on the interest rates paid on its standard variable rate ("**SVR**") mortgages at no more than 200 bps above the Bank of England base rate (the "**Base Rate**"). While this cap does not apply to the variable rate mortgages that comprise a portion of the Mortgage Enhancement, this commitment has limited TSB's ability to widen asset margins on a significant portion of its mortgage book.

TSB's customer liabilities are primarily variable rate and instant access. In a high interest rate environment, TSB may be more exposed to re-pricing of its liabilities than competitors with higher levels of term deposits.

In the event of sudden large or frequent increases in interest rates, TSB may not be able to re-price its floating rate assets and liabilities at the same time, giving rise to re-pricing gaps in the short term, which, in turn, can negatively affect overall net interest margin and overall revenue.

Thirdly, interest rates impact TSB's mortgage impairment levels and customer affordability, as well as its unsecured financial products. A rise in interest rates, without sufficient improvement in

customer earnings or employment levels, could, for example, lead to an increase in default rates among customers with variable rate mortgages who can no longer afford their repayments, in turn leading to increased impairment charges and lower profitability for TSB. A high interest rate environment also reduces demand for mortgages and unsecured financial products generally, as individuals are less likely or less able to borrow when interest rates are high, thereby reducing TSB's revenue. In addition, given that the majority of TSB's mortgage book (the SVR and homeowner variable rate ("**HVR**") balances) is variably priced and repayable without penalty, there is a risk that a sudden rise in interest rates, or an expectation thereof, could encourage significant demand for fixed rate products. High levels of movement between products in a concentrated time period could put considerable strain on TSB's business and operational capability. While this scenario would likely be an industry-wide phenomenon in response to increasing interest rates or the expectation thereof, TSB may not be willing or able to price its fixed rate products as competitively as others in the market. This could lead to high levels of customer attrition and, consequently, a negative impact on TSB's profitability.

Given current market conditions, TSB expects that any interest rate volatility will pose challenges. If TSB is unable to manage its exposure to interest rate volatility, whether through hedging, product pricing and maintenance of borrower credit quality or other means, its business, financial condition and results of operations may be adversely affected.

4 TSB is exposed to risks relating to high levels of unemployment.

As a retail bank, TSB's business performance is impacted by the economic status and wellbeing of its customers, a principal driver of which is overall employment levels. Although unemployment in the UK has fallen recently, it remains relatively high by historical standards. Furthermore, the recent shift in the UK workforce towards part-time, less secure employment adds to the risks faced by TSB from the labour market. Higher levels of unemployment have historically resulted, for example, in a decrease in new mortgage borrowing, lower deposit levels and reduced or deferred levels of spending, which adversely impact fees and commissions received on credit and debit card transactions and demand for unsecured lending. Higher unemployment rates and the resultant decrease in customer income can also have a negative impact on TSB's results, including through an increase in arrears, forbearance, impairment provisions and defaults. Consequently, sustained high levels of unemployment could have a material adverse impact on TSB's business, financial condition and results of operations.

RISKS RELATING TO THE OPERATION OF TSB'S BUSINESS

5 TSB faces risks associated with its operations' compliance with a wide range of laws and regulations.

TSB's operations must comply with numerous laws and regulations and, consequently, it faces risks, including:

- the high level of scrutiny of the treatment of customers by financial institutions from regulatory bodies, the press and politicians may continue; the FCA in particular continues to focus on retail conduct risk issues, as well as conduct of business activities through its supervision activity;
- the possibility of alleged mis-selling of financial products or the mishandling of complaints related to the sale of such products by or attributed to an employee of TSB may result in disciplinary action or requirements to amend sales processes, withdraw products or provide restitution to affected customers, all of which may require additional provisions;
- certain aspects of TSB's business may be determined by the relevant authorities, the FOS or the courts not to have been conducted in accordance with applicable local or, potentially, overseas laws or regulations or, in the case of the FOS, with what is fair and reasonable in the Ombudsman's opinion;
- a potential failure of processes, systems or security may expose TSB to heightened financial crime and/or fraud risk;
- contractual obligations may either not be enforceable as intended or may be enforced against TSB in an adverse way;
- the intellectual property of TSB (including trade marks) may not be adequately protected or enforceable, and the conduct of the TSB business may infringe the intellectual property of third parties;

- TSB may be liable for damages to third parties harmed by the conduct of its business; and
- regulatory proceedings and private litigation, may arise out of regulatory investigations, enforcement actions or otherwise (brought by individuals or groups of plaintiffs) in the UK and other jurisdictions.

Regulatory actions pose a number of risks to TSB, including substantial monetary damages or fines, the amounts of which are difficult to predict and may exceed the amount of provisions set aside to cover such risks. In addition, TSB may be subject to other penalties and injunctive relief, civil or private litigation arising out of a regulatory investigation, the potential for criminal prosecution in certain circumstances and regulatory restrictions on TSB's business. All of these issues could have a negative effect on TSB's reputation and the confidence of its customers in TSB, as well as taking a significant amount of management time and resources away from the implementation of TSB's strategy. While certain economic protection against losses arising out of historical conduct issues is provided by the Conduct Indemnity given to TSB by Lloyds Bank in the Separation Agreement, this indemnity may not cover all impacts of such historical conduct issues.

TSB may settle litigation or regulatory proceedings prior to a final judgment or determination of liability to avoid the cost, management efforts or negative business, regulatory or reputational consequences of continuing to contest liability, even when TSB believes that it has no liability or when the potential consequences of failing to prevail would be disproportionate to the costs of settlement. Furthermore, TSB may, for similar reasons, reimburse counterparties for their losses even in situations where TSB does not believe that it is legally compelled to do so. Failure to manage these risks adequately could materially affect TSB, both financially and in terms of its reputation.

Any of these risks, should they materialise, could have an adverse impact on TSB's business, financial condition and results of operations.

6 TSB is reliant on the success of its brand and on its ability to acquire and retain customers at a reasonable cost by differentiating itself from the wider retail banking industry.

The success of TSB's strategy relies significantly on the appeal of TSB's brand and its association with straightforward retail banking, transparency, fairness, meeting customer needs, delivering value to those customers with a focus on helping local people and local communities. The TSB Board believes that this brand, the business capabilities it has inherited and employed and its separation from many of the historical conduct issues impacting its larger competitors differentiate it from its competitors and provide a key competitive advantage. However, the TSB brand as applied to the current standalone business is relatively new and there can be no assurance that TSB will be successful in further developing its brand and leveraging it into market share growth over more established competitors. Any circumstance that causes real or perceived damage to the TSB brand would have a material adverse impact on TSB's business. While economic protection against losses arising out of historical conduct issues by Lloyds Banking Group is provided by the Conduct Indemnity given to TSB by Lloyds Bank in the Separation Agreement, the TSB brand remains subject to risks to its reputation associated with those historical conduct issues, as well as historical conduct issues of TSB's competitors. In addition, TSB is currently dependent on a single brand and any damage to the reputation of that brand may adversely affect TSB's ability to execute its strategy. An inability to manage risks to its brand could have an adverse impact on TSB's business, financial condition and results of operations.

7 TSB faces risks associated with the implementation of its business strategy.

TSB is a challenger bank in the UK financial services market and faces risks associated with the implementation of its strategy. The key pillars of TSB's growth strategy are: (i) growing its PCA market share; (ii) growing its asset book, most significantly with the re-introduction of a mortgage intermediary sales and servicing capability expected to occur in early 2015; and (iii) deploying its digital distribution and digital service capabilities in order to reduce customer servicing costs, deepen existing customer relationships and create new customer relationships. The current TSB business has a relatively limited operating history as a completely separate institution and implementing its strategy requires management to make complex judgements, including anticipating customer needs across a range of financial products, anticipating competitor activity and the likely direction of a number of macro-economic assumptions regarding the UK economy and the retail banking sector. TSB's ability to implement its strategy successfully is subject to execution risks, including those relating to the provision of services by Lloyds Bank under the Transitional Services Agreement (the "**TSA**") and the Long Term Services Agreement (the "**LTSA**"), management of its cost base and limitations in its

management or operational capacity. These risks may be exacerbated by a number of external factors, including a downturn in the UK, European or global economy, increased competition in the retail banking sector and/or significant or unexpected changes in the regulation of the financial services sector in the UK or Europe. With regard to the LTSA, new technology or use of technology could lead to material increases in transaction volumes that may lead to corresponding increases in LTSA charges. If TSB is unable to implement its business strategy, its business, financial condition and results of operations could be adversely impacted.

8 TSB faces risks associated with the growth rates targeted in its strategy.

If TSB fails to meet its strategic growth objectives, particularly the asset growth targeted through the mortgage intermediary sales and servicing function expected to be re-introduced in TSB in 2015, or as a result of a failure to deliver adequate levels of net customer acquisition or increases in its PCA, unsecured lending and savings deposit base, it risks failing to offset the anticipated increase in service charges arising at the end of the term of the TSA and upon the commencement of the LTSA, and anticipated reduction in revenues from the Mortgage Enhancement with equivalent increases in revenue from other sources. See also "*TSB is exposed to particular risks arising from the potentially contemporaneous occurrence of a number of events and circumstances relating to its cost base, revenues and margins*" below.

Moreover, banks seeking high rates of customer acquisition and growth have historically been susceptible to reduced asset quality, impairments and increased conduct risks, in particular those relating to the mis-selling of products and/or services that are either poorly matched with, or additional to, customer needs. If TSB fails to manage these risks adequately, it could result in legal or regulatory action against TSB, reputational damage to its brand and adverse impacts on the successful implementation of its strategy. TSB employee terms and conditions, including productivity targets and employee incentive schemes, may change from time to time, which could have an adverse impact on employee productivity and, as a result, TSB's growth. A failure to successfully manage the implementation of its growth strategy for the foregoing, or any other, reasons, could impair TSB's ability to optimise its cost to income ratio at a key point in its development, which could, in turn, have a material adverse impact on TSB's business, financial condition and results of operations.

9 TSB is exposed to particular risks arising from the potentially contemporaneous occurrence of a number of events and circumstances relating to its cost base, revenues and margins.

Starting towards the end of 2016 and continuing into 2017, a number of events with the potential to have a significant impact on the commercial and financial performance of TSB are expected to occur. These events include, but are not limited to:

- the anticipated increase in TSB's cost base from 1 January 2017, as a result of the transition from the TSA to the LTSA; and
- the reduction in revenues from the Mortgage Enhancement, such revenues not being expected to be significant by 2017, as a result of the expected maturity and yield of the Additional Mortgages.

The TSB Board has planned for the increase in costs resulting from the transition from the TSA to the LTSA and the decrease in revenues from the Mortgage Enhancement to be offset, to some extent, by growth in TSB's asset book, including through the launch of the mortgage intermediary sales and servicing function and the growth of the PCA franchise, with associated customer needs met.

The TSB Board has also based its plans on only a relatively modest expected increase in interest rates, which would additionally drive increased income. This growth is dependent on the factors set out above and the success of a number of initiatives, which will need to perform as expected in order to offset, to some extent, the anticipated increased costs and reduced revenues in 2017. Any material shortfall in expected returns, or any failure of the general economic recovery with the expected associated increase in interest rates and changes in consumer behaviour to increase at the expected rate or over the expected timescales or any combination thereof could result in a material adverse impact (including trading losses) on TSB's business, financial condition and results of operations, particularly from the start of 2017.

10 TSB is exposed to risks related to the delivery, operation and conduct of its mortgage intermediary sales and servicing capability.

A key component of TSB's growth strategy is the re-introduction to TSB of a mortgage intermediary sales and servicing capability, which is expected to occur in early 2015. This functionality is intended

to give TSB the ability that it had previously, but does not currently have, to access the significant portion of the UK retail mortgage market that is sold through intermediaries, optimising TSB's stable, high quality deposit base and allowing TSB to access the profit pools that are currently available to the industry on these products, even in a low base rate environment. Lloyds Bank has undertaken in the Mortgage Intermediary Platform Build Agreement to construct an IT platform which Lloyds Bank will use to provide certain IT services to TSB that will facilitate communication with mortgage intermediaries and allow TSB to market its products to intermediaries. If this platform is not completed on time or in line with agreed design plans, TSB may not be able to access this crucial market segment to the extent or in the manner intended. Additionally, TSB may fail to develop products that are attractive to intermediaries, to acquire the appropriate headcount to service intermediaries or otherwise fail to develop relationships with intermediaries, whether as a result of pricing, a disconnect with TSB's brand or otherwise.

Furthermore, TSB may be exposed to many of the risks inherent in dealing with intermediaries. For example, TSB will have limited oversight of the intermediaries' interactions with prospective customers and, consequently, TSB faces certain risks related to the conduct of the mortgage intermediaries with which it does business. The intermediaries' incentives may not always align with TSB's, which could lead to a deterioration in the quality and performance of TSB's mortgage book. If mortgage intermediaries are found to have violated applicable conduct regulations or standards in the sale of TSB's mortgage products, TSB's brand and/or reputation could be harmed as a result. Any of these factors could have a negative impact on TSB's ability to meet its strategic objectives for its asset base and, consequently, its business, financial condition and results of operations.

11 The TSB Franchise business is subject to risks relating to the cost and availability of liquidity and funding.

Liquidity and funding is a key area of focus for the TSB Franchise business and the UK financial services industry as a whole. While TSB's current funding is primarily obtained through PCA and retail savings deposits, its funding needs are likely to increase and/or its funding structure may not continue to be efficient, giving rise, in both cases, to a requirement to raise wholesale funding (although PCA and retail savings deposits are expected to remain the primary source of TSB's funding for the foreseeable future).

TSB aims to maintain a prudent loan-to-deposit ratio, which means that the majority of its retail lending is funded by retail deposits. Medium-term growth in TSB's retail lending activities will therefore depend, in part, on the availability of retail deposit funding on acceptable terms, for which there may be increased competition and which is dependent on a variety of factors outside TSB's control. These factors include general macro-economic conditions and market volatility, the confidence of retail depositors in the economy, the financial services industry and in TSB, as well as the availability and extent of deposit guarantees. Availability of retail deposit funding may also be impacted by increased competition from other deposit takers as a result of their strategies or factors that constrain the volume of liquidity in the market, including, but not limited to, the end of the UK Government's "Funding for Lending" Scheme. Increases in the cost of retail deposit funding will impact TSB's margins and affect profit, and a lack of availability of retail deposit funding could have a material adverse effect on TSB's future growth.

Any loss in consumer confidence in TSB could significantly increase the amount of retail deposit withdrawals in a short space of time. In such a situation, TSB may be more exposed to customer withdrawals as a significant proportion of its liabilities are in instant access products. Should TSB experience an unusually high and/or unforeseen level of withdrawals, TSB may require greater non-retail sources of funding in the future, which it may be unable to access, which could in turn have a material adverse effect on TSB's financial condition and profitability.

In addition, TSB is currently dependent on a single brand, which may limit its access to funding as it will be unable to attract new customer deposits to address temporary liquidity shortages by offering higher rates of interest under a second brand. Under the terms of the Separation Agreement, TSB is prohibited from using the C&G brand until the last date on which any savings products originated by Lloyds Banking Group under the C&G brand mature, which is currently expected to be in December 2017 (the "**C&G Period**"). In addition, under and during the term of the TSA, TSB is unable to compel Lloyds Bank to implement changes to the TSA services to support the conduct of business under an additional or alternative brand. As a result, the only brand through which TSB can currently raise new customer deposits when it requires additional liquidity is the TSB brand. Any initiative to

raise additional deposits through price leadership under the TSB brand could have an adverse impact on TSB's revenue and margins through both the cost of paying higher interest rates to new customers and existing customers switching to these higher-rate products. In addition, even after the expiration of the C&G Period, when TSB can use the C&G brand under the terms of the Separation Agreement, such use may be subject to regulatory restrictions that could restrict or prevent the use of the brand.

In addition, TSB does not currently hold a credit rating, which, particularly in a period where liquidity may be scarce, could exacerbate its difficulty in obtaining funding from the wholesale or capital markets. During such a period, whether caused by macro-economic conditions or otherwise, lending activity in the wholesale markets could contract, especially to borrowers perceived as comparatively higher risk. Under such circumstances, TSB's lack of a credit rating could be seen by some counterparties as evidencing an uncertainty regarding TSB's creditworthiness, thereby potentially limiting the number of parties willing to lend to, or otherwise be exposed to the credit of, TSB particularly on an unsecured basis. There is a risk that TSB's lack of a credit rating may impact its access to funding markets, which could, in turn, adversely affect TSB's ability to lend to customers at a level that is consistent with its strategic objectives.

While TSB does not currently rely heavily on wholesale funding, it may need to access wholesale markets where there is a residual funding requirement over and above funds held from, among other sources, PCAs and other customer deposits. In particular, in order to deliver its growth strategy, TSB may need to make use of the secured wholesale funding markets, to enhance both the quantum and flexibility of its funding options. If the wholesale funding markets were to be fully or partially closed, it is likely that wholesale funding would prove more difficult to obtain on commercial terms. Under such circumstances, TSB may be unlikely to be able to successfully deliver its growth strategy. Profound curtailments of central bank liquidity to the financial markets in connection with other market stresses, though unlikely, might have a material adverse impact on TSB's financial position and results of operations depending on TSB's funding position at that time.

Finally, the cost of funding under the RMBS Funding Facility includes a scheduled step-up in the interest payable to Lloyds Bank on 17 December 2018 and can otherwise increase on the occurrence of certain triggers and breaches of the RMBS Funding Facility Agreements by TSB. Such step-ups and increases could have a material impact on TSB's cost of funding.

Failure to manage these or any other risks relating to the cost and availability of liquidity and funding may compromise TSB's ability to deliver its growth strategy and, consequently, have a material adverse impact on TSB's business, financial condition and results of operations.

12 TSB is exposed to risks related to the possibility of Scottish independence.

TSB faces potential risks associated with the planned referendum on Scottish independence, to take place on 18 September 2014, and potential uncertainty preceding and post the referendum. Although the Company is registered in England and Wales, TSB Bank is registered in Scotland and TSB has extensive operations there, with 27 per cent. of its total customer base in Scotland. The outcome of the referendum could have a material impact on the regulatory, currency and tax regime to which TSB's operations are currently subject and could also result in TSB becoming subject to a new regulatory, currency and tax regime in Scotland. The effect of this could be to increase compliance and operating costs for TSB and may also materially impact TSB's tax position or financial position more generally. In addition, the outcome of the referendum could contribute to prolonged uncertainty around certain aspects of the Scottish economy, Scottish companies and UK consumers' confidence in businesses with significant operations in Scotland, which could, among other things, increase the cost of TSB's funding and create customer uncertainty. While TSB is monitoring and assessing the potential impacts on its business of a vote in favour of Scottish independence, the situation remains uncertain.

13 TSB is subject to regulatory capital requirements.

A perceived or actual shortage of capital could have a material adverse effect on TSB's business, which could, in turn, affect TSB's capacity to pay future dividends or implement its business strategy, impacting future growth potential. If, in response to any such shortage, TSB raises additional capital through the issuance of share capital or capital instruments, existing shareholders may experience a dilution of their holdings or reduced profitability and returns.

TSB may experience a depletion of its capital resources through increased costs or liabilities incurred as a result of the crystallisation of any of the other risk factors described elsewhere in this Part II: *"Risk*

Factors". TSB may also experience an increased demand for capital as a result of regulatory requirements as more fully described under "*TSB is subject to substantial and changing prudential regulation*" below.

TSB is expected to be impacted by the implementation of IFRS 9 "Financial Instruments", currently expected in 2018. IFRS 9 is expected to lead to a substantial one-off increase in impairment allowances for certain financial assets and, depending on its interpretation by the relevant regulators, could lead to a substantial negative impact on the capital position of affected institutions, including TSB.

TSB sets its internal target amount of capital by taking account of its own assessment of the risk profile of the business, market expectations and regulatory requirements. If market expectations as to capital levels increase, driven by, for example, the capital levels or targets amongst peer banks or if new regulatory requirements are introduced, then TSB may experience pressure to increase its capital ratios. If it is unable to do so, its business, financial condition and results of operations may be adversely impacted.

14 TSB faces risks from the highly competitive environment in which it operates.

The market for financial services in the UK is highly competitive and management expects such competition to intensify in response to competitor behaviour, consumer demand, technological changes, the impact of market consolidation and new market entrants, regulatory actions and other factors. The financial services markets in which TSB operates are mature, such that growth by any bank typically requires winning market share from competitors.

TSB faces competition from established providers of financial services, including banks and building societies, some of which have greater scale and financial resources, broader product offerings and more extensive distribution networks than TSB. TSB also faces potential competition from new entrants to the market, for example as a result of The Royal Bank of Scotland implementing the announced divestment of its "Rainbow" business, from banking businesses developed by large non-financial companies, such as Tesco and Virgin Money or from new entrants such as Aldermore and MetroBank.

In addition, the implementation in the second half of 2013 of a seven-day switching guarantee scheme by the Payments Council, which seeks to ensure that a change in current account provider is completed within seven days, may result in customers more readily moving to a competitor, thereby potentially increasing customer attrition rates. Increased competition, whether resulting from the switching service or otherwise, may lead to increased costs associated with acquiring new PCA or savings customers. Furthermore, customers whose accounts have been migrated to TSB as part of the separation from Lloyds Banking Group may retain loyalty to the Lloyds Banking Group brands and choose, at some point, to move their business back to Lloyds Banking Group. This risk may be more pronounced for "split" customers of TSB who hold financial products from both TSB and Lloyds Banking Group, thus maintaining a connection with Lloyds Banking Group or for customers who prefer to bank with a more established entity and who may view TSB's independence from Lloyds Banking Group negatively. Consequently, this switching risk, for the reasons given above, may be more significant for TSB than for its competitors. Under the terms of the Separation Agreement, subject to certain limited exceptions, Lloyds Bank has agreed to procure that Lloyds Banking Group will not conduct directed and targeted marketing to persons who were customers of TSB as at 9 September 2013 with respect to loans, credit cards, mortgages, PCAs or savings accounts or home insurance products for a period beginning at the date of the Separation Agreement and ending on the date that is two years from the date on which Lloyds Banking Group ceases to hold any beneficial interest in shares of TSB. In addition, under the Separation Agreement, Lloyds Bank has agreed and agreed to procure that, with limited exceptions, no Lloyds Bank, Halifax or Bank of Scotland branches will be opened in the United Kingdom within a 0.2 mile radius in towns and cities and otherwise within a one mile radius of a TSB branch for a period of two years from Admission. Once the relevant restrictions expire, however, there is a risk that Lloyds Banking Group may target TSB customers for acquisition given their familiarity with the Lloyds Banking Group brands, or invest in high quality new branches close to TSB branches, thereby potentially increasing customer attrition rates.

Any failure to manage the competitive dynamics to which it is exposed could have a material adverse impact on TSB's business, financial condition and results of operations.

15 TSB is subject to risks concerning customer and counterparty credit quality.

TSB has exposures to many different products, counterparties and obligors whose credit quality can have a significant adverse impact on TSB's earnings and the value of assets on TSB's balance sheet. As part of the ordinary course of its operations, TSB estimates and establishes provisions for credit risks and the potential credit losses inherent in these exposures. This process, which is critical to TSB's results and financial condition, requires complex judgements, including forecasts of how changing macro-economic conditions might impair the ability of customers to repay their loans. TSB may fail to adequately identify the relevant factors or accurately estimate the impact and/or magnitude of identified factors, which could adversely affect TSB's business, financial position and results of operations. In respect of TSB's interest-only mortgage book, such assessments may be incomplete. For example, TSB lacks information on customer repayment vehicles for certain of its interest-only mortgage holders. As a result, TSB has reduced visibility of future repayment issues in respect of its interest-only mortgages, which limits TSB's ability to estimate and establish reserves to cover exposures resulting from these mortgages.

Further, there is a risk that, despite TSB's belief that it conducts an accurate assessment of customer credit quality, customers are unable to meet their commitments as they fall due as a result of customer-specific circumstances, macro-economic disruptions or other external factors. Although current default rates are relatively low compared to medium-term historical default rates, the failure of customers to meet their commitments as they fall due may result in higher impairment charges or a negative impact on fair value in TSB's lending portfolio. A deterioration in customer credit quality and the consequent increase in impairments would have a material adverse impact on TSB's business, financial condition and results of operations.

16 Concentration of credit risk could increase TSB's potential for significant losses.

For the year ended 31 December 2013, substantially all of the TSB Franchise business related to customers in the UK, and in the case of mortgages, particularly in Scotland, London and the South East of England. In the event of a disruption to the credit markets in the UK generally or economic conditions, including interest rates and levels of unemployment in regions within the UK where TSB has significant presence, this concentration of retail credit risk could cause TSB to experience greater losses than its less concentrated competitors.

In addition, TSB faces concentration risks relating to its interest-only mortgage portfolio, which amounts to approximately 45 per cent. of TSB's residential mortgage lending as at 31 March 2014. As these mortgages near maturity, TSB may face greater repayment and asset quality risks than competitors with a lower proportion of interest-only mortgages. TSB may also be exposed to concentration risk due to the composition of the Additional Mortgages. The Additional Mortgages primarily comprise lender variable rate mortgages and tracker mortgages. While TSB regularly monitors its credit portfolios to assess potential concentration risk, efforts to divest, diversify or manage TSB's credit portfolio against concentration risks may not be successful and could result in an adverse impact on its business, financial condition and results of operations.

17 TSB is within the scope of the Pensions Regulator's powers in relation to Lloyds Banking Group's defined benefit pension schemes.

TSB does not participate in any of Lloyds Banking Group's pension schemes and is not directly liable in respect of any deficit arising in any Lloyds Banking Group defined benefit pension scheme. The Separation Agreement also provides an indemnity for certain liabilities in respect of the Lloyds Banking Group pension schemes (including liabilities relating to any exercise of the Pensions Regulator's financial support direction or contribution notice powers). However, TSB could be required to make contributions to, or otherwise financially support, one or more of Lloyds Banking Group's defined benefit pension schemes if the Pensions Regulator considered that to be a reasonable exercise of its contribution notice or financial support direction powers under the Pensions Act 2004 (as amended).

The Pensions Regulator's power to require TSB to financially support one or more of Lloyds Banking Group's defined benefit pension schemes will continue in respect of Lloyds Banking Group's defined benefit pension schemes for as long as TSB continues to be associated or connected with Lloyds Banking Group and for two years (in respect of a financial support direction) or six years (in respect of a contribution notice) after such association or connection has ceased. Such association or connection will cease on a change of control of TSB involving Lloyds Banking Group ceasing to hold, directly or indirectly, one third or more of the shares in TSB.

18 TSB is exposed to operational risks related to systems and processes.

TSB's business is exposed to operational risks related to systems and processes, whether people-related or external events, including the risk of fraud and other criminal acts carried out against TSB, including in relation to the banking operations services provided by Lloyds Bank under the TSA and LTSA. TSB's business is dependent on processing and reporting accurately and efficiently a high volume of complex transactions across numerous and diverse products and services. Any weakness in these systems or processes could have an adverse effect on TSB's results and on its ability to deliver appropriate customer outcomes during the affected period. In addition, any breach in security of TSB's systems (or the Lloyds Bank systems that support the services to TSB under the TSA and LTSA), for example from increasingly sophisticated attacks by cybercrime groups, could disrupt its business, result in the disclosure of confidential information and create significant financial and/or legal exposure and the possibility of damage to TSB's reputation and/or brand. While the services that Lloyds Bank will provide to TSB under the TSA and LTSA are supported by mature, proven systems and processes that also support Lloyds Bank's retained businesses, Lloyds Bank has no previous experience of using the systems and processes to provide services of a comparative breadth and scale to a third party financial institution. Moreover, the services, as well as the agreements under which they are provided, are highly complex. As a result, TSB faces the risk that the systems and processes that underpin the TSA and LTSA services may not function in the manner anticipated and necessary to deliver the required outcomes for customers.

TSB's operations must also be considered in light of the risks, uncertainties, expenses and difficulties frequently encountered by companies in their early stages of development. TSB has a relatively limited history operating as a separate entity and, consequently, does not have a long track record on which it can assess the performance of its systems and processes or the analysis of those systems' outputs. While TSB does have disaster recovery and business continuity contingency plans in place, the occurrence of a serious disaster resulting in interruptions, delays, the loss or corruption of data or the cessation of the availability of systems (including those provided pursuant to the TSA and LTSA) could have a material adverse impact on TSB's business. Any such actual or perceived inadequacies, weaknesses or failures in TSB systems or processes could have a material adverse effect on TSB's business, financial condition and results of operations.

19 TSB is subject to risks associated with its hedging and treasury operations, including potential negative fair value adjustments.

TSB faces risks related to its customer-driven hedging operations. TSB engages in hedging activities, for example in relation to interest rate risk, in an attempt to limit the potential adverse effect of interest rate fluctuations on its results of operations. TSB's treasury operation has responsibility for managing the interest rate risk that arises through its customer facing business, management of its liquid asset buffer and investment of free reserves and interest rate insensitive deposit balances. Interest rate hedges for both customer assets and liabilities are calculated using a behavioural model. However, TSB does not hedge all of its risk exposure and cannot guarantee that its hedging strategies will be successful because of factors such as behavioural risk, unforeseen volatility in interest rates or the decreasing credit quality of hedge counterparties in times of market dislocation. If its hedging strategies are not effective, TSB may be required to record further negative fair value adjustments. Material losses from the fair value of financial assets would also have an adverse impact on TSB's capital ratios.

Through its treasury operations, TSB will hold liquid assets portfolios for its own account, exposing TSB to interest rate risk, basis risk and credit spread risk. To the extent that volatile market conditions occur, the fair value of TSB's liquid asset portfolios could fall more than estimated and cause TSB to record mark to market losses. In a distressed economic or market environment, the fair value of certain of TSB's exposures may be volatile and more difficult to estimate because of market illiquidity. Valuations in future periods, reflecting then prevailing market conditions, may result in significant negative changes in the fair value of TSB's exposures, which could have a material adverse impact on TSB's business, financial condition and results of operations.

Interest-rate insensitive PCA balances form a significant part of TSB's funding. TSB makes the assumption that these balances will have a maturity in excess of five years and they are currently invested, along with free reserves, in a rolling series of five-year interest rate swaps. TSB believes that the current, historically low, level of five-year swap interest rates, coupled with the probability of their rising in advance of any increase in the Bank of England base rate, means that these balances are expected in future to generate a higher level of revenue than they do currently. However, if customer

behaviour were to change significantly, PCA balances may become more volatile and may no longer be suitable for swaps of the current duration, which could have an adverse impact on the revenue generated by these balances.

The historical financial information includes derivative mark to market losses of £39 million in 2013. This loss will unwind over a period matching the effective maturity of the underlying derivatives. While the quantum of the unwind is known, the path of the unwind is uncertain and will lead to accounting volatility in the financial results of TSB. Had hedge accounting been applied from 1 November 2013, when these derivatives were first entered into, this mark to market loss would not have been recognised and accounting volatility in the financial results avoided. Hedge accounting has been applied from 1 January 2014.

With respect to hedge accounting, TSB follows the requirements in the EU's endorsed version of IAS 39 ("**EU Carve Out**"). Whilst no decision has yet been made, there is a risk that the EU Carve Out will not be available when IFRS 9 (Financial Instruments) eventually replaces IAS 39. If the EU Carve Out is not available, TSB will be subject to additional accounting volatility in its future financial results.

As part of the Mortgage Enhancement, TSB entered into approximately £3.0 billion of basis swaps with Lloyds Bank in order to hedge against the economic risks associated with the structure of the Mortgage Enhancement (where some mortgages are priced relative to Base Rate, while the funding for those mortgages is LIBOR denominated). While this arrangement is designed to protect TSB from the economic consequences of interest rate volatility with respect to the Mortgage Enhancement, at the date of this Prospectus, these swaps had not been placed in designated hedging relationships for accounting purposes. As a result, the fair value treatment of these swaps could lead to future accounting volatility in TSB's financial results. TSB is currently working to implement hedge accounting with respect to these swaps, but the achievability of hedge accounting and the timing of that implementation is uncertain.

20 TSB's financial performance during the Track Record Period, as set out in its historical financial information, may not in all respects be indicative of its future performance.

TSB's historical financial information presented in Part XVI: *"Historical Financial Information"* has been prepared on a "carve out" basis (that is, prepared by identifying transactions and balances relating to TSB's business from the financial records of Lloyds Banking Group). During the Track Record Period, TSB's business was, subject to transitional governance arrangements, managed as part of Lloyds Banking Group and, as a result: (i) many of its core operations and back-office functions were highly integrated with the Lloyds Banking Group business; and (ii) up until 1 November 2013, its funding, liquidity, capital and interest rate risk arrangements were managed by Lloyds Banking Group and subject to central charging processes. These factors are reflected in the operating and funding cost bases shown in the historical financial information set out in Part XVI: "*Historical Financial Information*". In relation to (i), TSB's core operations and back-office functions have now been substantially developed on an independent and, as supported by the TSA or the LTSA, self-standing basis and, in relation to (ii), stand-alone funding, liquidity, capital and interest rate risk arrangements, managed by TSB, have progressively been put in place between 1 November 2013 and the date of this document. In these respects, and with respect to operating costs after 31 March 2014, therefore, the historical financial information presented in Part XVI: *"Historical Financial Information"* may not be indicative of the TSB Board's expectations as to TSB's future performance.

21 TSB could fail to attract or retain Senior Management or other key employees.

TSB's success depends on the continued service and performance of its key employees, particularly its Senior Management, and its ability to attract, retain and develop high-calibre talent. TSB may not succeed in attracting and retaining key personnel if they do not identify or engage with TSB's brand and values, which represents a major component of TSB's overall strategy. In addition, as a new market entrant, TSB may not have sufficient scale to offer employees rates of compensation or opportunities to advance within the organisation comparable to its larger competitors, particularly at more senior levels. Each of these factors could have an adverse effect on TSB's ability to recruit and retain key employees, which could, in turn, adversely affect TSB's business. In addition, external factors such as macro-economic conditions, the developing and increasingly rigorous and intrusive regulatory environment or negative media attention on the financial services industry may adversely impact employee retention, sentiment and engagement. Further, as part of the separation of TSB from Lloyds Banking Group, large groups of employees, including Senior Management, were transferred and/or hired contemporaneously. There is a risk that as the careers of these employees

progress, the timing of their decisions to leave TSB may coincide, which may result in a concurrent loss of personnel, including Senior Management.

Further, the successful launch and management of TSB's early stage operations as a completely separate entity is a significant achievement for TSB's Senior Management team. This unique experience may make them more attractive to TSB's competitors or other institutions who may seek to hire them away from TSB and TSB may be unable to find and hire a qualified replacement for a departing member of the Senior Management team with an appropriate degree of experience and expertise. Any failure to attract and retain key employees, including Senior Management, could have an adverse impact on TSB's business, financial condition and results of operations.

22 TSB could be exposed to industrial action and increased labour costs resulting from employee membership in trade unions.

As of November 2013, TSB estimates that the majority of its employees are covered by a number of collective bargaining agreements. If TSB sought to change any of the contractual terms with its employees, it would have to undertake a consultation and negotiation process with the relevant trade union representatives. Consultations with trade unions may not always be successful, potentially leading to increased labour costs. In the unlikely event that negotiations are unsuccessful and result in formal industrial action, TSB could experience a work stoppage that could materially adversely impact its business, financial condition and results of operations.

23 The Mortgage Enhancement may not deliver the expected profit pool.

The Mortgage Enhancement structure has been designed in order to meet Lloyds Banking Group's obligations under its State aid commitments, as amended in this respect following the September 2013 recommendations of the OFT in relation to TSB's competitiveness and financial strength, and has specifically been designed to enhance TSB's profitability by approximately £220 million in aggregate in the four years from 2014. Lloyds Banking Group is not required to guarantee or underwrite, and has not guaranteed or underwritten, the profit streams contemplated in the Profit Objective. The Additional Mortgages are part-funded by TSB through the RMBS Funding Facility, which provides TSB flexible and committed funding for a specified period of time, subject to certain term-out events, some of which are based on asset performance.

The Mortgage Enhancement structure has been constructed in a manner that aims to achieve the Profit Objective through income from the Additional Mortgage portfolio (less the costs associated with the portfolio, including funding through the RMBS Funding Facility). While the Profit Objective is designed to enhance TSB's short-term profitability and competitiveness, it does not represent a guaranteed stream of income.

The Profit Objective is predicated on certain assumptions. These assumptions relate principally to customer attrition rates in the Additional Mortgage portfolio, customer refinancing rates and new and existing mortgage business margin levels, particularly with respect to the lender variable rate products in the portfolio. Attrition rates, in particular, could be driven by circumstances outside of TSB's control, including volatility in interest rates and increased competition in the market. Variations in the elements underlying these assumptions could impact the income stream from the Mortgage Enhancement in different ways. Higher than expected customer attrition rates or lower new and existing mortgage business margin levels could lead to lower Deemed Profits and to the Deemed Profit Trigger being met later than expected or not being met at all. There is no minimum income stream from the Mortgage Enhancement.

The Deemed Profit Calculation is also based on assumptions regarding the cost of funding and hedging. If these assumptions prove to be inaccurate, there is a risk that the Deemed Profit may not be reflective of the actual profit received by TSB and that the Deemed Profit Trigger will be reached before TSB receives the expected amount of actual profit from the Mortgage Enhancement, which could have an adverse impact on TSB's business.

Finally, while the Bank of Scotland has agreed not to treat the Additional Mortgages in a manner that is different to that in which it treats the rest of its mortgage portfolio, it may, from time to time, consistent with the terms of the relevant products, re-price its entire portfolio, which includes the Additional Mortgages (specifically the managed variable rate mortgages, which are subject to a

discretionary, managed rate and make up the majority of the Additional Mortgages) or otherwise alter the policies impacting its mortgage book as a whole, which includes the Additional Mortgages. Among other things, this could lead to a decrease in the income that TSB will receive.

24 Failure to manage the risks associated with changes in taxation rates or applicable tax laws, or misinterpretation of such tax laws, could materially adversely affect TSB's results of operations, financial condition or prospects.

TSB faces risks associated with changes in taxation rates or applicable tax laws, or misinterpretation of such tax laws, any of which could result in increased charges, financial loss, including penalties, and reputational damage. Deferred tax assets of £122 million at 31 December 2013 arose on the Part VII customer transfers during 2013. Note 3 to the historical financial information in Part XVI: "*Historical Financial Information*" explains that the recognition of the deferred tax assets is subject to the availability of sufficient future taxable profits. Failure to manage these risks adequately could have a material adverse effect on TSB's results of operations, financial condition or prospects.

25 The Conduct Indemnity may not cover all potential losses arising as a result of conduct-related issues.

TSB benefits from the Conduct Indemnity pursuant to the Separation Agreement in respect of losses arising from pre-Admission acts or omissions relating to customer agreements constituting breaches of applicable laws and regulations. While the Conduct Indemnity is broad and, save in certain limited circumstances, uncapped, there are and will be limits to its coverage. For example, credit losses arising as a result of matters that are covered by the Conduct Indemnity will only be recoverable in certain circumstances.

In addition, while the terms of the Conduct Indemnity provide for a "grace period" after Admission during which, subject to certain conditions, losses arising as a result of the continued use by the TSB Group of practices, policies and procedures inherited from Lloyds Banking Group will be recoverable, the "grace period" has a fixed and limited duration and, after its expiry, any acts and omissions of the TSB Group, including those taken in reliance on such practices, policies and procedures inherited from Lloyds Banking Group, will fall outside the scope of the Conduct Indemnity.

Claims made by TSB pursuant to the Conduct Indemnity may be disputed and there can be no guarantee that the Conduct Indemnity will be found to be applicable in all cases. In addition, TSB may be exposed to conduct-related risks and losses that fall outside the scope of the Conduct Indemnity that could have a material adverse impact on its reputation, business, results of operations and financial position.

REGULATORY RISKS

TSB's business is subject to ongoing regulation and associated regulatory risks, including the effects of new and changing laws, regulations, policies, voluntary codes of practice and interpretations of such in the UK and the European Union. These laws and regulations include (i) prudential regulatory developments, (ii) increased regulatory oversight in respect of conduct issues and (iii) industry-wide initiatives, each of which has costs associated with it and which may significantly affect the way that TSB does business and which may restrict the scope of its existing businesses, limit its ability to expand its product offerings or make its products and services more expensive for clients and customers. Unfavourable developments across any of these three regulatory areas, discussed in greater detail below, could materially adversely affect TSB's access to liquidity, increase its funding costs or its strategic development and, hence, have a material adverse effect on TSB's business, results of operations and financial condition.

26 TSB is subject to substantial and changing prudential regulation.

TSB faces risks associated with an uncertain and rapidly evolving prudential regulatory environment, pursuant to which it is required, among other things, to maintain adequate capital resources and to satisfy specified capital ratios at all times. TSB's borrowing costs and capital requirements could be affected by these prudential regulatory developments, which include (i) the legislative package ("**CRD IV**") implementing the proposals of the Basel Committee (known as Basel III) in the European Union and amending and supplementing the existing Capital Requirements Directive and other regulatory developments impacting capital, leverage and liquidity positions and (ii) the proposed directive providing for the establishment of an EU-wide framework for the recovery and resolution of credit institutions and investment firms, commonly known as the Recovery and Resolution Directive

(the "**RRD**"). Any future unfavourable regulatory developments could have a material adverse effect on TSB's business, results of operations and financial condition.

CRD IV

CRD IV introduced significant changes in the prudential regulatory regime applicable to banks with effect from 1 January 2014, including: increased minimum levels of capital and additional minimum capital buffers; enhanced quality standards for qualifying capital; increased risk weighting of assets, particularly in relation to market risk and counterparty credit risk; and the introduction of a minimum Leverage Ratio. Although CRD IV provides for some of these measures to be phased in over a transitional period to 2018, the PRA's supervisory expectation is for TSB to meet certain of these capital and Leverage Ratio targets in expedited timeframes.

CRD IV requirements adopted in the United Kingdom may change, whether as a result of further changes to CRD IV agreed by EU legislators, binding regulatory technical standards to be developed by the European Banking Authority, changes to the way in which the PRA interprets and applies these requirements to UK banks (including as regards individual model approvals granted under CRD II and III) or otherwise. Such changes, either individually and/or in aggregate, may lead to further unexpected enhanced requirements in relation to TSB's capital, leverage, liquidity and funding ratios or alter the way such ratios are calculated.

A market perception or actual shortage of capital issued by TSB could result in Governmental actions, including requiring TSB to issue additional Common Equity Tier 1 securities, requiring TSB to retain earnings or suspend dividends or issuing a public censure or the imposition of sanctions. This may affect TSB's capacity to continue its business operations, generate a return on capital, pay future dividends or pursue acquisitions or other strategic opportunities, impacting future growth potential. If, in response to any such shortage, TSB raises additional capital through the issuance of share capital or capital instruments, existing shareholders may experience a dilution of their holdings.

Recovery and Resolution Directive

TSB also faces risks from anticipated legislation that will create additional bail-in or resolution powers. On 16 April 2014, the European Parliament published a provisional version of the RRD, which is intended to complement CRD IV. Political agreement on the RRD was reached between the European Parliament and the EU Member States in December 2013. The powers referred to in the RRD include certain powers which overlap in part with those available under the Banking Act. The powers provided to resolution authorities in the provisional version of the RRD include write-down powers to ensure relevant capital instruments absorb losses upon, amongst other events, the occurrence of the non-viability of the relevant institution or its parent company, as well as a bail-in tool comprising a more general power for resolution authorities to write down the claims of unsecured creditors of a failing institution and to convert unsecured debt claims to equity. It is expected that the RRD as it relates to capital write-down will be implemented by EU Member States not later than 1 January 2015 with a more general bail-in tool (applicable to a broader range of eligible liabilities) being required to be implemented from a later date, expected to be not later than 1 January 2016. However, following recent UK Government announcements, these powers are expected to be enacted in the United Kingdom in advance of those dates pursuant to enabling provisions contained in the Banking Reform Act. If TSB becomes subject to such bail-in or resolution powers, existing shareholders may experience a dilution or cancellation of their holdings without any compensation therefor.

27 TSB is subject to substantial and changing conduct regulations.

TSB is exposed to many forms of conduct risk, which may arise in a number of ways. In particular:

- certain aspects of TSB's business may be determined by its regulators, including the FCA, the PRA, HM Treasury, the FOS, the CMA or the courts, as not being conducted in accordance with applicable local or, potentially, overseas laws or regulations, or, in the case of the FOS, with what is fair and reasonable in the Ombudsman's opinion. If TSB fails to comply with any relevant regulations, there is a risk of an adverse impact on its business and reputation due to sanctions, fines or other actions imposed by the regulatory authorities;
- TSB may be subject to allegations of mis-selling of financial products, including as a result of having sales practices and/or reward structures in place that are determined to have been inappropriate, may result in disciplinary action (including significant fines) or requirements to

amend sales processes, withdraw products or provide restitution to affected customers, any or all of which could result in the incurrence of significant costs, may require provisions to be recorded in TSB's financial statements and could adversely impact future revenues from affected products;

- TSB may be liable for damages to third parties harmed by the manner in which TSB has conducted one or more aspects of its business; and
- for the conduct of its business, TSB relies heavily on banking operations services from Lloyds Bank under the TSA and LTSA, which will require changes from time to time to meet new laws and regulations. While TSB will receive the benefit of Lloyds Banking Group initiated regulatory changes under the TSA and LTSA at no additional charge, to the extent that TSB requires additional or different changes to the services in response to new laws and regulations, the implementation of such TSB specific changes will attract additional charges under the TSA and LTSA.

In addition, on 8 July 2013, the UK Government accepted the overall conclusions and all of the principal recommendations of a report issued by the Parliamentary Commission on Banking Standards on 19 June 2013, entitled "Changing Banking for Good". Among other things, the report included proposals for a new banking standards regime governing the conduct of bank staff, the introduction of a criminal offence for reckless misconduct by senior bank staff and steps to improve competition and conduct in the banking sector. Depending on the manner in which these proposals are implemented and enforced, such changes could have a significant impact on TSB's operations, structure, costs and/or capital requirements.

The FCA has introduced new rules following the publication of its Mortgage Market Review (the "**MMR**"), which require, among other things, an assessment of customer affordability in connection with mortgage lending. The MMR also permits interest-only loans solely where there is a clearly understood and credible strategy for repaying the principal of the loan, evidence of which the lender must obtain before making the loan and must check at least once during the term of the loan, and the cost of the repayment strategy must be included in the affordability assessment. TSB has implemented a plan to fully comply with the MMR. The plan included, among other things, creating a dedicated team to manage issues arising in respect of TSB's interest-only mortgage holders and assess repayment strategies. TSB expects to incur costs related to its compliance efforts. However, TSB may nevertheless face penalties or other sanctions associated with any non-compliance, including as a result of any potential retrospective review. TSB is also subject to the consumer credit regime under the FSMA, which regulates a wide range of credit agreements. The regulation of consumer credit pursuant to the Consumer Credit Act 1974 and its retained secondary legislation (the "**CCA**") was transferred from the Office of Fair Trading (the "**OFT**") to the FCA in April 2014. Certain pieces of secondary legislation, made pursuant to the CCA, as well as OFT guidance, have been replaced by FCA rules and guidance set out within the FCA Handbook, though some pieces of secondary legislation remain. The FCA has greater powers of enforcement than the OFT did previously and is anticipated to take a more proactive and intrusive approach to the regulation of consumer credit. Along with other credit providers that will need to comply with the FCA requirements applicable to the provision of consumer credit, TSB may come under a greater degree of scrutiny from the FCA, incur additional compliance costs and be subject to potential penalties and other sanctions for non-compliance.

Failure to manage these risks adequately could lead to significant liabilities or reputational damage and damage to TSB's brand, which could have a material adverse effect on its business, financial condition, results of operations and relations with customers.

28 TSB is subject to the potential impacts of UK and European banking reform initiatives.

In recent years, the relevant regulatory authorities in the UK and Europe have proposed (and in some cases have commenced implementation of) dramatic reforms to many aspects of the banking sector, including, among others, institutional structure, resolution procedures and deposit guarantees. While the impact of these regulatory developments remains uncertain (and indeed while some of the specific written proposals are not in final form), TSB expects that the evolution of these and future initiatives could have an impact on its business.

On 14 June 2012, HM Treasury issued a white paper entitled "*Banking reform: delivering stability and supporting a sustainable economy*" on how the UK Government intends to implement the measures recommended by Sir John Vickers' Independent Commission on Banking (the "**ICB**") final report of

12 September 2011. In October 2012, the UK Government published the draft Financial Services (Banking Reform) Bill (the "**Banking Reform Bill**") to give effect to the recommendations of the ICB, which was subsequently amended by HM Treasury following scrutiny by, and recommendations of, the Parliamentary Commission on Banking Standards. The Banking Reform Bill received Royal Assent as the Financial Services (Banking Reform) Act 2013 (the "**Banking Reform Act**") on 18 December 2013. The UK Government intends for all relevant secondary legislation to be completed by May 2015 and banks will be expected to have implemented reforms by 2019 at the latest. The Banking Reform Act introduces a number of measures which could impact TSB's business, including (i) a new bail-in option through an amendment to the Banking Act 2009 for resolving failing banks (in addition to the existing stabilisation options) whereby the Bank of England is given the power, in a resolution scenario, to cancel, reduce or defer the equity liabilities of a bank (including divesting shareholders of a bank of their shares), convert an instrument issued by a bank from one form or class to another (for example, a debt instrument into equity) and/or transfer some or all of the securities of a bank to an appointed bail-in administrator, (ii) powers for the PRA and HM Treasury to implement further detailed rules to give effect to the recommendations of the ICB on ring-fencing requirements for the banking sector, (iii) powers for the PRA and the FCA to require non-regulated qualifying parent undertakings of regulated entities to take actions to facilitate resolution and (iv) preferential ranking of insured depositors on a winding-up to rank ahead of all other unsecured creditors.

At the European level, following the report of the Liikanen Group, which was published in October 2012, structural reform regulation covering similar areas to some of those contained in the Banking Reform Act was published by the European Commission. The regulation is not expected to be adopted by the European Council and Parliament before June 2015. Further, in addition to the bail-in tools discussed above, the provisional text of the RRD provides, among other things, for resolution authorities to have the power to require institutions and groups to make structural changes to ensure legal and operational separation of "critical functions" from other functions where necessary or to require institutions to limit or cease existing or proposed activities in certain circumstances. It also proposes protection for depositors on insolvency to uninsured elements of deposits, introduces a bank funded resolution fund and introduces additional power to write down or convert capital before an actual resolution event. It is currently contemplated that the RRD will be implemented in EU Member States by 1 January 2015, except for certain bail-in provisions which are to be implemented by 1 January 2016.

In addition, TSB is responsible for contributing to compensation schemes such as the UK Financial Services Compensation Scheme (the "**FSCS**") in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers. Further provisions in respect of these costs are likely to be necessary in the future. The ultimate cost to the industry, which will also include the cost of any compensation payments made by the FSCS and, if necessary, the cost of meeting any shortfall after recoveries on the borrowings entered into by the FSCS, remains uncertain but may be significant and may have a material effect on TSB's business, results of operations and financial condition.

In Europe, the EU Deposit Guarantee Scheme Directive ("**EU DGSD**") required EU Member States to introduce at least one deposit guarantee scheme by 1 July 1995. The EU DGSD was reviewed and a new legislative proposal was published by the European Commission in July 2010. The main changes proposed include a tightened definition of deposits, a requirement that the deposit guarantee scheme repay customers within one week and that banks must be able to provide information at any time. On 15 April 2014, the European Parliament adopted a directive revising the EU DGSD. Member States will have one year to implement it into national law following its publication in the Official Journal. An Impact Assessment conducted by the European Commission indicates that the revisions will impose greater administrative and financial burdens on participating firms. Cost increases will result from increased contributions to the schemes. Until the UK implementing legislation is published, the specific implications for TSB Bank's business arising from the adoption and implementation of the EU DGSD are uncertain.

Given the early stages of these proposed reform measures, it is difficult to predict the financial obligations that may be imposed on TSB pursuant to the RRD or the EU DGSD or effect that these proposed changes will have on TSB's operations, business or prospects. However, depending on the specific nature of the requirements and how they are enforced, such changes could have a significant impact on TSB's operations, structure, costs and/or capital requirements.

29 TSB is subject to substantial and increasing industry-wide regulatory and Governmental oversight.

In addition to the promulgation of new legislation and regulation, the UK Government, the PRA, the FCA and other regulators in the UK, the European Union and overseas have in recent years become substantially more activist in their application and monitoring of certain regulations and they may intervene further in relation to areas of industry risk already identified, or in new areas, which could affect TSB.

Areas where regulatory changes could have an adverse effect on TSB include, but are not limited to:

- general changes in Government, central bank or regulatory policy, or changes in regulatory regimes, including changes that apply retroactively, that may influence investor decisions in particular markets in which TSB operates, which may change the structure of those markets and the products offered or may increase the costs of doing business in those markets;
- external bodies applying or interpreting standards or laws differently to those applied by TSB;
- one or more of TSB's regulators intervening to mandate the pricing of certain of TSB's products as a consumer protection measure;
- one or more of TSB's regulators intervening to prevent or delay the launch of a product or service, or prohibiting an existing product or service;
- changes in competitive and pricing environments, including changes to interchange fees receivable on debit and credit card transactions;
- further requirements relating to financial reporting, corporate governance, conduct of business and employee remuneration;
- changes to regulation and legislation relating to economic and trading sanctions, money laundering and terrorist financing;
- CMA market studies or investigations, FCA market studies on payment systems regulator market studies potentially resulting in a range of measures, including behavioural and/or structural remedies;
- changes in business strategy, particularly impacting the rate of growth of the business; and
- changes to conditions imposed on the sales and servicing of products, which have the effect of making such products unprofitable or unattractive to sell.

TSB, in common with much of the UK and European financial services industry, continues to be the focus of significant regulatory change and scrutiny. This has led to a more intensive approach to supervision and oversight, increased expectations and enhanced regulatory requirements. As a result, regulatory risk will continue to require senior management attention and consume significant levels of business resources. Furthermore, as enhanced supervisory standards are developed and implemented, this more intensive approach and the enhanced regulatory requirements, along with uncertainty and the extent of international regulatory co-ordination, may adversely affect TSB's business, capital and risk management strategies and/or may result in TSB deciding to modify its legal entity structure, capital and funding structures and business mix or to exit certain business activities altogether or to determine not to expand in areas despite their otherwise attractive potential.

Further, heightened levels of political discussion in the period preceding the next general election, which must occur by May 2015, may lead to increased pressure for further restrictions or additional regulatory oversight of retail banks. The nature of any such changes and the potential effects on TSB's business is to some extent uncertain.

TSB continually assesses the impacts of legal and regulatory developments which could have an effect on it and will participate in relevant consultation and calibration processes undertaken by the various regulatory and other bodies. Implementation of the foregoing regulatory developments could result in additional costs or limit or restrict the way that TSB conducts business, although uncertainty remains about the details, impact and timing of these reforms. TSB continues to work closely with regulatory authorities and industry associations to ensure that it is able to identify and respond to proposed regulatory changes and mitigate against risks to TSB and its stakeholders.

30 TSB must comply with anti-money laundering, anti-bribery and sanctions regulations.

TSB is subject to laws regarding money laundering and the financing of terrorism, as well as laws that prohibit TSB, its employees or intermediaries from making improper payments or offers of payment to foreign Governments and their officials and political parties for the purpose of obtaining or retaining business, including the UK Bribery Act 2010. Monitoring compliance with anti-money laundering and anti-bribery rules can put a significant financial burden on banks and other financial institutions and requires significant technical capabilities. In recent years, enforcement of these laws and regulations against financial institutions has become more aggressive, resulting in several landmark fines against UK financial institutions. In addition, TSB cannot predict the nature, scope or effect of future regulatory requirements to which it might be subject or the manner in which existing laws might be administered or interpreted. Although TSB believes that its current policies and procedures are sufficient to comply with applicable anti-money laundering, anti-bribery and sanctions rules and regulations, it cannot guarantee that such policies completely prevent situations of money laundering or bribery, including actions by TSB's employees, for which TSB might be held responsible. Any of such events may have severe consequences, including sanctions, fines and reputational consequences, which could have a material adverse effect on TSB's financial condition and results of operations.

RISKS RELATED TO TSB'S RELATIONSHIP WITH LLOYDS BANKING GROUP

As a condition to the European Commission's approval of State aid given to it by HM Treasury, Lloyds Banking Group is required to divest any remaining interest in TSB by December 2015 with this date extendable to June 2016 or December 2016 in certain circumstances. Notwithstanding the timing of the completion of any such divestment, there are risks that might impact TSB as long as Lloyds Banking Group and TSB have an ongoing contractual relationship, including through the TSA, LTSA and/or Separation Agreement (including the Conduct Indemnity). Highlighted below are certain of the key risks that apply to TSB's relationship with Lloyds Banking Group and that, should they arise, may have a material adverse effect on TSB's business, prospects, results of operations and financial position.

31 TSB's reliance on services arrangements with Lloyds Bank exposes TSB to a range of potential operational and regulatory risks.

In connection with TSB's divestment from Lloyds Banking Group, TSB Bank has entered into an arm's-length TSA with Lloyds Bank for the continued provision of a range of banking operations services to TSB on a transitional basis (see Part XXII: "*Additional Information – Material contracts – Transitional Services Agreement*"). Following the term of the TSA, which will commence on Admission and continue in effect through 31 December 2016, a subset of the TSA services will continue to be provided by Lloyds Bank for a further period of up to seven and a half years under the LTSA (see Part XXII: "*Additional Information – Material contracts – Long Term Services Agreement*"). Lloyds Bank's ability to terminate the TSA or LTSA before the end of the term of such agreement is limited. Lloyds Bank may only terminate the TSA or LTSA if required to do so by a regulatory authority or law, or for the non-payment of a sum in excess of £20 million by TSB Bank.

Given that TSB will own and operate limited IT systems and infrastructure for itself on Admission, TSB will be heavily reliant on Lloyds Bank under the TSA and LTSA for the provision of a broad range of IT and related services (including support for branch sales, services and branch counter processes, support for telephone banking and online/mobile banking services, access to third party software licences, systems support and maintenance) that are critical to supporting the day-to-day operation of TSB's business. In particular, Lloyds Bank will provide hosting and back-up services for TSB's data, including customer data, under the TSA and LTSA. While a number of non-IT business functions and processes, for example those relating to risk and treasury, have been created and implemented for TSB (including the transfer of employees from Lloyds Banking Group companies) as part of its operational separation from Lloyds Banking Group (see Part IX: "*Introduction to TSB*"), these business functions and processes will continue to be dependent upon the various non-IT banking operations services (including printing and mail administration services, processing services for credit and debit cards, electronic payments and cheques) under the TSA and LTSA. Although TSB will be heavily reliant on Lloyds Bank in relation to the services provided under the TSA and LTSA, the TSA and LTSA give TSB the ability to effect strategic changes to differentiate TSB's offering in the markets in which it operates (for example, to develop and launch new products and services) and to effect changes appropriate to TSB's business and risk profile in order to comply with new laws and regulations.

The systems and infrastructure that Lloyds Bank will use to provide services to TSB may not operate as expected, may not fulfil their intended purpose or may be damaged or interrupted by unanticipated increases in usage, human error, unauthorised access, natural hazards or disasters or similarly disruptive events. Whilst past issues with the IT systems provided by Lloyds Bank to TSB (including a hardware failure on 26 January 2014 that lasted approximately six hours and affected approximately half of TSB's ATM network and debit card holders) have been resolved and remedied in accordance with agreed procedures, there can be no guarantee that future issues will be similarly resolved and remedied, with a consequent risk to TSB's day-to-day operations. In addition, while Lloyds Bank will be bound by arm's-length contractual obligations under the TSA and LTSA (including with respect to service performance, recovery of service, change management, confidentiality/data security and disaster recovery), Lloyds Bank has no experience of providing services of a comparable breadth and scale to a third party financial institution. Lloyds Bank has invested significantly in a project to enhance its capability to provide banking operations services; however, events impacting Lloyds Bank's ability to honour its contractual commitments to TSB Bank under the TSA or LTSA, such as human errors, events of force majeure, insolvency or other triggers for its recovery or resolution or any failure of the underlying systems or infrastructure used by Lloyds Bank or its subcontractors, could result in significant disruptions (including in the delivery of services to TSB) and costs that adversely affect the overall operational performance, financial performance, financial position or prospects of TSB's business, as well as harm TSB's reputation or brand and/or attract increased regulatory scrutiny.

In recognition of the potential conflict of interest that Lloyds Bank may face in its position as both a significant service provider and competitor to TSB, Lloyds Bank has implemented various technical and organisational measures to manage potential conflicts and associated competition/regulatory risks, including: (i) the segregation (where appropriate) and training of staff; (ii) the implementation of systems and controls to prevent unauthorised access to TSB's data (including customer data); (iii) updates to Lloyds Banking Group procedures to reflect Lloyds Bank's responsibilities as a service provider; and (iv) the creation of an account management unit containing Lloyds Bank personnel dedicated to managing the relationship under the TSA and LTSA with TSB. In addition, a number of contractual safeguards (including an obligation on Lloyds Bank to maintain data access controls (including controls to guard against unauthorised or unlawful access of TSB customer data and information by Lloyds Bank personnel) and an obligation on both parties to comply with an information sharing protocol) have been incorporated into the TSA and LTSA. Nonetheless, a failure of these measures or safeguards could result in damage to TSB's business or reputation or result in TSB breaching applicable law.

Any interruption to the banking operations services provided under the TSA or LTSA could cause material damage to TSB's business and reputation, and could cause TSB to incur higher administrative and other costs both for the processing of business and the potential remediation of disputes. If Lloyds Bank fails to provide or procure the services envisaged or fails to provide them in a timely manner, under the TSA or LTSA, such failure could have a material adverse effect on TSB's business, prospects, results of operations and financial position.

Notwithstanding anything in this risk factor, this risk factor should not be taken as implying that TSB will be unable to comply with its obligations as a company with securities admitted to the Official List or as a supervised firm regulated by the FCA and the PRA.

32 TSB is exposed to risks associated with the exit from the LTSA, including with respect to costs and the logistics of transferring its cloned IT infrastructure to an alternate service provider or migrating to an alternative system.

The cloning of the IT infrastructure provided as an option under the exit provisions in the TSA and LTSA is inherently risky. Irrespective of the quality of a new service provider or platform and support received from Lloyds Bank, there may be disruptions which could adversely impact TSB's business operations and its customers and could cause TSB to incur higher administrative and other costs both for the processing of business and the potential remediation of disputes. Alternatively, the TSA and LTSA provide for the migration of data and systems to a new banking platform. However, a migration process would inherently be more complex, riskier and more expensive for TSB than an exit approach based on transferring to cloned IT infrastructure and could, in turn, have a material adverse effect on TSB's business, financial condition and results of operations.

33 TSB could have difficulty in continuing to operate if Lloyds Banking Group were to experience a severe deterioration in its financial or operating condition.

While the financial performance of Lloyds Banking Group does not have a direct impact on the performance of TSB, any catastrophic deterioration in Lloyds Banking Group's business, financial condition or results of operations, such that it required recovery or resolution or other Government intervention, could jeopardise TSB's ability to continue to operate and ultimately meet its regulatory threshold conditions. The provision of services by Lloyds Bank pursuant to the TSA and LTSA is vital to TSB's ability to operate its business. TSB has also entered into a £2.5 billion RMBS Funding Facility with Lloyds Bank. If Lloyds Bank were unable to continue to meet its obligations under the TSA and/or LTSA or any other relevant arrangements, either due to an industry-wide dislocation or to circumstances particular to Lloyds Banking Group, the consequences to TSB would be severe.

34 TSB faces potential risks associated with its separation from Lloyds Banking Group.

As part of its separation from Lloyds Banking Group, TSB established its own functions and processes in a wide range of areas, including finance, human resources, internal audit, legal, treasury, risk, corporate affairs, product management and purchasing. These functions and processes will in some respects continue to be supported by various services under the TSA and LTSA. While these services and functions are relatively new as standalone functions for TSB, they have been subject to testing and are now implemented into the ordinary operational and reporting processes of TSB. There can, however, be no assurance that these services and functions will continue to operate as intended and there remains a risk that TSB could suffer operational difficulties in due course which, either directly or as a result of the need for further investment in these new services and functions, could have a material adverse effect on TSB's business, financial condition and results of operations.

35 TSB faces potential risks associated with Lloyds Banking Group remaining a significant shareholder in TSB.

Immediately following Admission, the Parent will continue to own, through the Selling Shareholder, 75 per cent. (assuming the Offer Size is set at the Expected Offer Size and no exercise of the Over-allotment Option), and 72.5 per cent. (assuming the Offer Size is set at the Expected Offer Size and the Over-allotment Option is exercised in full) of the issued ordinary share capital of the Company. The interests of the Parent, including its obligation to divest its entire interest in TSB by 31 December 2015 (with this date extendable to 30 June 2016 or 31 December 2016 in the event of Disorderly Markets), could conflict with those of TSB. While it remains a significant shareholder of the Company, the Parent will, subject to the terms of the Relationship Agreement which imposes certain restrictions on the ability of the Parent and its associates to control or intervene in the management and operation of the Company, continue to have the power, among other things, to affect or influence TSB's legal and capital structure and to approve other changes to its operations. The ability of the Parent and its associates to exercise voting rights as a shareholder in TSB, which are restricted under the terms of the Relationship Agreement, may also have the effect of delaying, deferring or preventing TSB from effecting certain types of transactions that require approval by the Parent, including by special resolution. More generally, the Relationship Agreement will, in part (in accordance with the requirements of the Listing Rules in relation to TSB's independence), regulate the degree of control that the Parent and its associates may exercise over the management of TSB (see Part XXII: "*Additional Information – Material contracts – Relationship Agreement*").

36 Lloyds Banking Group is subject to a variety of risks as a result of implementing the State Aid Restructuring Plan which could adversely affect TSB.

As part of the approval by the European Commission of the State aid granted to Lloyds Banking Group by HM Treasury, Lloyds Banking Group undertook to implement a restructuring plan agreed in November 2009 (the "**State Aid Restructuring Plan**"). Under the State Aid Restructuring Plan, Lloyds Banking Group agreed to undertake a series of measures, which include disposing of TSB by 31 December 2015 (with this date extendable to 30 June 2016 or 31 December 2016 in the event of Disorderly Markets). If Lloyds Banking Group fails to complete the required disposal of TSB by 31 December 2015 and this deadline is not extended, under the terms of the State aid approval, a divestiture trustee may be empowered to conduct the disposal, with the mandate to complete the disposal of Lloyds Banking Group's residual interest in the Ordinary Shares at no minimum price, which could have a material and adverse impact on the liquidity and trading price of the Ordinary Shares.

37 Lloyds Banking Group has a legal obligation to divest its entire interest in TSB by 31 December 2015, with the manner and exact timing of any divestment yet to be determined.

As a condition to receiving State aid, Lloyds Banking Group is required to divest its entire interest in TSB by 31 December 2015 (with this date extendable to 30 June 2016 or 31 December 2016 in the event of Disorderly Markets), with the manner and exact timing of any divestment yet to be determined. Lloyds Banking Group's current intention for disposal of its interest in TSB is by way of the Offer (including the transfer of the Bonus Shares) and then, subject to (i) market conditions and (ii) the terms of the lock-up provisions that prevent Lloyds Banking Group from disposing of any Ordinary Shares, without the prior written consent of the Joint Bookrunners, for a period of 90 days from Admission, the sale of the Ordinary Shares held by Lloyds Banking Group following Admission (the "**Residual Shares**") in a number of tranches.

However, there remains considerable uncertainty over the timing and manner of the divestment of the Residual Shares and TSB has no control over the manner in which Lloyds Banking Group may seek to divest its Residual Shares. The divestment could be achieved in a number of different ways, including, without limitation: (i) by the sale of the Residual Shares in a number of tranches (as described above); (ii) by the sale of all the Residual Shares in a single tranche whether to one or more purchasers; or (iii) by the sale of a significant tranche of the Residual Shares representing in excess of 30 per cent. of the issued share capital of the Company whether to one or more purchasers. Sales under paragraphs (ii) and (iii) could be made to a single third party purchaser which might be another financial institution. Any sale under paragraph (ii) or (iii) would, if acquired by a single purchaser (or a group of purchasers acting in concert), absent the consent of the Takeover Panel and a vote of independent directors, require such a purchaser (or group of purchasers) to make an offer to acquire all the Ordinary Shares not held by it or them at the price at which the Residual Shares are sold by Lloyds Banking Group, subject to and in accordance with the UK Takeover Code. The TSB Board would have to consider whether or not to recommend such an offer to shareholders, and there can be no guarantee that the price at which Lloyds Banking Group is willing to sell its Residual Shares will be at a level that the TSB Board is prepared to make such a recommendation. A publicly announced offer of this nature at a price per Ordinary Share lower than the prevailing market price of the Ordinary Shares at the time the offer is announced would be likely to depress the market price of the Ordinary Shares.

Should the divestment of the Residual Shares occur by way of a single or significant tranche sale to a third party result in a purchaser being required to make an offer as described above, while holders of Ordinary Shares may not be obliged to accept any tender offer made (unless: (i) the compulsory acquisition provisions of the Companies Act apply; or (ii) if any such offer were to be implemented by way of a scheme of arrangement, which would bind all holders of Ordinary Shares if Shareholders holding 75 per cent. in value and being 50 per cent. in number vote in favour of such scheme), this could subsequently result in a significant change to the strategy, management and risk profile of TSB, including, subject to regulatory restrictions, TSB's capital management policy, financial leverage, investment or dividend policy and, depending on the level of ownership secured by the purchaser, could result in the delisting of the Ordinary Shares from the Official List and the London Stock Exchange's main market for listed securities.

In addition, a change of control of TSB could result in key contracts being terminated by the counterparties to such contracts (although Lloyds Bank has no right to terminate the TSA or LTSA upon a change of control of TSB), which could give rise to material disruptions to TSB's business, additional costs to renegotiate those contracts, difficulties in managing its operations and adverse impacts to its customers. As a result of these effects, the eventual change in ownership could have a material adverse effect on TSB's business, results of operations and financial position.

RISKS RELATING TO THE OFFER AND THE ORDINARY SHARES

38 As a result of any of the foregoing risks, TSB may be subject to the provisions of the Banking Act 2009 in the future.

Under the Banking Act 2009 (the "**Banking Act**"), substantial powers have been granted to HM Treasury, the Bank of England (including the PRA) and the FCA (together, the "**Authorities**") as part of the special resolution regime (the "**SRR**"). These powers enable the Authorities to engage with and stabilise UK-incorporated institutions with permission to accept deposits pursuant to Part IV of the FSMA that are failing or are likely to fail to satisfy FSMA's threshold conditions (within the meaning of

section 41 of FSMA). The SRR consists of three stabilisation options, which could be imposed on any bank, including TSB, that did not meet the FSMA's threshold conditions: (i) transfer of all or part of the business of the relevant entity or the shares of the relevant entity to a third party private sector purchaser; (ii) transfer of all or part of the business of the relevant entity to a "bridge bank" established and wholly owned by the Bank of England; and (iii) temporary public ownership of the relevant entity. HM Treasury may also take a parent company of a relevant entity into temporary public ownership where certain conditions are met. The Banking Act also provides for two new insolvency and administration procedures for relevant entities. Certain ancillary powers include the power to modify certain contractual arrangements in certain circumstances. Use of any such powers in the case of a resolution of TSB would impact Ordinary Shareholders' ongoing holding of Ordinary Shares, including, but not limited to, potential substantial reductions in the value of such holdings. See also, "*TSB's business is subject to substantial and changing prudential regulation – Recovery and Resolution Directive*" above.

39 There has been no prior trading market for the Ordinary Shares.

Prior to the Offer, there has been no public trading market for the Ordinary Shares. The Offer Price will be determined by the Parent and the Selling Shareholder after consultation with the Joint Global Co-ordinators and the Company and may not be indicative of the market price for the Ordinary Shares following Admission. Although TSB intends to apply to the FCA for admission of the Ordinary Shares to the premium segment of the Official List and intends to apply to the London Stock Exchange for admission of the Ordinary Shares to trading on its main market for listed securities, TSB can give no assurance that an active trading market for the Ordinary Shares will develop or, if developed, can be sustained following the closing of the Offer. If an active trading market is not developed or maintained, the liquidity and trading price of the Ordinary Shares could be materially adversely affected.

40 The value of the Ordinary Shares may fluctuate significantly.

Following the Offer, the value of the Ordinary Shares may fluctuate significantly as a result of a large number of factors, including, but not limited to, those referred to in this Part II: "*Risk Factors*", as well as period-to-period variations in operating results or change in revenue or profit estimates by TSB, industry participants or financial analysts. The value of the Ordinary Shares could also be affected by developments unrelated to TSB's operating performance, such as the operating and share price performance of other companies that investors may consider comparable to TSB, speculation about TSB in the press or the investment community, strategic actions by competitors, including acquisitions and/or restructurings, changes in market conditions and regulatory changes in any number of countries, whether or not TSB derives significant revenue therefrom.

It is expected that, following completion of the Offer, the Parent, through the Selling Shareholder, will own 75 per cent. of the Company's issued Ordinary Share capital (assuming the Offer Size is set at the Expected Offer Size and no exercise of the Over-allotment Option) and 72.5 per cent. of the Company's issued Ordinary Share capital (assuming the Offer Size is set at the Expected Offer Size and the Over-allotment Option is exercised in full).

The market price of the Ordinary Shares could be negatively affected by sales of substantial amounts of Ordinary Shares in the public markets, including following the expiry of the lock-up restrictions applicable to the Selling Shareholder, the Company and the Directors or following the Bonus Share Record Date, or the perception that these sales could occur.

Sales of a substantial number of Ordinary Shares by the Directors or, despite the known requirement to divest described above, the Selling Shareholder in the public market after these restrictions expire, or the knowledge that they will, or perception that these sales may occur, could depress the market price of the Ordinary Shares and could impair TSB's ability to raise capital through the sale of additional equity securities.

41 Shareholders may earn a negative or no return on their investment in TSB.

TSB is a non-operating holding company and, as a result, depends on the receipt of dividends and other amounts from its subsidiaries to meet its obligations, including its payment obligations with respect to its debt securities, and to provide profits for payment of future dividends to ordinary shareholders. The ability of the Company's subsidiaries to pay dividends and other amounts and the Company's ability to receive these distributions is subject not only to the financial performance of the Company's subsidiaries but also to applicable laws and other restrictions. These restrictions could

include, among others, any regulatory, capital and leverage requirements. As a matter of applicable company law, the Company may only pay dividends if and to the extent that, among other requirements, it has distributable reserves and sufficient cash available for this purpose. Any decision to declare and pay dividends in the future will be made at the discretion of the Board and with the approval of regulators and will depend on, among other things, the Company's financial position, general economic conditions and other factors the Directors deem significant from time to time. As a result, there can be no assurance that the Company will pay dividends in the future.

42 The issue of additional shares in the Company in connection with future acquisitions, any share incentive or share option plan or otherwise may dilute all other shareholdings.

TSB may seek to raise financing to fund future acquisitions and other growth opportunities. The Company may, for these and other purposes, such as in connection with share incentive and share option plans, issue additional equity or convertible equity securities. As a result, the Company's existing shareholders would suffer dilution in their percentage ownership if such issues were not done on a pre-emptive basis.

43 Shareholders outside the United Kingdom may not be able to participate in future equity offerings.

The Articles of the Company provide for pre-emptive rights to be granted to shareholders in the Company, unless such rights are disapplied by a shareholder resolution. However, securities laws of certain jurisdictions may restrict TSB's ability to allow participation by shareholders in future offerings. In particular, shareholders in the United States may not be entitled to exercise these rights unless either the rights and Ordinary Shares are registered under the Securities Act, or the rights and Ordinary Shares are offered pursuant to an exemption form, or transaction not subject to, the registration requirements of the Securities Act.

PART III
PRESENTATION OF INFORMATION

General

Investors should only rely on the information in this Prospectus. No person has been authorised to give any information or to make any representations in connection with the Offer other than the information and representations contained in this Prospectus and, if any other information or representations is or are given or made, such information or representations must not be relied upon as having been authorised by or on behalf of the Company, the Directors, the Prospective Non-executive Director, TSB Bank, the Parent, the Selling Shareholder or the Underwriters. No representation or warranty, express or implied, is made by any of the Underwriters or any selling agent as to the accuracy or completeness of such information, and nothing contained in this Prospectus is, or shall be relied upon as, a promise or representation by the Underwriters or any selling agent as to the past, present or future.

Without prejudice to any obligation of the Company to publish a supplementary prospectus pursuant to section 87G of FSMA and paragraph 3.4.1 of the Prospectus Rules, neither the delivery of this Prospectus nor any sale made under this Prospectus shall, under any circumstances, create any implication that there has been no change in the business or affairs of the Company or of the TSB Group taken as a whole since the date hereof or that the information contained herein is correct as of any time subsequent to its date.

The Company does not accept any responsibility for the accuracy or completeness of any information reported by the press or other media, nor the fairness or appropriateness of any forecasts, views or opinions expressed by the press or other media regarding the Offer or the TSB Group. The Company makes no representation as to the appropriateness, accuracy, completeness or reliability of any such information or publication.

The Company will update the information provided in this Prospectus by means of a supplement hereto if a significant new factor that may affect the ability of prospective investors to make an informed assessment of the matters set out in section 87(A)(2) of the FSMA occurs prior to Admission or if this Prospectus contains any material mistake or inaccuracy. This Prospectus and any supplement thereto will be subject to approval by the FCA and will be made public in accordance with the Prospectus Rules. If a supplement to the Prospectus is published prior to Admission, investors shall have the right to withdraw their offers to purchase Ordinary Shares made prior to the publication of the supplement. Such withdrawal must be done within the time limits set out in the supplement (if any) (which shall not be shorter than two days after publication of the supplement).

The contents of this Prospectus are not to be construed as legal, business or tax advice. Each prospective investor should consult his or her own lawyer, financial adviser or tax adviser for legal, financial or tax advice in relation to any purchase or proposed purchase of Offer Shares. In making an investment decision, each investor must rely on his or her own examination, analysis and enquiry of the Company and the terms of the Offer, including the merits and risks involved.

Each of Citigroup, Investec, J.P. Morgan Securities plc, NM Rothschild & Sons Limited, RBC and UBS is authorised and regulated by the Prudential Regulation Authority (the "**PRA**") and regulated by the FCA and Numis is authorised and regulated by the FCA and each of the Underwriters is acting exclusively for the Parent, the Selling Shareholder and the Company and no one else in connection with the Offer. They will not regard any other person (whether or not a recipient of this Prospectus) as a client in relation to the Offer and will not be responsible to anyone other than the Parent, the Selling Shareholder and the Company for providing the protections afforded to their respective clients nor for giving advice in relation to the Offer or any transaction or arrangement referred to in this Prospectus. NM Rothschild & Sons Limited is acting exclusively for the TSB Board and no one else in connection with the Offer and will not regard any other person as a client in relation to the Offer and will not be responsible to anyone other than the TSB Board for providing the protections afforded to its clients nor for giving advice in relation to the Offer or any transaction or arrangement referred to in this Prospectus.

The Underwriters and any of their respective affiliates may have engaged in transactions with, and provided various investment banking, financial advisory and other services for, the Parent, the Selling Shareholder, the Company and TSB Bank for which they would have received customary fees.

In connection with the Offer, each of the Underwriters and any of their respective affiliates acting as an investor for its or his or her own account may retain, purchase, sell, offer to sell or otherwise deal for its or

his or her own account(s) in the Offer Shares, any other securities of the Company or other related investments in connection with the Offer or otherwise. Accordingly, references in this Prospectus to the Offer Shares being offered or otherwise dealt with should be read as including any offer to, or dealing by, the Underwriters and any of their respective affiliates acting as an investor for its or his or her own account(s). Such persons do not intend to disclose the extent of any such investment or transaction otherwise than in accordance with any legal or regulatory obligation to do so.

None of the Company, the Directors, the Prospective Non-executive Director, TSB Bank, the Parent, the Selling Shareholder or the Underwriters is making any representation to any offeree or purchaser of Ordinary Shares regarding the legality of an investment by such offeree or purchaser.

Apart from the responsibilities and liabilities, if any, which may be imposed on the Underwriters by the FSMA or the regulatory regime established thereunder or under the regulatory regime of any jurisdiction where exclusion of liability under the relevant regulatory regime would be illegal, void or unenforceable, none of the Underwriters accepts any responsibility or liability whatsoever for the contents of this Prospectus, including its accuracy, completeness or verification, or for any other statement made or purported to be made by it, or on its behalf, in connection with the Company, the TSB Group, the Ordinary Shares or the Offer. The Underwriters accordingly disclaim all and any liability, whether arising in tort, contract or otherwise (save as referred to above), which they might otherwise have in respect of this Prospectus or any such statement.

No representation or warranty, express or implied, is made by the Underwriters as to the accuracy or completeness of information contained in this Prospectus, and nothing in this Prospectus is, or shall be relied upon as, a promise or representation by the Underwriters.

Prior to making any decision as to whether to purchase Offer Shares, prospective investors should read this Prospectus in its entirety and should not just rely on key information or information summarised within it. In making an investment decision, prospective investors must rely upon his or her own examination of the Company and the terms of this Prospectus, including the risks involved.

Investors who purchase Offer Shares in the Offer will be deemed to have acknowledged that: (i) they have not relied on any of the Underwriters or any person affiliated with any of them in connection with any investigation of the accuracy of any information contained in this Prospectus or their investment decision; and (ii) they have relied on the information contained in this Prospectus, and no person has been authorised to give any information or to make any representation concerning the Company, TSB Group or the Ordinary Shares (other than as contained in this Prospectus) and, if given or made, any such other information or representation should not be relied upon as having been authorised by the Company, the Directors, the Prospective Non-executive Director, TSB Bank, the Parent, the Selling Shareholder or any of the Underwriters.

In connection with the Offer, J.P. Morgan Cazenove as Stabilising Manager, or any of its agents, may (but will be under no obligation to), to the extent permitted by applicable law, over-allot Ordinary Shares or effect other transactions with a view to supporting the market price of the Ordinary Shares at a higher level than that which might otherwise prevail in the open market. The Stabilising Manager is not required to enter into such transactions and such transactions may be effected on any securities market, over-the-counter market, stock exchange or otherwise and may be undertaken at any time during the period commencing on the date of the commencement of conditional dealings of the Ordinary Shares on the London Stock Exchange and ending no later than 30 calendar days thereafter. However, there will be no obligation on the Stabilising Manager or any of its agents to effect stabilising transactions and there is no assurance that stabilising transactions will be undertaken. Such stabilisation, if commenced, may be discontinued at any time without prior notice. In no event will measures be taken to stabilise the market price of the Ordinary Shares above the Offer Price. Except as required by law or regulation, neither the Stabilising Manager nor any of its agents intends to disclose the extent of any over-allotments made and/or stabilisation transactions conducted in relation to the Offer.

In connection with the Offer, the Stabilising Manager may, for stabilisation purposes, over-allot Ordinary Shares up to a maximum of 10 per cent. of the total number of Offer Shares. For the purposes of allowing the Stabilising Manager to cover short positions resulting from any such over-allotments and/or from sales of Ordinary Shares effected by it during the stabilising period, the Selling Shareholder has granted to it the Over-allotment Option, pursuant to which the Stabilising Manager may purchase or procure purchasers for additional Ordinary Shares up to a maximum of 10 per cent. of the total number of Offer Shares (the "**Over-allotment Shares**") at the Offer Price. The Over-allotment Option is exercisable in whole or in part, upon notice by the Stabilising Manager, at any time on or before the 30th calendar day after the

commencement of conditional dealings of the Ordinary Shares on the London Stock Exchange. Any Over-allotment Shares made available pursuant to the Over-allotment Option will rank *pari passu* in all respects with the Ordinary Shares, including for all dividends and other distributions declared, made or paid on the Ordinary Shares, will be purchased on the same terms and conditions as the Ordinary Shares being sold in the Offer and will form a single class for all purposes with the other Ordinary Shares.

Presentation of financial information and non-financial operating data

Historical financial information

The historical financial information in this Prospectus has been prepared in accordance with the requirements of the Prospectus Directive Regulation, the UK Listing Rules and the International Financial Reporting Standards, as adopted by the European Union ("EU-IFRS"). The basis of preparation is further explained in Part XVI: "*Historical Financial Information*" and in Part XVII: "*Condensed Combined Interim Financial Information (Unaudited)".* The historical financial information presented in this Prospectus consists of condensed combined interim financial information (unaudited) of the TSB Bank Group for the three months ended 31 March 2014 and audited combined financial information of the TSB Bank Group for the years ended 31 December 2013, 2012 and 2011.

Part XII: *"Selected Financial and Other Information"* and Part XIII: *"Operating and Financial Review"* present income statement data on the Management Basis, because the TSB Board believes that it better highlights the underlying performance of the business. In accordance with IFRS 8 "Operating Segments", the Management Basis is used to present the performance of individual operating segments. Further analysis of the Management Basis is provided in note 4 to each of the HFI and the Unaudited Interim Financial Information.

Pro forma financial information

In this Prospectus, any reference to "pro forma" financial information is to information which has been extracted without material adjustment from the unaudited pro forma financial information contained in Part XVIII: "*Unaudited Pro forma Financial Information*". The unaudited pro forma financial information contained in Part XVIII: "*Unaudited Pro forma Financial Information*" is based on the unaudited condensed consolidated interim financial information of TSB for the three months ended 31 March 2014. The unaudited pro forma financial information has been prepared to illustrate the effect of certain specified actions and events as if they had taken place or been incurred on 31 March 2014.

The unaudited pro forma financial information has been prepared for illustrative purposes only and, because of its nature, addresses a hypothetical situation and, therefore, does not represent the TSB Group's actual financial performance or results. It may not, therefore, give a true picture of the TSB Group's financial position or results nor is it indicative of the results that may or may not be expected to be achieved in the future.

Non-financial operating data

The non-financial operating data included in this Prospectus has been extracted without material adjustment from the management records of the TSB Group and is unaudited.

Currency presentation

Unless otherwise indicated, all references in this Prospectus to "sterling", "pounds sterling", "GBP", "£" or "pence" are to the lawful currency of the United Kingdom. All references to the "Euro", "euro" or "€" are to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community (the "**EC Treaty**"), as amended. All references to "dollars", "$" or "U.S.$" are to the lawful currency of the United States.

The Offer Price will be stated in pounds sterling.

The Company will prepare its financial statements in pounds sterling.

Unless otherwise indicated, the financial information contained in this Prospectus has been expressed in pounds sterling.

Roundings

Percentages and certain amounts in this Prospectus, including financial, statistical and operating information, have been rounded. As a result, the figures shown as totals may not be the precise sum of the figures that precede them.

Market, economic and industry data

Certain information in this Prospectus, in particular the information in Part VIII: "*Market Overview*", has been sourced from third parties. The Company confirms that all third party information contained in this Prospectus has been accurately reproduced and, so far as the Company is aware and able to ascertain from information published by that third party, no facts have been omitted that would render the reproduced information inaccurate or misleading.

Where third party information has been used in this Prospectus, the source of such information has been identified.

Information on Overall UK Retail Banking Market

Where information on the overall financial performance of the UK retail banking market is presented in Part VIII of this Prospectus, that information has been determined on the basis of the aggregation of publicly available information on the financial performance of the retail banking divisions (or closest consistently available approximation) of the six largest retail banks and building societies in the UK, using published data from annual reports and other financial announcements. The financial performance information included in relation to retail banking divisions contains, in the case of some of the banks, limited financial information in relation to small business banking. This is referenced as "source: Annual Reports" throughout Part VIII. The TSB Board believes this analysis provides a reasonable approximation to the trends observed in the UK retail banking market.

This published data includes that taken from: Barclays UK Retail Banking (2004-2009), Barclays UK Retail & Business Banking (2010-2013), Barclaycard (2004-2013), HSBC UK PFS plus UK Commercial (2004-2007), HSBC UK Retail (2008-2012), RBS UK Retail (2004-2012), LTSB UK Retail (2004-2007), HBOS Retail (2004-2007), Lloyds Banking Group Retail (2008-2013), Abbey National Retail (2004-2007), Alliance & Leicester Retail Banking (2004-2007), Santander UK Retail (2008-2013), Nationwide PFS (2004-2006), Nationwide Retail (2007-2013).

Several of the required financial metrics were not published for HSBC UK PFS and UK Commercial, and so to allow HSBC to be included in this analysis, some financial metrics have been estimated for 2004 – 2007 by applying a ratio from HSBC UK Retail in 2008. These metrics include Net Interest Income, Non-Interest Income, Operating Expense, Impairment, Customer Assets & Customer Liabilities and Impairment. In 2013, HSBC changed its financial reporting segments, and to allow HSBC 2013 to be included in the analysis, the financial metrics for HSBC have been estimated for 2013 by applying what the TSB Board believes to be an appropriate growth rate from HSBC UK Retail in 2012, based on the growth rate from 2012 to 2013 under the new segmentation. For Nationwide, a full-year figure has been estimated by multiplying the half-year values contained in the interim report covering six months from April to September 2013, by two. Metrics estimated in this way are: Net Interest Income, Non-Interest Income, Operating Expense, and Impairment.

The measure of profitability presented in Part VIII for these banks and building societies has been calculated as total income less operating expenses and impairments. It is presented on a pre-tax basis, and unless otherwise stated, excludes one-off charges (e.g. PPI conduct issues, and Transform and goodwill expenses incurred by Barclays in 2011 and 2013). Return on Capital has been calculated on a post-tax basis assuming a Common Equity Tier 1 Capital Ratio of 10 per cent.

PCA Market Share Information

Information presented in this Prospectus in relation to TSB's share of the UK PCA market has been determined on the basis of a definition of "PCA" that was agreed by the European Commission, which definition excludes basic bank accounts.

Information regarding forward-looking statements

Certain information contained in this Prospectus, including any information as to TSB's strategy, market position, plans or future financial or operating performance, constitutes "forward-looking statements". All statements, other than statements of historical fact, are forward-looking statements. The words "believe", "expect", "anticipate", "contemplate", "target", "plan", "intend", "continue", "budget", "project", "aim", "estimate", "may", "will", "could", "should", "schedule" and similar expressions identify forward-looking statements.

Forward-looking statements are necessarily based upon a number of estimates and assumptions that, while considered reasonable by the Company, are inherently subject to significant business, economic and

competitive uncertainties and contingencies. Known and unknown factors could cause actual results to differ materially from those projected in the forward-looking statements. Such factors include, but are not limited to: general economic and business conditions in the UK and internationally; inflation, deflation, interest rates and policies of the Bank of England, the European Central Bank and other G8 (Group of Eight) central banks; fluctuations in exchange rates, stock markets and currencies; the ability to access sufficient funding to meet TSB's liquidity needs; changes to any future credit ratings for TSB or its securities; changing demographic developments, including mortality and changing customer behaviour, including consumer spending, saving and borrowing habits; changes in customer preferences; changes to borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability and the impact of any sovereign credit rating downgrade or other sovereign financial issues; technological changes; natural and other disasters, adverse weather and similar contingencies outside TSB's control; inadequate or failed internal or external processes, people and systems; terrorist acts and other acts of war or hostility and responses to those acts; geopolitical, pandemic or other such events; changes in laws, regulations, taxation, accounting standards or practices; regulatory capital or liquidity requirements and similar contingencies outside TSB's control; the policies and actions of Governmental or regulatory authorities in the UK, the European Union, the U.S. or elsewhere; the outcome of the planned referendum on Scottish Independence; the implementation of the draft EU crisis management framework directive and banking reform, following the recommendations made by the ICB; the ability to attract and retain senior management and other employees; the extent of any future impairment charges or write-downs caused by depressed asset valuations, market disruptions and illiquid markets; market relating trends and developments; exposure to regulatory scrutiny, legal proceedings, regulatory investigations or complaints; changes in competition and pricing environments; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors, including non-bank financial services and lending companies; and the success of TSB in managing the risks of the foregoing.

Investors are cautioned that forward-looking statements are not guarantees of future performance. Forward-looking statements may, and often do, differ materially from actual results. Any forward-looking statements in this Prospectus speak only as at the date of this Prospectus, reflect the TSB Board's current view with respect to future events and are subject to risks relating to future events and other risks, uncertainties and assumptions relating to TSB's operations, results of operations, growth strategy, capital and leverage ratios and the availability of new funding. Investors should specifically consider the factors identified in this Prospectus that could cause actual results to differ before making an investment decision. All of the forward-looking statements made in this Prospectus are qualified by these cautionary statements. Specific reference is made to Part II: "*Risk Factors*", Part X: "*Information on the TSB Group*" and Part XIII: "*Operating and Financial Review*".

Subject to the requirements of the Prospectus Rules, the Disclosure and Transparency Rules and the Listing Rules, or applicable law, the Company explicitly disclaims any intention or obligation or undertaking publicly to release the result of any revisions to any forward-looking statements in this Prospectus that may occur due to any change in the Company's expectations or to reflect events or circumstances after the date of issue.

Definitions

Certain terms used in this Prospectus, including all capitalised terms and certain technical and other terms, are defined and explained in Part XXIII: "*Definitions and Industry Terms*".

U.S. considerations

Available information

The Company has agreed that, for so long as any of the Ordinary Shares are "restricted securities" as defined in Rule 144(a)(3) under the Securities Act, the Company will, during any period in which it is neither subject to section 13 or 15(d) of the U.S. Securities Exchange Act of 1934, as amended (the "**Exchange Act**"), nor exempt from reporting under the Exchange Act pursuant to Rule 12g3-2(b) thereunder, make available to any holder or beneficial owner of such restricted securities or to any prospective purchaser of such restricted securities designated by such holder or beneficial owner, upon the request of such holder, beneficial owner or prospective purchaser, the information required to be delivered pursuant to Rule 144A(d)(4) under the Securities Act.

Service of process and enforcement of civil liabilities

The Company is incorporated under the laws of England and Wales. Service of process upon Directors, the Prospective Non-executive Director and the Senior Management of the Company, all of whom reside

outside the United States, may be difficult to obtain within the United States. Furthermore, since most directly owned assets of the Company are outside the United States, any judgment obtained in the United States against it may not be collectible within the United States. There is doubt as to the enforceability of certain civil liabilities under the U.S. federal securities laws in original actions in the English courts, and, subject to certain exemptions and time limitations, English courts will treat a final and conclusive judgment of a U.S. court for a liquidated amount as a debt enforceable by fresh proceedings in the English courts.

No person has been authorised to give any information or make any representation other than those contained in this Prospectus and, if given or made, such information or representation must not be relied upon as having been so authorised. Neither the delivery of this Prospectus nor any subscription or sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Company since the date of this Prospectus or that the information in this Prospectus is correct as of any time subsequent to the date hereof.

No incorporation of website information

The contents of the Company's website, any website mentioned in this Prospectus (including tsbshareoffer.equiniti.com) or any website directly or indirectly linked to these websites have not been verified and do not form part of this Prospectus, and investors should not rely on any information provided on such websites.

PART IV
DIRECTORS, SECRETARY, REGISTERED AND HEAD OFFICE AND ADVISERS

Directors and Prospective Non-executive Director	Will Samuel (Chairman) Paul Pester (Chief Executive Officer) Darren Pope (Chief Financial Officer) Norval Bryson (Non-executive Director) Mark Fisher (Prospective Non-executive Director)[1] Godfrey Robson (Non-executive Director) Sandra Dawson (Senior Independent Director) Philip Augar (Independent Non-executive Director) Alexandra Kinney Pritchard (Independent Non-executive Director) Stuart Sinclair (Independent Non-executive Director) Polly Williams (Independent Non-executive Director)
Company Secretary and General Counsel	Susan Crichton
Registered and head office of the Company	20 Gresham Street London EC2V 7JE United Kingdom
Joint Sponsors, Joint Global Co-ordinators and Joint Bookrunners	**Citigroup Global Markets Limited** Citigroup Centre, Canada Square London E14 5LB United Kingdom **J.P. Morgan Securities plc** 25 Bank Street London E14 5JP United Kingdom
Joint Bookrunner and Joint Lead Manager	**UBS Limited** 1 Finsbury Avenue London EC2M 2PP United Kingdom
Joint Lead Managers	**Investec Bank plc** 2 Gresham Street London EC2V 7QP United Kingdom **Numis Securities Limited** 10 Paternoster Square London EC4M 7LT United Kingdom **RBC Europe Limited (trading as RBC Capital Markets)** Riverbank House 2 Swan Lane London EC4R 3BF United Kingdom
Independent Financial Adviser to the Company	**Deloitte LLP** 2 New Street Square London EC4A 3BZ United Kingdom
Independent Financial Adviser to the Board of the Company	**N M Rothschild & Sons Limited** New Court St. Swithin's Lane London EC4N 8AL United Kingdom
English and U.S. legal advisers to the Company, the Selling Shareholder and the Parent	**Linklaters LLP** One Silk Street London EC2Y 8HQ United Kingdom

[1] Mark Fisher has been appointed to the TSB Board conditional upon, and from the date of, receipt of PRA approvals.

English and U.S. legal advisers to the Underwriters	**Freshfields Bruckhaus Deringer LLP** 65 Fleet Street London EC4Y 1HS United Kingdom
Independent English legal advisers to the Company	**Herbert Smith Freehills LLP** Exchange House Primrose Street London EC2A 2EG United Kingdom
Reporting Accountants	**PricewaterhouseCoopers LLP** 1 Embankment Place London WC2N 6RH United Kingdom
Auditors	**PricewaterhouseCoopers LLP** Erskine House 68-73 Queen Street Edinburgh EH2 4NH United Kingdom
Registrar	**Equiniti Limited** Aspect House Spencer Road Lancing West Sussex BN9 6DA United Kingdom

PART V
EXPECTED TIMETABLE OF PRINCIPAL EVENTS

Expected timetable of principal events

Event	Time and Date
Latest date for applications to be received by Intermediaries from retail investors in respect of the Intermediaries Offer	17 June 2014
Latest time and date for receipt of completed application forms from the Intermediaries in respect of the Intermediaries Offer	5.00pm on 18 June 2014
Latest time and date for receipt of indications of interest from institutional investors under the Institutional Offer	5.00pm on 19 June 2014
Publication of the Pricing Statement containing the Offer Price, Offer Size and basis of allocation[(1)]	20 June 2014
Announcement of the results of the Offer through a Regulatory Information Service and notification of allocations	7.00am on 20 June 2014
Commencement of conditional dealings on the London Stock Exchange	8.00am on 20 June 2014
Admission and commencement of unconditional dealings on the London Stock Exchange	8.00am on 25 June 2014
CREST accounts credited	25 June 2014
Bonus Share Record Date	25 June 2015

References to times are to London times. Each of the times and dates in the above timetable is subject to change without further notice.

It should be noted that, if Admission does not occur, all conditional dealings will be of no effect and any such dealings will be at the sole risk of the parties concerned. Temporary documents of title will not be issued.

Note:

(1) The Offer Price and Offer Size will be set out in the Pricing Statement. The Pricing Statement will not automatically be sent to persons who receive this Prospectus but it will be available free of charge at the Company's registered office at 20 Gresham Street, London EC2V 7JE. In addition, the Pricing Statement will (subject to certain restrictions) be published online at tsbshareoffer.equiniti.com.

PART VI
OFFER STATISTICS

Offer Statistics

Offer Price Range (per Ordinary Share)[1]	220 pence to 290 pence
Number of Ordinary Shares in issue on Admission	500,000,000
Expected number of Ordinary Shares in the Offer[2]	125,000,000
Expected number of Ordinary Shares in the Offer as a percentage of total number of Ordinary Shares in existence on Admission[2]	25%
Expected maximum number of Ordinary Shares subject to the Over-allotment Option[3]	12,500,000
Estimated gross proceeds of the Offer receivable by the Selling Shareholder at the mid-point of the Offer Price Range and assuming an Offer Size of 25 per cent. of the issued Ordinary Share capital of the Company[4]	£318.8 million
Market capitalisation of the Company at the mid-point of the Offer Price Range[5]	£1,275 million

Notes:

(1) It is currently expected that the Offer Price will be set within the Offer Price Range. If the Offer Price is set above the Offer Price Range, then prospective investors would have a statutory right to withdraw their offer to purchase Ordinary Shares in the Offer pursuant to section 87Q of FSMA before the end of a period of two Business Days commencing on the first Business Day after the date on which an announcement of this is published by the Company via a Regulatory Information Service. The arrangements for withdrawing offers to purchase Ordinary Shares would be made clear in the announcement. The Company expects to publish the Pricing Statement containing the Offer Price and the Offer Size on or around 20 June 2014.

(2) Calculated (i) on the basis that the Offer Size will be set at the Expected Offer Size and (ii) before taking into account any over-allotment of Ordinary Shares pursuant to the exercise of the Over-allotment Option or any Bonus Shares. It is currently expected that the Offer Size (which excludes Over-allotment Shares and Bonus Shares) will be set at the Expected Offer Size. However, the number of Ordinary Shares subject to the Offer may represent a higher or, with the approval of the UK Listing Authority, lower percentage than that indicated by the Expected Offer Size. If the Offer Size is set below the Expected Offer Size or above the Maximum Offer Size, then prospective investors would have a statutory right to withdraw their offer to purchase Ordinary Shares in the Offer pursuant to section 87Q of FSMA before the end of a period of two Business Days commencing on the first Business Day after the date on which an announcement of this is published by the Company via a Regulatory Information Service. The arrangements for withdrawing offers to purchase Ordinary Shares will be made clear in the announcement.

(3) Calculated on the basis that the Offer Size is set at the Expected Offer Size. The maximum number of Ordinary Shares subject to the Over-allotment Option is subject at all times to a maximum of 10 per cent. of the number of Offer Shares. In the event that the Offer Size is set above or below the Expected Offer Size, the maximum number of Ordinary Shares subject to the Over-allotment Option would correspondingly increase or decrease.

(4) Calculated on the basis that the Offer Size is set at the Expected Offer Size and the Offer Price is set at the mid-point of the Offer Price Range. The estimated gross proceeds receivable by the Selling Shareholder are stated before taking into account any proceeds which may be receivable by the Selling Shareholder pursuant to exercise of the Over-allotment Option. The estimated gross proceeds are stated without the deduction of £33.2 million, expected to be incurred by the Selling Shareholder in connection with the Offer and Admission, including commissions payable (excluding any discretionary commissions), other estimated fees and expenses in connection with the Offer (excluding any fees and expenses in relation to the transfer of any Bonus Shares pursuant to the Bonus Share Scheme) and amounts in respect of VAT and United Kingdom stamp duty and SDRT. The amounts referred to above are calculated on the basis of the following assumptions: (a) the Offer Size is set at the Expected Offer Size; (b) the Offer Price is set at the mid-point of the Offer Price Range; and (c) approximately 85 per cent. of the Ordinary Shares sold in the Offer (excluding pursuant to any exercise of the Over-allotment Option and excluding any Bonus Shares) are sold pursuant to the Institutional Offer and 15 per cent. are sold pursuant to the Intermediaries Offer.

(5) Calculated on the basis of the number of Ordinary Shares in issue at Admission. The market capitalisation of the Company at any given time will depend on the market price of the Ordinary Shares at that time. There can be no assurance that the market price of an Ordinary Share will be equal to or exceed the Offer Price.

PART VII
USE OF PROCEEDS AND DIVIDEND POLICY

1 Use of Proceeds

The Company is not selling any Ordinary Shares in the Offer and will not receive any of the proceeds of the Offer. The Company will bear one-off fees and expenses of an amount of approximately £3 million (inclusive of amounts in respect of VAT) in connection with the Offer and Admission. The Selling Shareholder will bear approximately £33.2 million of fees and expenses in connection with the Offer and Admission, including commissions payable (excluding any discretionary commissions), other estimated fees and expenses in connection with the Offer (excluding any fees and expenses in relation to the transfer of any Bonus Shares pursuant to the Bonus Share Scheme) and amounts in respect of VAT and United Kingdom stamp duty and SDRT (assuming the Offer Size is set at the Expected Offer Size, no exercise of the Over-allotment Option and that the Offer Price is set at the mid-point of the Offer Price Range) and will receive all of the net Offer proceeds.

2 Dividend Policy

The TSB Board believes that the Company will, in time, be able to support a dividend distribution of 40 to 60 per cent. of underlying earnings, reflecting the strength of the capital position and franchise of the Company.

In the near term however, as TSB grows its earnings and balance sheet, the TSB Board will have particular regard to the low level of profitability of the underlying business and the need to preserve capital to support TSB's growth strategy. Taking this into account, it is the TSB Board's current expectation that the Company's inaugural dividend would be in respect of the financial year ending 31 December 2017.

The TSB Board intends to review, on an ongoing basis, the expected timing and quantum of any dividend payments in the context of progress on delivery of TSB's strategy and the broader operating environment.

PART VIII
MARKET OVERVIEW

The following information relating to the retail banking industry in the United Kingdom has been provided for background purposes only. The information has been extracted from a variety of sources released by public and private organisations. TSB operates in the UK retail banking market, although it should be noted that TSB's branches are situated in England, Scotland and Wales and it does not currently have any branches in Northern Ireland. The information has been accurately reproduced and, as far as the Company is aware and is able to ascertain from information published by such sources, no facts have been omitted which would render the reproduced information inaccurate or misleading. Investors should read this Part VIII: "Market Overview" in conjunction with the more detailed information contained in this Prospectus, including Part II: "Risk Factors", Part X: "Information on the TSB Group", Part XIII: "Operating and Financial Review" and Part XIX: "Supervision and Regulation".

1 Summary of the Retail Banking Market in the UK

1.1 The Role of Retail Banks

Retail banks in the UK provide a range of banking services to meet the needs of their customers, which include borrowing, saving, transacting and protection. TSB participates in the retail banking market alongside other banks, building societies and other providers. TSB's primary focus is on meeting the needs of its personal banking customers, although it does also have some, predominantly 'micro', business banking customers (see *"Business Banking"* below). TSB does not participate in any other banking market.

Retail banks meet customers' needs by offering a range of products and services. These include personal current accounts ("**PCAs**"), savings accounts, mortgages, personal loans, credit cards, insurance products and investment products (a product line that TSB does not currently offer). These products are offered through a number of bank-owned distribution channels such as branches, telephone and digital channels (internet and mobile) and through third party distribution channels such as mortgage intermediaries.

1.2 Retail Bank Balance Sheets: Assets, Funding and Capital

The majority of a retail bank's assets consists of loans made to customers (including loans secured by mortgages). Those assets are funded by liabilities, including in the form of a mix of customer deposits and wholesale funding. Today, customer deposits are the main funding source for UK retail banks.

Banks are also required to hold capital to cover potential losses (including impairments). The amount of capital a bank is required to hold depends on the bank's total assets and the risk weighting of these assets (which depends on the risk profile of the underlying loans).

1.3 Retail Bank Income and Expenses

1.3.1 Retail banks have two primary sources of income: (a) interest income; and (b) fees and commissions income.

(a) Interest income is primarily earned by a bank lending money to customers and charging customers an interest rate on the amount lent. A bank earns interest income by lending money to customers at higher rates of interest than it costs the bank to borrow funds from depositors and/or wholesale markets. At a bank level, net interest income ("**Net Interest Income**") is the difference between the interest received on assets and that paid on liabilities. Net Interest Income is then used to determine the bank's overall net interest margin ("**NIM**"), which at a bank level is typically calculated as the bank's total Net Interest Income expressed as a percentage of the bank's average interest-earning assets during a year.

(b) Banks earn fees and commissions income by charging customers fees for services and receiving commissions from, and participating in profit sharing arrangements with, other product providers.

See *"How Retail Banks Make Money"* below for further information on retail banks' income.

1.3.2 Retail banks have two main categories of costs: (a) impairments; and (b) operating costs.

(a) Impairment charges are caused by losses on loans where customers have defaulted or are expected to default. Macro-economic conditions, and in particular house prices, interest rates and unemployment, are key drivers of impairment charges.

(b) A bank's operating costs typically consist primarily of costs relating to employees, IT and property. A common way of measuring a bank's operating cost efficiency is the cost:income ratio ("**CIR**"), which is defined as the ratio of operating costs (excluding impairments) to income.

In addition, recent years have seen increased volatility in the net profitability of retail banks in the UK as a result of conduct costs and provisions (mainly related to the mis-selling of PPI).

2 Background to the Retail Banking Market in the UK

2.1 Market Participants

There are a number of broad categories of participants in the retail banking market in the UK:

- *Banks:* These include *large established providers*, which typically have national coverage and a full retail banking product offering; *smaller established providers*, which may be more geographically focused; and *challenger banks,* which have entered the market over the last decade and which may have a more limited product range (sometimes excluding PCAs), may only use direct distribution channels, may have a more limited geographical footprint or may focus on specific customer segments.
- *Building societies:* These are owned by their members (i.e. customers) and not shareholders. Historically, they tended to focus on offering mortgages and savings products, but many now offer a broader range of retail banking products.
- *Credit unions*: These are small and localised non-profit making lending institutions, owned by their members, and typically serving those customers who are unable to access standard retail bank products through the established high street banks.
- *Monoline product providers:* These do not provide a full range of retail banking services, but focus on the provision of specific products, such as credit cards.
- *Specialist lenders*: These include short-term (or "pay-day") lenders, online specialists, peer-to-peer lending facilitators, crowd funding providers and specialist mortgage lenders.

Historically, a number of factors and capabilities have been important in determining the extent of the success of participants in the retail banking market. These factors are in addition to the standard market entry requirements, such as the relevant banking and credit licences, and sufficient capital and liquidity. They can be broadly categorised as follows:

- *Sufficient national and regional scale, including through a branch network,* given demand from many customers for a local branch presence and the importance of the branch channel for sales of many products;
- *A well-recognised brand and good reputation,* as customers seek a bank that they can trust to meet their banking needs and provide good value for money;
- *Access to banking technology (including digital banking channels),* which in particular affects the ability to service highly transactional products such as PCAs and to innovate and differentiate products versus competitors; and
- *Ability to generate sufficient profit to invest in the business*, in order to continue to improve the products, services and infrastructure of the business over time and thereby increase revenues.

The OFT[1] has also identified several of the above factors as being important in determining whether a bank is likely to be an effective competitor in the PCA and SME banking markets.

[1] Source: letter from OFT CEO to the Chancellor of the Exchequer, 11 September 2013

Market participants have adopted a number of strategies to enter and/or grow in the UK retail banking market over the last few decades. These strategies have included:

- *Growth driven by offering additional products to an established client base:* Following the Building Societies Act of 1986, a number of the largest building societies were able to offer PCAs and other banking products to their customers. By leveraging existing branch networks, customer relationships, recognised brands and investment in the technology platforms necessary to offer transactional banking products, many of these former building societies have successfully developed into significant participants in the broader retail banking market.
- *Leveraging a strong brand and/or customer franchise:* Several well-known consumer brands and retailers have entered the retail banking market. They have leveraged their strong brand, customer franchise and store/online footfall to attract customers and achieve material market positions. Typically, they have launched with a limited set of products (e.g. savings, loans and/or credit cards) reducing the required investment in banking technology.
- *Asset driven growth*: During the late 1980s to the early 2000s, a number of participants achieved rapid growth by focusing on the mortgage market. These participants relied heavily on wholesale funding to fund their mortgage assets. During the financial crisis, wholesale funding became more expensive and difficult for these banks to access, and resulted in the failure of a number of these participants.

2.2 Distribution and Customer Interaction

Retail banking products are offered to customers through a range of distribution channels. These include the banks' own channels, such as branches, telephone and digital channels (internet and mobile), and third party channels, such as intermediaries (sometimes called brokers), which are particularly important in the mortgage market, where intermediaries accounted for 54 per cent. of all new mortgage loans sold in 2013 (source: Bank of England, Council of Mortgage Lenders, excluding further advances).

The bank branch was traditionally the most common way in which individuals interacted with their retail bank. Branches remain an important channel, with 22 per cent. of customers saying they use their bank or building society branch at least once every two weeks (source: Payments Council[2]).

Over recent years customers have had a much broader choice of channels, including telephone banking and more recently digital banking (internet and mobile). The availability of additional channels has had a marked impact on the way customers interact with banks, and has driven a significant growth in overall customer contacts. Between 2003 and 2013, the percentage of adult customers using the internet for banking rose from 22 per cent. to 54 per cent. (source: Eurostat[3]). Growth in the numbers of customers using online channels has been much faster than the small decline witnessed in the number of customers regularly using branch and telephone channels, as customers increasingly interact with their banks through multiple channels.

2.3 Customer Perceptions

Key features of the current UK retail banking market include sustained low levels of consumer trust in established providers, and increased willingness of customers to consider alternatives for the provision of retail banking services. Research demonstrates that 75 per cent. of those surveyed believe that UK banking still has major problems, 80 per cent. do not believe that "banks put their customers first", 69 per cent. did not agree with the statement that "high street banks treat their customers fairly" and only 14 per cent. believe that "UK banks think more these days about their role in wider society and how they can contribute positively" (source: YouGov Research, May 2013).

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2 Payments Council, May 2011 http://www.paymentscouncil.org.uk/media_centre/press_releases/-/page/1523/. http://www.paymentscouncil.org.uk/media_centre/press_releases/-/page/1523/

3 Eurostat: http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&language=en&pcode=tin00099&plugin=0

3 Retail Bank Balance Sheets: Assets, Funding and Capital

The strength of a bank's balance sheet is of critical importance to its viability and success and is subject to significant regulatory scrutiny at a UK and European level.

3.1 Assets and Risk-Weighted Assets

The majority of a retail bank's assets consists of loans made to customers, which may be unsecured (e.g. personal loans and credit cards) or secured (e.g. mortgages). Each asset (or group of assets) is assigned a "risk weighting", which is a measure of how much risk the bank is exposed to on that asset (or group of assets) and is based on an assessment of credit risk. A further overall risk weighting for market and operational risks is added at a bank level. The resulting measure is known as risk-weighted assets ("**RWA**") and is typically lower than total assets for a retail bank. There are two models which banks apply to determine the risk weightings applied to assets in respect of credit risk, which, together with total assets, determine the levels of capital the bank is required to hold:

- *Standardised approach:* Banks in the EU use standardised risk weightings (set in accordance with the Capital Requirements Directive, regulatory technical standards published by the European Banking Authority and local regulatory guidance) to determine risk-weightings for credit risk; or
- *Advanced or Internal Ratings Based ("**IRB**") approach:* Banks use their own empirical models to determine risk weightings for credit risk. Banks in the UK can use the "Advanced" or "IRB" approach only with the approval of the PRA.

3.2 Funding

Banks' assets are typically funded by a mix of customer deposits, wholesale funding and capital. Customer deposits are the main funding source for most retail banks today. Wholesale funding may be unsecured or collateralised with the bank's assets (for example, in the form of residential mortgage backed securitisations).

3.3 Capital and Liquidity

In the UK, the minimum capital and liquidity required to be held by a retail bank are established through discussions between that retail bank and the PRA and are set by the PRA in the form of Individual Capital Guidance ("**ICG**") and Individual Liquidity Guidance ("**ILG**"). The PRA sets a retail bank's ICG and ILG following submission by that bank of an Internal Capital Adequacy Assessment Process ("**ICAAP**") and an Individual Liquidity Adequacy Assessment ("**ILAA**"). Typically a bank will hold a capital and liquidity buffer above these minimum requirements. This is the approach followed by TSB.

Capital

A bank's ability to absorb losses is determined by the amount of capital it holds. Consequently, a bank's total assets and RWAs determine the minimum capital the bank is required to hold. Three types of capital (among others) are defined by the Capital Requirements Regulation:

- Common Equity Tier 1 ("**CET1**") Capital: comprising common equity and retained earnings;
- Additional Tier 1 Capital: comprising deeply subordinated perpetual instruments issued in accordance with the requirements of the Capital Requirements Regulation; and
- Tier 2 Capital: comprising dated or perpetual subordinated instruments issued in accordance with the requirements of the Capital Requirements Regulation as well as: (i) any share premium account generated by the issuance of such instruments; and (ii) certain other risk-weighted exposure amounts.

The principal metrics used to assess capital strength are the Common Equity Tier 1 Capital Ratio and the Leverage Ratio. For details in relation to the methodology used by TSB to calculate its Common Equity Tier 1 Capital Ratio and Leverage Ratio, see notes (5) and (6) to Part XVIII: *"Unaudited Pro forma Financial Information"*.

In the UK, the PRA currently requires banks and building societies to meet a minimum 7 per cent. Common Equity Tier 1 Capital Ratio and a minimum 3 per cent. Leverage Ratio. However, the PRA expects banks and building societies to hold significant buffers above these levels and is reviewing the minimum Leverage Ratio requirements.

Liquidity

A bank's ability to manage shocks to the financial system is assessed by the extent to which its assets are covered by funding with equal or longer maturity. The principal metrics to assess bank long term funding are the Loan to Deposit Ratio, Net Stable Funding Ratio and the Liquidity Coverage Ratio.

- The Loan to Deposit Ratio ("**LDR**") is defined as the ratio of total customer loans to deposits. While the PRA does not officially set a maximum limit for this ratio, reducing the LDR has been a key focus of UK retail banks since the financial crisis.
- The Net Stable Funding Ratio ("**NSFR**") is a key component of Basel III due to come into force in 2018. The ratio seeks to calculate the proportion of long-term assets which are funded by long term, stable funding. The Basel III regulations state that a bank's NSFR must be at least 100 per cent.
- The Liquidity Coverage Ratio ("**LCR**") is designed to ensure that financial institutions have the necessary assets available to withstand short-term liquidity disruptions. Banks are required to hold an amount of highly liquid assets equal to or greater than their net cash outflow over a 30-day period. The LCR will be introduced in January 2015, but subject to a phased implementation such that the full 100 per cent. minimum will not be enforced until 2019.

Further detail on capital adequacy and the regulatory minimum standards is set out in Part XIX: "*Supervision and Regulation*". Information in relation to TSB's capital and liquidity is set out in Part X: "*Information on the TSB Group* – Capitalisation, liquidity and sources of funding".

4 How Retail Banks Make Money

Retail banks principally generate income in two ways, by earning Net Interest Income and fees and commissions income. Banks also incur costs in a number of forms, including impairment charges and operating costs. Additionally, in recent years, many banks have incurred significant non-recurring costs associated with customer redress (for example, in the context of PPI mis-selling).

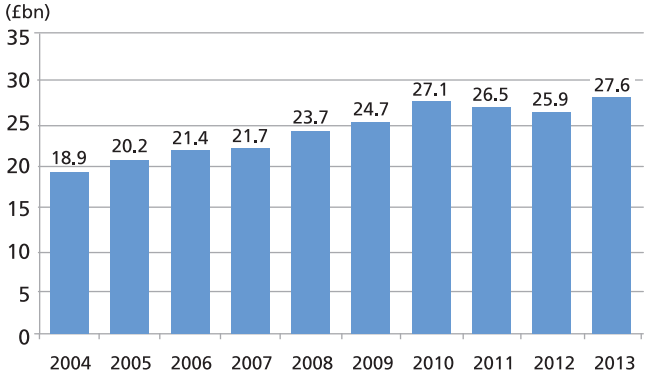
A bank's profit comes from the difference between its income and its costs. Where "profit" is referred to in this Part VIII, it is used as a measure of underlying profitability (income less impairment and operating expenses) and excludes one-off items or timing of profit recognition items (such as hedge volatility). This may therefore be different from a bank's reported profitability.

4.1 Net Interest Income

As illustrated in Exhibit 1 (source: Annual Reports), it is estimated that Net Interest Income (see *"Summary of Retail Banking Market in the UK - Retail Bank Income and Expense"* above for an explanation of Net Interest Income and NIM) for the retail banking divisions of the six largest UK retail banks and building societies rose steadily in the period between 2004 and 2010 (from £18.9 billion to £27.1 billion) and remained relatively stable in the period between 2010 and 2013.

Exhibit 1:

Net Interest Income for the retail banking divisions of the 6 largest UK retail banks and building societies (source: Annual Reports)



In addition to measuring Net Interest Income and NIM at a bank level, banks also use a variation of the concepts of Net Interest Income and NIM at a product level ("**Product Net Interest Income**" and "**Product NIM**"). Product Net Interest Income and Product NIM are used for internal purposes by a bank's management to reflect and monitor relative performance/profitability of a particular product or range of products.

The meanings of "Product NIM" and "Product Net Interest Income" when applied to customer loans (assets) is slightly different to their meanings when applied to customer deposits (liabilities). In all cases, the starting point for the determination of Product NIM is the "**Customer Rate**", being the interest rate charged to the customer (in the case of loans) or paid to the customer (in the case of deposits).

For a customer loan, the Product NIM is defined as the applicable Customer Rate less the applicable "**Cost of Funds**", which is an internal estimate of how much it costs the bank to raise the funding required to provide that customer loan. In other words, Product Net Interest Income and Product NIM for loans/assets measures the difference between: (i) the income generated by the assets; and (ii) the estimated cost to the bank of funding the assets.

For a customer deposit, the Product NIM is defined as the applicable "**Value of Funds**", which is an internal estimate of how valuable that deposit is to the bank as a source of funding, less the applicable Customer Rate.

The Cost of Funds and Value of Funds vary by product and depend on that product's characteristics, most notably its expected lifetime (often referred to as its "**behavioural maturity**"). The Cost/Value of Funds is typically higher for products with longer behavioural maturities. Banks have different approaches to calculating their internal Cost of Funds and Value of Funds, but most banks use the cost of wholesale funding with the same behavioural maturity as the relevant product. For loans and deposits of the same behavioural maturity, the Cost of Funds and Value of Funds are typically very similar.

Product Net Interest Income for a given product is defined as the applicable Product NIM multiplied by the outstanding balance of assets or liabilities for that product.

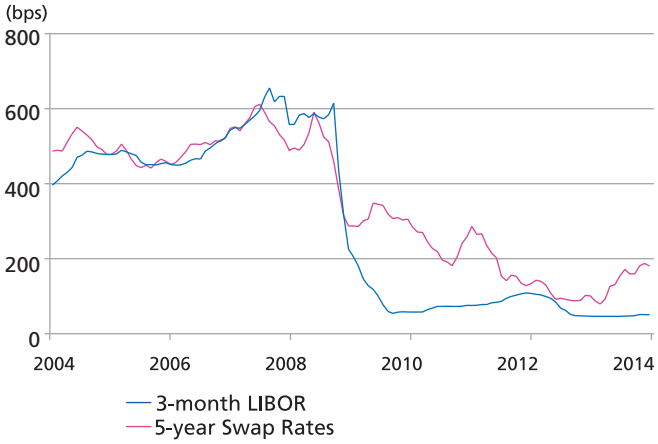
For the purpose of presenting Product NIM trends in a consistent way throughout this Part VIII, three-month LIBOR has been used as a proxy for both the Cost of Funds and the Value of Funds. When calculated in this way, the sum of the Product NIM on liabilities (weighted average) and the Product NIM on assets (weighted average) results in a close approximation to overall bank NIM, but is illustrative only.

Interest Rate Sensitivity

Product Net Interest Income (and therefore Product NIM) for loans/assets and for deposits/ liabilities is sensitive to changes in the prevailing interest rate environment. Exhibit 2 shows the evolution of three-month LIBOR and five-year swap rates since 2004[4]. These are two key measures of the prevailing interest rate environment. Three-month LIBOR fell rapidly during 2008 and 2009. Five-year swap rates are a forward-looking measure, and are illustrative of the expected average interest rate over the subsequent five years. Five-year swap rates did not fall as rapidly as three-month LIBOR during the same period. Note that the historical five-year swap rates illustrated in Exhibit 2 are for market rates achieved by Lloyds Banking Group, which the TSB Board believes are illustrative of the five-year swap rates for TSB Bank over the period shown.

Exhibit 2:

Comparison of three-month LIBOR and five-year Swap Rates (source: Bank of England, Lloyds Banking Group)



Customer Rates on new lending and deposit products tend to move in response to changes in three-month LIBOR and swap rates.

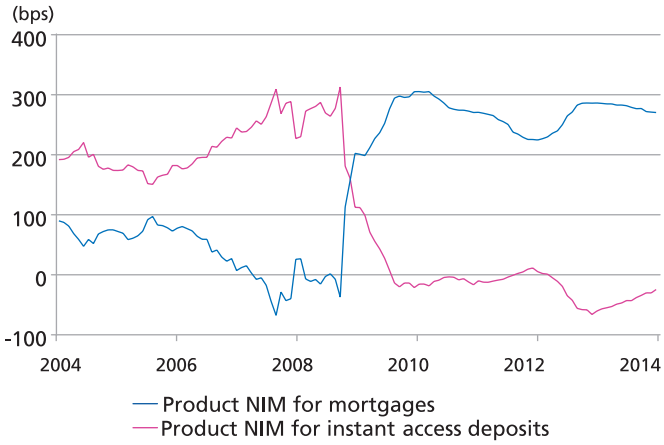
The sensitivity of lending and deposit Product NIM to changes in the prevailing Bank of England base rate is illustrated in Exhibit 3[5] which shows historical trends in the difference between: (i) the average Customer Rate paid by a mortgage customer less three-month LIBOR (which is used for the purposes of illustration as a proxy for mortgage Product NIM); and (ii) three-month LIBOR less the average Customer Rate received by a savings customer (which is used for the purposes of illustration as a proxy for savings Product NIM). Lending Product NIM increased significantly and deposit Product NIM reduced significantly as prevailing interest rates fell during 2008 and 2009. Note that the mortgages data series illustrated in Exhibit 3 shows Product NIM for household loans secured on dwellings as reported by the Bank of England, which the TSB Board believes to be a reasonable approximation to the Product NIM for household mortgages. The savings data series illustrated in Exhibit 3 shows Product NIM for interest bearing sight deposits (deposits that can be withdrawn without advance notice) from households, which the TSB Board believes to be a reasonable approximation to the Product NIM for instant access household deposits.

4 Calculated from Bank of England series IUMAAMIJ. Data series shown until 28 February 2014

5 Calculated from Bank of England series CFMHSDE, IUMAAMIJ and CFMHSCV. Data series shown until 28 February 2014

Exhibit 3:

Comparison of illustrative Product NIM for mortgages and instant access deposits (source: Calculated from Bank of England)



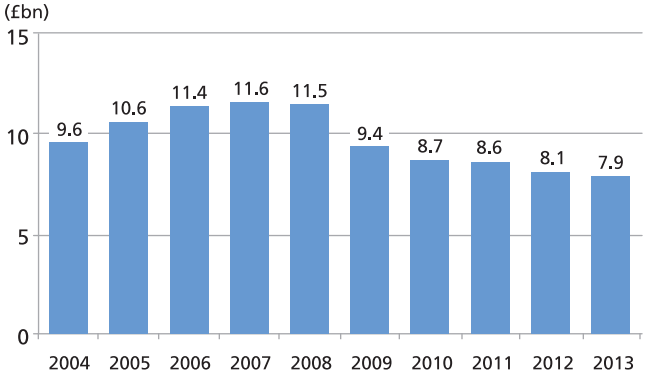
4.2 Fees and Commissions Income

Banks charge customers fees for a variety of services, and receive commissions for the distribution of a variety of products, most notably insurance and investment products. These are typically recorded as fees and commissions income. In aggregate, fees are estimated to have represented 22 per cent. of total banking income for the six largest UK retail banks and building societies in 2013 (source: Annual Reports).

The drivers of fee income vary by product. Fee income has come under significant regulatory scrutiny over the last decade, particularly around the level and transparency with which customer fees are charged. Recently this has focused on the fees for added value accounts ("**AVAs**") (accounts that provide additional products as part of the PCA) and overdraft charges. There has been an overall reduction in fees since 2004. Exhibit 4 (source: Annual Reports) shows fees and commissions income for the retail banking divisions of the six largest UK banks and building societies falling from £11.6 billion in 2007 to £7.9 billion in 2013.

Exhibit 4:

Fees and Commissions income for the retail banking divisions of the six largest UK retail banks and building societies (source: Annual Reports)



4.3 Impairments

When a customer does not repay a loan, a retail bank may incur a loss. These losses are known as impairments. Impairments may also arise when a customer is not expected to repay a loan. Banks aim to ensure that asset pricing through the economic cycle is sufficient to cover impairments as and when they arise.

Impairment losses tend to be higher on unsecured assets than on secured assets (such as those secured on residential property) as, in the case of secured assets, the bank is able to repossess and sell the property in order to repay some or all of the loan. For secured assets, the extent to

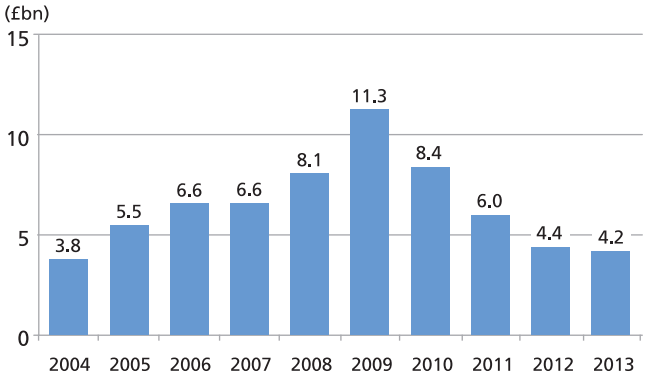
which the value of the security is greater than the loan amount is an important determinant of credit risk. Low Indexed LTV mortgages (i.e. where the size of the outstanding balance of an existing mortgage loan is low relative to the indexed value of the property on which it is secured) will have lower impairments than high Indexed LTV mortgages, as the likelihood that the proceeds from selling a repossessed property can cover the outstanding balance of the loan is increased.

Macro-economic conditions, and in particular house prices, interest rates and unemployment, are key drivers of impairment levels. House prices are the main determinants of a bank's ability to recoup losses on property taken as security. Rising interest rates typically increase borrowers' monthly repayments and some customers may struggle to make scheduled loan repayments. Changes in unemployment levels also drive levels of failures to make repayments. Further information relating to how these factors affect TSB is set out in Part II: *"Risk Factors"*.

As detailed in Exhibit 5 (source: Annual Reports), impairments for the six largest UK retail banks and building societies rose during the years of the financial crisis, but have since returned to pre-crisis levels as the economy has returned to growth, unemployment has fallen, interest rates have remained low and risk appetite has tightened as UK retail banks have sought to reduce their LDRs.

Exhibit 5:

Total impairments for the retail banking divisions of the six largest UK retail banks and building societies (source: Annual Reports)



4.4 Operating Costs

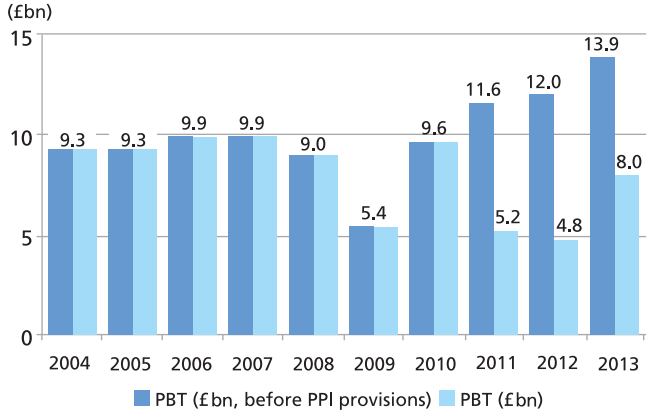
A retail bank's operating costs typically consist primarily of costs relating to employees, IT and property. A common way of measuring a bank's operating cost efficiency is its CIR, which is defined as the ratio of operating costs (excluding impairments) to income, and is a measure of cost efficiency. The overall CIR for the six largest UK retail banks and building societies has been broadly flat over recent years (source: Annual Reports) as cost reduction initiatives and increased automation have helped banks offset the increasing costs of regulation and compliance.

4.5 Profitability

The underlying profitability of the six largest UK retail banks and building societies (as measured by income less impairment and operating expenses) was £13.9 billion in 2013. Underlying profitability dropped sharply during the financial crisis but has rebounded since, as illustrated in Exhibit 6 (source: Annual Reports).

Exhibit 6:

Calculated Profit Before Tax for the retail banking divisions of the six largest UK retail banks and building societies (source: Annual Reports)



4.6 Regulatory Costs and Provisions

A recent factor impacting the reported profitability of UK retail banks has been regulatory and conduct-related costs. The largest of these costs relate to fines and payments for the mis-selling of PPI. As of year-end 2013, the total provisions made by the six largest UK retail banks and building societies to cover the cost of PPI mis-selling and other conduct-related issues was £19.6 billion (source: Annual Reports). This was equivalent to 52 per cent. of pre-tax profit during the period 2011 to 2013.

5 Role of Government Support Schemes

The UK Government plays an important role in the retail banking market through its interventions to support the UK economy. A number of Government schemes have been introduced over recent years to support the UK economy, including the 'Funding for Lending Scheme', 'Help to Buy 1' and 'Help to Buy 2'.

The Funding for Lending Scheme ("**FLS**") was introduced in July 2012. It provides banks and building societies with lower-cost collateralised funding to support lending to individuals (such lending has now ceased under the scheme) and small businesses (until January 2015 when the scheme will be withdrawn). FLS has had an impact on bank funding costs, which fell by between 0.7 and 1.5 percentage points between June 2012 and October 2013 (source: Bank of England[6]). In addition to increasing lending to individuals and small businesses, FLS has had a material impact on the savings market in the UK. Banks and building societies have used FLS as an alternative to more expensive deposit funding. Consequently, over the course of the second half of 2012 and during 2013, savings rates for new deposits fell (for further information, see *"Savings Accounts"* below). The availability of lower-cost funding (both directly from the FLS and indirectly from lower-cost customer deposit funding) has allowed banks to reduce pricing on customer lending whilst maintaining overall levels of profitability.

Help to Buy 1 was introduced by the Government in April 2013 to provide £3.5 billion of mortgage support over three years, mainly targeted at new builds and the first time buyers market (source: Homes and Communities Agency[7]). Help to Buy 2 is a scheme also designed to encourage mortgage lending, with the Government providing a guarantee to lenders of up to 15 per cent. of a loan's value. The Government has made available up to £12 billion of support over the three years to 2 January 2017 in the form of Government guarantees (source: UK Government[8]), which it believes is sufficient to support c.£130 billion of gross mortgage lending. Help to Buy 2 enables more customers to gain access to mortgage lending and, if fully utilised, could result in up to c.£40 to 45 billion of additional lending per year, representing approximately 25 per cent. of the overall

6 Bank of England, http://www.bankofengland.co.uk/publications/Pages/news/2013/100.aspx

7 http://www.homesandcommunities.co.uk/news/homes-and-communities-agency-strong-position-deliver-%C2%A345bn-budget-investment

8 http://www.cml.org.uk/cml/policy/issues/6850, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/221897/help_to_buy_mortgage_guarantee_scheme_outline.pdf

market (total gross mortgage lending in 2013 was £176 billion; source: Council of Mortgage Lenders[9]). The introduction of the Help to Buy 2 scheme has already improved the availability[10] of higher loan-to-value ("**LTV**") mortgages (i.e. where the size of the mortgage loan at origination is high relative to the value of the property at completion on which it is secured) and reduced new business rates on those mortgages.

6 Personal Current Accounts

6.1 Introduction to PCAs

A PCA is central to most retail customers' personal finances, and it typically defines their primary relationship with a bank. A PCA provides the facility to hold deposits, receive and make payments (e.g. using debit cards, online payments, direct debits, standing orders, continuous payment authorities and cheques) and to use ATMs. Additionally, many PCAs have overdraft facilities that provide customers with an available line of credit. The UK Government, through the FSCS, guarantees deposits (including PCA deposits) up to £85,000 per customer of an authorised financial services firm.

Retail banking is a mature market. An OFT study published in January 2013 notes that 94 per cent. of UK adults hold at least one PCA and 40 per cent. have more than one (source: Office of Fair Trading: Review of the Personal Current Account, January 2013, (the "**OFT PCA Review**")). Across the market, new PCA openings have been stable at 5.5 to 6 million per year over 2011 to 2013 (source: CACI Current and Savings Account market database (CSDB)[11]). There are three principal types of PCA:

- *Standard Accounts (67 per cent. of total number of active accounts)* (source: OFT PCA Review) typically offer 'Free if in Credit' banking with no annual/monthly fixed charge. Banks may apply additional charges for unarranged borrowing and for non-standard services.
- *AVAs, or Packaged Accounts (17 per cent.*) provide additional products packaged with the PCA in return for a fixed monthly charge (typically in the range of £5 to £15). Such products can include mobile phone insurance and car breakdown cover.
- *Basic Accounts (9 per cent.)* provide a simple cash deposit and withdrawal and payments service without access to an overdraft facility or any credit.

There are, in addition, several other account types which collectively form approximately 7 per cent. of the total market. These include Student Accounts and Youth Accounts.

PCA customers are considered to be very valuable by banks as they have historically been likely to hold other products (such as mortgages, savings and loans) with the bank providing their PCA. PCAs also provide a valuable source of stable, long-term funding which is typically lower cost for the banks than savings deposits or wholesale funding.

6.2 PCA Distribution Channels

Historically, branches have been the most important channel for PCA sales, and there is a strong correlation between a UK bank's national share of branches and its PCA market share. On a year on year basis, a growing percentage of PCAs are also set up via online channels, which are growing in importance in this regard. Technology has increased the channels available for customers to interact with their PCAs, and there has been a significant increase in the number of online and mobile transactions.

6.3 The PCA Competitive Landscape

The five largest providers in the UK PCA market have between them a market share of approximately 85 per cent. (source: Mintel banking overviews, quoted in OFT Review of the Personal Current Account market 2013, p46). A number of challenger banks have gained

9 Council of Mortgage Lenders: Gross mortgage lending, not seasonally adjusted, January 2013

10 http://www.bankofengland.co.uk/publications/Documents/other/monetary/ccs/creditconditionssurvey 140403.pdf

11 Annual flow excludes account upgrades

market share in recent years, and several other challenger banks have signalled their intent to enter the PCA market.

In the third quarter of 2012, the percentage of PCA holders that switched PCA in the preceding 12 months was 3.1 per cent. (source: OFT PCA Review). An OFT survey published in January 2013 found that 75 per cent. of customers surveyed had never changed PCA provider and, of those, 75 per cent. had never considered switching (source: OFT PCA Review).

In September 2013, the UK Payments Council introduced a seven-day switching guarantee scheme. The scheme provides a guarantee (by the bank or building society signed up to it) that an account can be switched within seven working days, with all existing payment arrangements automatically transferred to the transferee account. Thirty-three bank brands (including TSB) have agreed to participate, together accounting for almost all of the UK PCA market (source: UK Payments Council[12]). Between August 2013 and March 2014, the percentage of adults in England, Scotland and Wales aware of the switching guarantee rose from 26 per cent. to 61 per cent. (source: TNS Switching Index, March 2014) and, following the introduction of the switching guarantee scheme, there was a 14 per cent. increase in PCA switching volumes in the market between 1 October 2013 and 31 March 2014 as against the same six-month period a year earlier[13].

6.4 UK PCA Market: Key Metrics

There are approximately 76 million PCAs in the UK, of which approximately 61 million are "active" (source: OFT PCA Review). Since 2007, the number of PCA accounts in the UK has grown by 9.4 per cent. (source: OFT PCA Review).

Total customer deposit and lending (overdraft) balances are another key measure of the PCA market, as these are key drivers of profitability. As at 31 December 2013, there were £169 billion of PCA deposit balances in the UK (source: CACI Current and Savings Account Market Database). As at 31 December 2013, there were £7.9 billion of outstanding PCA overdraft balances in the UK (source: BBA[14]).

6.5 PCA Revenues and Profits: How Retail Banks make Money from PCAs – Interest and Fees and Commissions Income

The principal sources of income generated by PCAs for their providers are Product Net Interest Income on deposits and overdraft balances, and fees and commissions income from the provision of banking services. According to the OFT, the total income earned by providers of PCAs increased from £8.3 billion in 2007 to £8.8 billion in 2011 (source: OFT PCA Review).

12 UK Payments Council: http://www.paymentscouncil.org.uk/switch_service/who_is_participating/

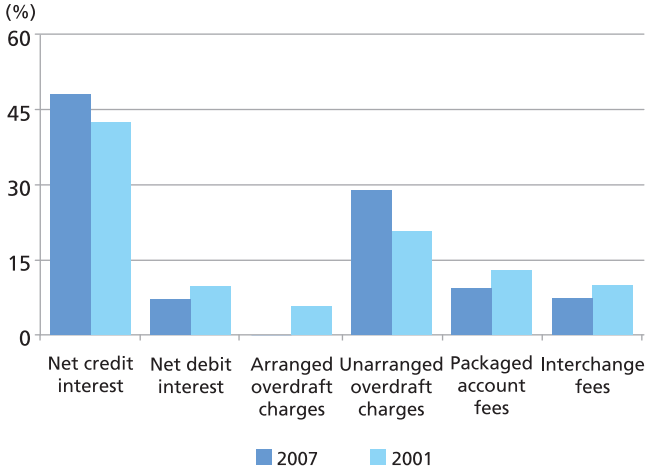
13 http://www.paymentscouncil.org.uk/media_centre/press_releases/-/page/2863/

14 https://www.bba.org.uk/news/statistics/high-street-banking/december-2013-figures-for-the-high-street-banks/

As shown in Exhibit 7, Product Net Interest Income is the largest component of PCA income. As PCAs are, for banks, both liabilities (in the form of credit balances) and assets (in the form of overdrafts), there are two types of Product Net Interest Income for PCAs, those relating to credit balances and those relating to overdraft debit balances. Banks have significantly greater balances of customer deposits in PCAs than customer overdrafts. Consequently Product Net Interest Income from customers' PCA deposits (shown in Exhibit 7 as "Net credit interest") is greater than Product Net Interest Income for customers' overdraft balances (shown as "Net debit interest").

Exhibit 7:

Components of total PCA income in 2007 and 2011 (source: OFT PCA Review)



As outlined in *"How Retail Banks Make Money – Net Interest Income"* above, the Value of Funds assigned by a bank to deposit balances depends (in part) on the expected behavioural maturity of those deposits. Banks typically view PCA deposits as having a relatively long maturity (generally more than five years). Consequently, banks receive a high Value of Funds and the Product NIM on deposit balances is higher than on many other types of deposits.

The total Net Interest Income for PCAs in 2007 and 2011 shows minimal change at £4.6 billion (source: OFT PCA Review). While deposit Product NIM declined slightly during the same period, this was offset by growth in PCA deposit balances and higher overdraft Product NIMs (source: OFT PCA Review).

Fees and commissions income from PCAs is largely from fees on unarranged and arranged overdrafts, AVAs and interchange fees (source: OFT PCA Review). In 2011, these fees generated £4.2 billion of revenues for providers of PCAs, up from £3.7 billion in 2007. The share of overall PCA income represented by fee income increased from 45 per cent. in 2007 to 48 per cent. in 2011 (source: OFT PCA Review).

Following a review in 2011 of AVAs, the FSA expressed concerns that customers may be too easily sold an AVA with features they neither understand nor need. New rules came into force in March 2013 requiring providers to check whether customers are eligible to claim on insurance cover (a typical AVA feature) before selling them the product, and to provide an annual eligibility statement (source: OFT PCA Review).

The rise in interchange fees has been driven by an increase in the number of debit card transactions for purchases in the UK and a rise in interchange fees per transaction. In July 2013, the European Commission published plans to cap debit card interchange fees at the lower of 0.20 per cent. and €0.07 (source: European Commission[15]). On 3 April 2014, the European Parliament voted to adopt the plans and, if they enter EU legislation, they are likely to reduce interchange revenue[16].

15 European Commission: Payment Services Directive and Interchange Fees Regulation: frequently asked questions, July 2013

16 European Parliament press release, April 2014: MEPs push for card payment fee caps and online payment safeguards

7 Savings Accounts

7.1 Introduction to Savings Accounts

Savings accounts allow customers to deposit cash funds and receive interest on those funds. There are two main types of savings accounts:

- *Fixed rate savings accounts* (sometimes referred to as "Time" or "Term" deposits) offer a fixed interest rate for a fixed term.
- *Variable rate savings accounts* pay a variable rate of interest (which may change at the discretion of the bank or building society but often moves in response to changes in the prevailing Bank of England base rate).

A subset of fixed and variable rate savings accounts are cash ISAs, the income generated from which is exempt from tax.

7.2 Savings Distribution Channels

Savings accounts are distributed through multiple channels. While the number of savings accounts distributed via the internet is growing relative to other channels, the majority of savings accounts are still distributed through branches. Some banks offer different savings rates through different channels.

7.3 The Savings Competitive Landscape

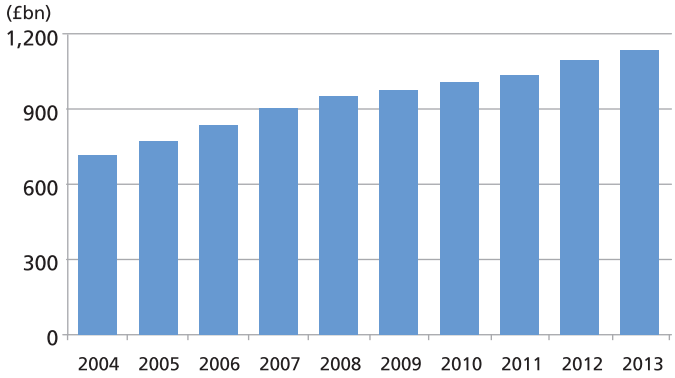
As at 17 October 2013, there were 40 authorised providers of cash-based savings accounts across the UK (source: FCA[17]). Excluding the Government's National Savings and Investments, (a significant provider with over £100 billion of customer deposits), as at 30 April 2014, the five largest providers had over 50 per cent market share (source: NS&I website, BoE data set LPMVWLM, GfK NoP Ltd[18]).

7.4 Savings Market: Key Metrics

The overall size of the UK savings market can be measured in terms of total deposit balances. Total household deposits (including PCA balances) stood at £1,138 billion as at 31 December 2013 (source: Bank of England[19]) as shown in Exhibit 8. The UK savings ratio (the amount that UK households save as a proportion of disposable income) is a key determinant of the growth of savings balances. It is currently broadly in line with the average over the last 20 years, having increased from its historical low in 2008 (source: ONS[20]). Over the past three years, household deposit balances have grown at 4.1 per cent. per annum CAGR (source: Bank of England[21]).

Exhibit 8:

Monetary Financial Institutions
Sterling Deposits from Households
(source: Bank of England)



17 http://www.fca.org.uk/consumers/complaints-and-compensation/how-to-claim-compensation/banking-and-saving/banking-and-savings-brands

18 All with savings account excluding National Savings© GfK NoP Ltd. Financial Research Survey (FRS) 6 months including April 2014, 30,833 adults interviewed

19 Bank of England series LPMVWLM

20 ONS: http://www.ons.gov.uk/ons/datasets-and-tables/data-selector.html?cdid=NRJS&dataset=qna&table-id=J3

21 Bank of England series LPMVWLM

Savings customer rates fell significantly during 2008 and 2009 as the Bank of England base rate fell to historically low levels. Through 2010 to 2012, savings customer rates increased gradually as banks offered very attractive fixed rate savings rates as they sought to reduce their LDR and reliance on wholesale funding. However, since the second half of 2012, average savings customer rates on new deposits have fallen, partly driven by the FLS and a reduction in average LDR, both of which have reduced bank/building society need for deposits.

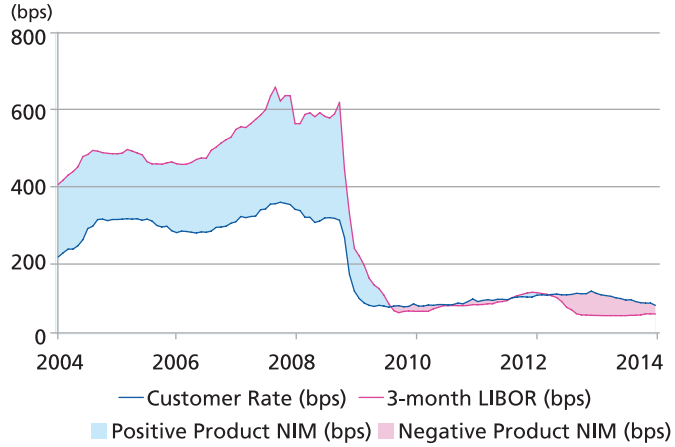
7.5 Savings Revenues and Profits: How Retail Banks make Money from Savings

The key source of income for providers of savings accounts is Product Net Interest Income on savings balances. Savings Product NIM has fallen significantly since 2008 as customer rates have not fallen as quickly as the value of funds. As shown in Exhibit 9[22], the difference between three-month LIBOR and the average savings customer rate (which is used for the purposes of illustration as a proxy for NIM) was 255 bps in 2008 for instant access deposits, compared to -47 bps for 2013 (source: Bank of England). The same trend also impacted time deposits, where the Product NIM fell from 60 bps in 2008 to -208 bps during 2013[23].

During the second half of 2012 and during 2013, reduced competition for deposits following the introduction of FLS led to lower customer rates and, consequently, higher (i.e. less negative) Product NIM. Note that the savings data series illustrated in Exhibit 9 shows Customer Rate and Product NIM for interest bearing sight deposits from households, which the TSB Board believes to be a close approximation to the Customer Rate and Product NIM for instant access household savings deposits.

Exhibit 9:

Customer Rate and illustrative Product NIM for household instant-access deposits (source: Calculated from Bank of England)



8 Mortgages

8.1 Introduction to Mortgages

The most common form of financing used by individuals in the UK to purchase residential property is a loan secured by a mortgage (such loans being commonly referred to as "mortgages"), using the property as collateral against the amount borrowed. In the UK, a mortgage is typically repaid, with interest, over a 20 to 35 year period through regular monthly payments. There are two principal types of mortgage products:

- *Owner-occupied mortgages* are loans provided to owner-occupiers. This market can be further sub-divided into first time buyers, re-mortgages and home-movers. This is the largest segment of the mortgage market and accounted for 82 per cent. of gross new mortgage lending in 2013 (source: Council of Mortgage Lenders[24]).

22 Calculated from Bank of England series CFMHSCV, CFMHSCW and IUMAAMIJ. Data series shown until 28 February 2014

23 Calculated from Bank of England series CFMHSCW and IUMAAMIJ

24 Council of Mortgage Lenders: Table MM22; Gross advances by purpose of loan, PRA/FCA data

- *Buy-to-let (BTL) mortgages* provide financing for individuals who intend to let the purchased property. In 2013, BTL mortgages represented 12 per cent. of gross new mortgage lending (source: Council of Mortgage Lenders[25]).

Sub-sets of these two principal kinds of mortgages include equity release mortgages, offset mortgages, 'jumbo' mortgages (typically loans of more than £1 million) and self-build mortgages. In aggregate, these represent a small part of the overall market.

New mortgages often have an introductory interest rate which can be fixed or variable and which typically applies for a period of one to five years.

Following the introductory period, the customer rate reverts to a discretionary rate set by a mortgage provider, which is typically set by reference to, but is not necessarily the same as, the Bank of England base rate. Historically, some mortgage providers contractually linked their discretionary rate to the Bank of England base rate, and some of these loans are still outstanding. At 31 December 2013, 67 per cent. of total outstanding balances were subject to a variable rate and 33 per cent. were subject to a fixed rate (source: Council of Mortgages Lenders[26]).

Mortgages are most commonly 'repayment' or 'interest-only' (and can be part repayment/part interest-only). Due to concerns regarding customer ability to repay at the end of the term, many market participants have withdrawn from the sale of interest-only mortgages.

Mortgage interest rates vary depending on the size of the mortgage loan at origination relative to the value of the property at completion on which the mortgage is secured (LTV Ratio) and the type of mortgage. Mortgage rates increase with LTVs because the impairment risk increases and higher LTVs can be subject to higher capital requirements. The average Indexed LTV across the largest mortgage providers in the UK was 57 per cent. in 2012 (source: Council of Mortgage Lenders and Annual Reports[27]). BTL mortgages tend to have higher rates than home purchase mortgages at comparable LTVs.

8.2 Mortgage Distribution Channels

The majority of mortgages are provided 'face to face' by a bank mortgage adviser or an intermediary. An August 2013 survey showed that while the majority of consumers used a face to face channel when applying for their mortgages, about a quarter also used the online channel during their mortgage application (source: Datamonitor[28]). In 2013, 54 per cent. of gross new mortgage lending (excluding further advances) was written through intermediaries (source: Bank of England/Council of Mortgage Lenders[29]). Intermediaries are typically able to advise clients on a broad range of mortgage products from multiple providers. Today, a relatively small number of large mortgage intermediaries account for the majority of mortgage intermediary lending. Between January 2013 and November 2013, the ten largest intermediaries accounted for nearly 85 per cent. of intermediary lending (source: Touchstone, January to November 2013[30]). Consequently, banks need a relatively small number of intermediary relationships to access a significant proportion of this market.

8.3 The Mortgages Competitive Landscape

In April 2014, 89 mortgage lenders undertook the majority of mortgage lending in the UK (source: Moneyfacts[31]). In the fourth quarter of 2013, the five largest providers in the UK mortgage market had between them a c.66 per cent. market share of outstanding mortgage balances (source: Bank of England[32]).

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25 Council of Mortgage Lenders: Table MM22: Gross advances by purpose of loan, PRA/FCA data. Remaining lending consists largely of further advances on owner-occupied or BTL mortgages

26 Council of Mortgages Lenders: Table MM19; balances outstanding by interest rate type and bank rate premium

27 Council of Mortgage Lenders: Market Share from Council of Mortgages Lenders and LTV from annual reports

28 Datamonitor: What Consumers Want: Mortgage Product, Provider and Channel Positioning, 2013

29 Council of Mortgage Lenders: Table RM56MA, Distribution Channels, Regulated Mortgage Survey

30 Touchstone Applications data

31 Moneyfacts database, 15/04/14

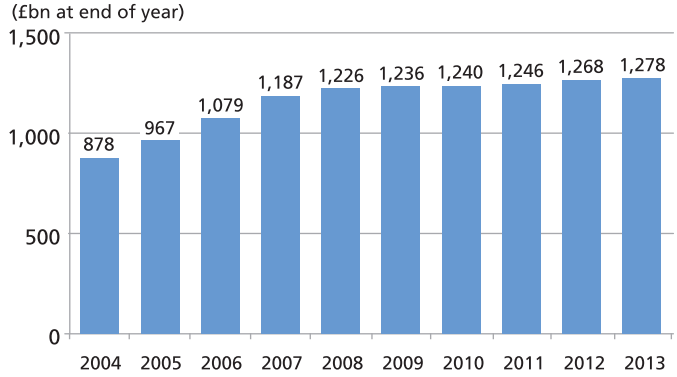
32 Bank of England dataset LPMVTXH and TSB calculations

8.4 Mortgage Market: Key Metrics

The total value of outstanding mortgage balances in the UK was £1.28 trillion as at 31 December 2013 as shown in Exhibit 10, and has been relatively stable over recent years, with a CAGR of only 1.0 per cent. per annum for the three years to 31 December 2013 (source: Bank of England[33]). Note that the data series illustrated in Exhibit 10 shows total outstanding secured lending to individuals and housing associations as reported by the Bank of England, which the TSB Board believes to be a reasonable approximation to total outstanding balances for household mortgages.

Exhibit 10:

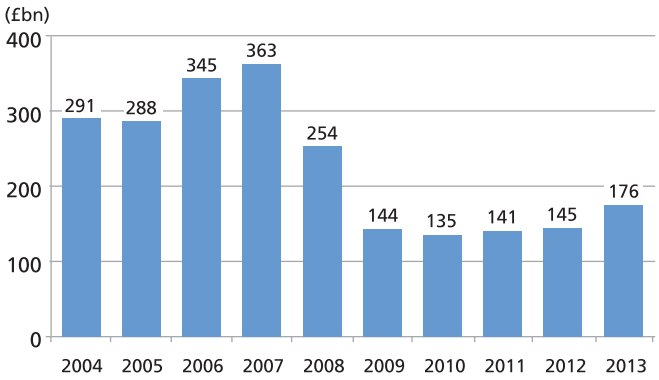
Total outstanding mortgage lending to individuals and housing associations (source: Bank of England)



There has been a significant reduction in gross lending from the pre-crisis peak, as shown in Exhibit 11. Gross lending in 2007 was £363 billion compared to £176 billion in 2013 (source: Council of Mortgage Lenders[34]). The mortgage market grew strongly in the second half of 2013: quarterly gross lending volumes in the third and fourth quarter of 2013 were 30+ per cent. higher than for the same quarters in 2012 (source: Council of Mortgage Lenders[35]).

Exhibit 11:

Gross new mortgage lending per annum (source: CML)



Customer demand for mortgages is affected by the strength of the housing market, amongst other factors. The number of housing transactions per calendar year fell by 48 per cent. from 2007 to 2009, from 1.67 million to 0.85 million; by 2013 it had increased to 1.07 million but this is still 34 per cent. lower than the 2009 figure (source: Council of Mortgage Lenders[36]). The average (nominal) house price in England and Wales fell by 17 per cent. from the peak in November 2007 to the trough in April 2009 (source: Land Registry[37]).

33 Bank of England series LPMVTXH
34 Council of Mortgage Lenders: Table 1: Gross mortgage lending, not seasonally adjusted, January 2014
35 Council of Mortgage Lenders: Gross mortgage lending, not seasonally adjusted, January 2014
36 HMRC: UK Property Transactions Count – December 2013, Table 5, annual, from Council of Mortgage Lenders
37 Land Registry: http://www.landregistry.gov.uk/public/house-prices-and-sales/search-the-index

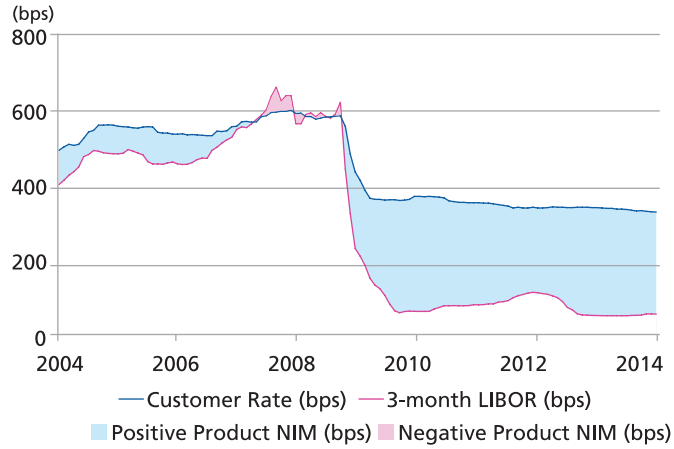
8.5 Mortgage Revenues and Profits: How Retail Banks make Money from Mortgages

The key source of income for providers of mortgages is the Product Net Interest Income earned on mortgage loan balances.

The mortgage Product NIM has increased significantly since pre-2008, as customer rates have not fallen as far as funding costs. As shown in Exhibit 12[38], the difference between the average mortgage customer rate and three-month LIBOR (which is used for the purposes of illustration as a proxy for NIM) increased from 50 to 100bps in 2004 to 2006 to around 250 to 300bps in 2010 to 2013. This reflects a higher Product NIM on both new mortgages and on SVR mortgages. Note that the data series illustrated in Exhibit 12 shows total Customer Rate and Product NIM for household loans secured on dwellings as reported by the Bank of England, which the TSB Board believes to be a reasonable approximation to the Customer Rate and Product NIM for household mortgages.

Exhibit 12:

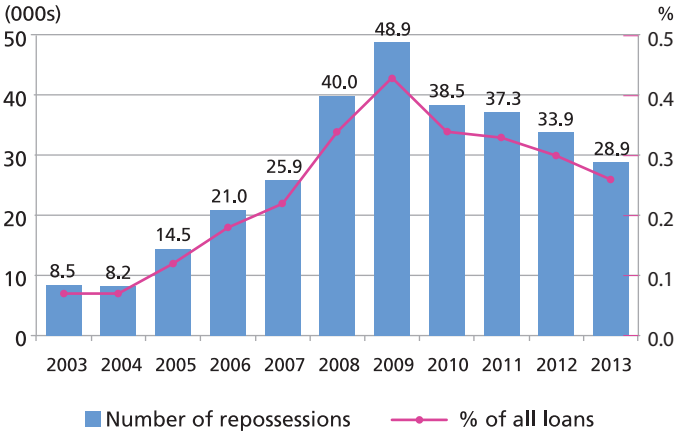
Customer Rate and illustrative Product NIM for household mortgages (source: Calculated from Bank of England)



During the financial crisis, banks incurred significant impairments on their mortgage loans. Rates of housing repossession, which are illustrated in Exhibit 13 (source: Council of Mortgage Lenders[39]) serve as a useful proxy for rates of impairment. 2009 to 2013 saw an improvement in rates of housing repossessions as the economy improved, unemployment fell and interest rates remained low.

Exhibit 13:

Mortgage repossessions (000s) per annum, absolute figures and as a percentage of all loans (source: CML)



38 Calculated from Bank of England series CFMHSDE, IUMAAMIJ. Data Series ends at 28 February 2014

39 Council of Mortgage Lenders, Table AP4: Mortgage possessions CML: http://www.cml.org.uk/cml/media/press/3731

9 Personal Loans

9.1 Introduction to Personal Loans

Unsecured personal loans allow customers to borrow an agreed sum of money for a specified period of time, without any collateral.

Interest rates on personal loans are typically fixed at the time the loan is agreed. The interest rate varies with loan value and term, as well as customer credit quality. Repayments to the loan provider are made in equal instalments according to a fixed schedule (usually monthly). The loan amount and accrued interest are fully repaid by the end of the loan term. Retail banks typically provide unsecured loans of up to approximately £25,000 with contractual terms of up to 10 years (more commonly three to five years).

9.2 Personal Loan Distribution Channels

Personal loans are distributed through branch, telephone and digital channels. Branches remain the most popular channel for personal loan sales, with the digital channels becoming increasingly important, as many lenders now provide an end-to-end online application process, including a credit decision and fund disbursement.

9.3 The Personal Loan Competitive Landscape

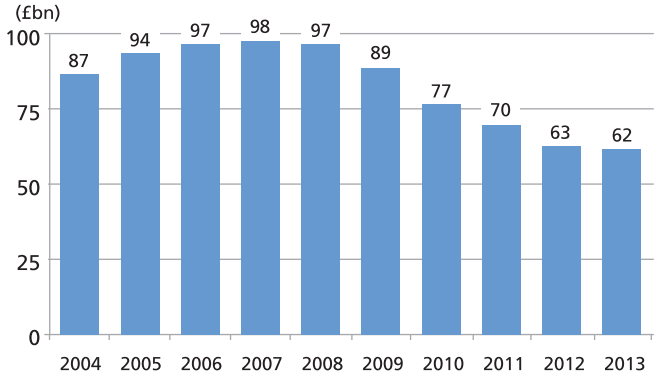
The personal loan market is relatively concentrated with the largest six providers holding the majority of the market share of loan accounts as at 30 April 2014 (source: GfK NoP Ltd[40]). The market is much less concentrated if providers of specialist unsecured lending are included, such as pay-day lending and auto finance (but TSB does not participate in the specialist unsecured lending market).

9.4 Personal Loan Market: Key Metrics

The overall size of the market can be measured in terms of total outstanding loan balances. Outstanding loan balances (including PCA overdrafts) reduced from a peak of £99 billion in October 2007 to £62 billion on 31 December 2013, a fall of 38 per cent. over the period, as shown in Exhibit 14 (source: Bank of England[41]). As loans typically have shorter terms than mortgages, a reduction in new personal lending tends more rapidly to feed through into a reduction in outstanding balances than is the case for mortgages. Note that the data series illustrated in Exhibit 14 shows Monetary Financial Institutions' other consumer credit lending to individuals as reported by the Bank of England, which the TSB Board believes to be a reasonable approximation to total outstanding balances for personal loans.

Exhibit 14:

Monetary financial institutions personal loan lending to individuals (source: average balance outstanding for year calculated from Bank of England monthly data)



Following the financial crisis, the supply of new unsecured personal loans by banks and building societies was significantly reduced. Banks tightened their lending criteria as they sought to reduce their credit losses, and to reduce the size of their balance sheets more

40 All with GfK NoP Ltd, Financial Research Survey (FRS) 6 months including April 2014, 1,800 adults interviewed

41 Bank of England series LPMVVZZ

generally. Reduced consumer demand and consumer spending confidence also impacted unsecured lending volumes. The volume of outstanding balances has remained relatively stable since mid-2012.

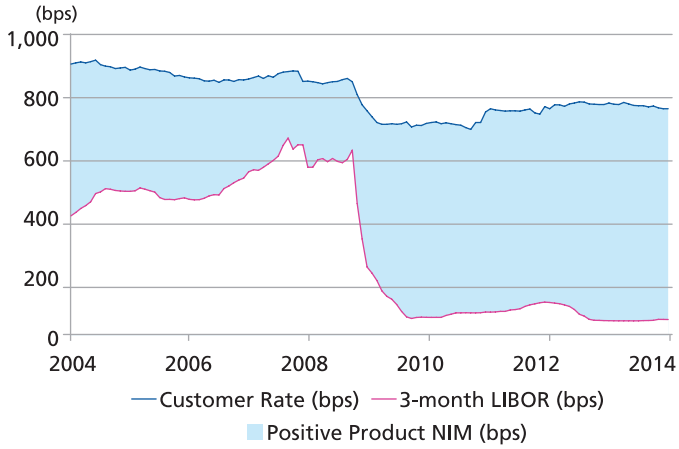
9.5 Personal Loan Revenues and Profits: How Retail Banks make Money from Personal Loans

The principal source of income for providers of personal loans is the Product Net Interest Income earned on loan balances. A secondary, smaller source of income is fees paid by customers. Product NIM tends to be significantly higher for personal loans than for mortgages because of higher associated risk.

Average customer rates for unsecured loans fell from 8.37 per cent. in 2008 to 7.68 per cent. in 2013 (source: Bank of England[42]). Personal loans Product NIM has increased significantly since pre-2008, as shown in Exhibit 15[43]. The increase in Product NIM has more than offset the decline in loan balances over the period, causing Product Net Interest Income to increase. Note that the data series illustrated in Exhibit 15 shows Customer Rate and Product NIM trends for other loans to households as reported by the Bank of England, which the TSB Board believes to be a reasonable approximation to the Customer Rate and Product NIM for personal loans.

Exhibit 15:

Customer Rate and illustrative Product NIM for personal loans (source: Calculated from Bank of England)



Personal loans generate a small amount of fee income for banks. The majority of this fee income comprises penalties for late payments and, to a lesser extent, fees for early repayment. Fee income has reduced significantly following regulatory intervention to restrict the sale of PPI, which previously generated a relatively large amount of fee income for banks.

During the financial crisis, retail banks incurred significant impairments on their unsecured loans.

10 Credit Cards

10.1 Introduction to Credit Cards

Credit cards provide customers with two services: a means of making payments and an unsecured revolving credit facility. The maximum outstanding amount (commonly known as the "credit limit") for a credit card is set in advance according to the provider's view of the customers risk profile and is regularly reviewed by the credit card provider.

Card issuers rely on a third party payment system, provided in the UK by Visa, MasterCard or American Express, to authorise, clear and settle credit card transactions.

42 Bank of England series CFMHSDI

43 Calculated from Bank of England series CFMHSDI and IUMAAMIJ. Data series ends at 28 February 2014

10.2 Credit Card Distribution Channels

The branch channel has historically been, and remains, an important distribution channel for credit cards, although the number of credit card products sold through digital channels is now almost as significant.

10.3 The Credit Card Competitive Landscape

There is a diverse range of market participants in the UK credit card market, including high street banks, building societies and mono-line card issuers. Many non-banking consumer brands often offer credit cards in partnership with an underwriting bank.

10.4 Credit Card Market: Key Metrics

The overall size of the UK credit card market can be measured in terms of the value of outstanding loan balances and the volume of cards in issue. Outstanding credit card balances were £58 billion as at 31 December 2013 (source: Bank of England[44]) which includes both interest bearing and fees and commissions bearing balances. As at 31 December 2013, there were 58 million cards in issue and 50 million credit card accounts. 66 per cent. of the credit card accounts (or 33 million) were "active" (source: BBA[45]).

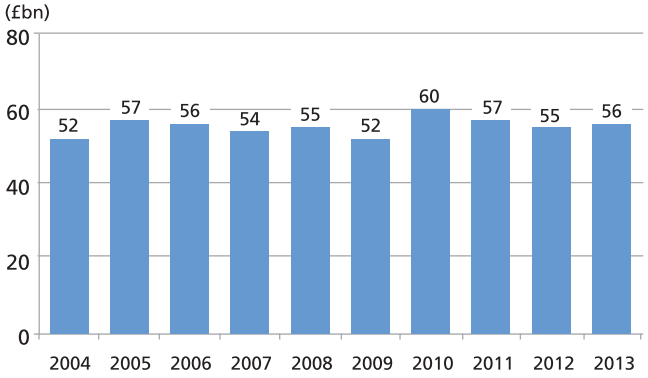
Growth of credit card balances is driven by both consumer demand for credit, and by banks' appetite to issue new credit cards and to increase (or decrease) the credit limits on outstanding credit cards. Outstanding balances decreased by a CAGR of 2.1 per cent. per annum for the three years ended 31 December 2013 (source: Bank of England[46]).

Over recent years, as banks sought to reduce their LDRs, and were required by regulators to increase their capital and liquidity ratios, the supply of credit card lending reduced. Customer demand for credit card borrowing also reduced over the same period.

Excluding the effect of certain reclassifications, credit card balances returned to underlying growth in 2013, driven by increased customer demand following slow macro-economic recovery and increases in consumer confidence, as well as the increased appetite of banks to lend.

Exhibit 16:

Average outstanding credit card lending to individuals (source: calculated from Bank of England monthly statistics)[47]



10.5 Credit Card Revenues and Profits: How Retail Banks make Money from Credit Cards

The primary source of income for credit cards is Product Net Interest Income on card balances. In addition, issuers generate fees and commissions income through interchange fees, late payment penalties and card fees charged to customers on an annual or monthly basis.

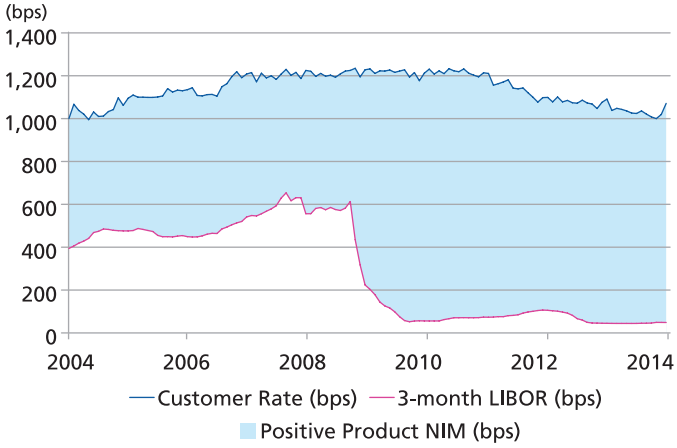
Average customer rates on credit card balances fell from 12.2 per cent. in 2008 to 10.4 per cent. in 2013 (source: Bank of England[48]). Historical trends in credit card Product NIM are

44 Bank of England series LPMVZRE
45 British Bankers' Association 'Credit Cards Monthly release tables', December 2013
46 Bank of England series LPMVZRE
47 Bank of England series LPMVZRE
48 Bank of England series CFMHSDP

shown in Exhibit 17[49]. As with personal loans, credit card Product NIM has increased significantly since pre-2008 but has decreased (by a lesser amount since 2009) as customer rates have fallen. The spread between average credit card customer rates and three-month LIBOR (which is used for the purposes of illustration as a proxy for NIM) was 952 bps at 31 December 2013, down from an average of 1153 bps in 2010 (source: Bank of England[50]). Note that the data series illustrated in Exhibit 17 shows Customer Rate and Product NIM trends for household credit card lending by UK-resident Monetary Financial Institutions, as reported by the Bank of England, which the TSB Board believes to be a reasonable approximation to the Customer Rate and Product NIM for credit card lending to households.

Exhibit 17:

Customer Rate and illustrative Product NIM for household Credit Card Lending (source: Calculated from Bank of England)



In addition to Product Net Interest Income, credit cards generate fee income for banks consisting primarily of credit card interchange fees, penalties for late payments and annual product charges for some cards. In the past, this also included significant income from the sale of PPI. These types of income have declined following a period of increased regulatory scrutiny.

In July 2013, the European Commission published plans to limit credit card interchange fees to 30 bps (source: European Commission[51]). On 3 April 2014, the European Parliament voted to adopt the plans[52] and, if they enter EU legislation, they are likely to result in reduced market interchange fee revenue from current levels.

Impairments are a key driver of credit card profitability. In 2007, non-performing card lending was at 4.0 per cent. of total outstanding balances (in 2007), peaking at 4.8 per cent. in 2010 and falling to 4.3 per cent. in 2013 (source: Euromonitor[53]).

11 Insurance

11.1 Introduction to Insurance

Retail banks in the UK may provide, or act as the introducer to, several types of insurance products. These products are provided by insurers (which may be part of the broader parent banking group) who design the product, underwrite the product and service the customer. The retail bank is able to offer these products to its customers to meet their protection needs. In return for direct product provision or acting as an introducer, the retail bank will typically receive a payment from the insurer.

Protection products provide customers with cover and security for specific events. This can range from theft of property, the impact of a natural hazard, critical illness or early loss of life.

49 Calculated from Bank of England series CFMHSDP and IUMAAMIJ. Data series ends at 28 February 2014
50 Calculated from Bank of England series CFMHSDP and IUMAAMIJ
51 European Commission: Payment Services Directive and Interchange Fees Regulation: frequently asked questions, July 2013
52 European Parliament press release, April 2014: MEPs push for card payment fee caps and online payment safeguards
53 'Consumer Lending in the United Kingdom', Euromonitor, Table 8. Information in this Prospectus on the UK Credit Card market attributed to Euromonitor is from independent research carried out by Euromonitor International Limited. Research by Euromonitor International Limited should not be considered as the opinion of Euromonitor International Limited as to the value of any security or the advisability of investing in the Company

Where such an event arises or takes place, the insurer agrees to pay for the financial consequences of the event within pre-agreed limits. In return, the customer pays a fee, known as a premium.

TSB currently distributes a home and contents insurance product to its customers through branches and has recently entered into a referral arrangement in relation to life and critical illness insurance products. Some banks also provide other types of insurance. These include pet, motor, travel and health insurance. TSB does not currently participate in these markets.

11.2 Insurance Distribution by Retail Banks

Retail banks play an important role in the distribution of insurance products. In 2012, banks had a 26 per cent. market share of home insurance distribution (source: ABI[54]). Banks had a 22 per cent. share of individual protection policy distribution in 2012, which fell to 16 per cent. in 2013 (source: ABI[55]).

Many banks will offer customers home insurance and mortgage-linked life insurance with mortgage sales. Consequently, there is a correlation between retail banks' market share of insurance sales and the level of housing transactions.

Many banks offer products from a single insurer, selected on a product-by-product basis. For home insurance, products are sometimes offered from a panel of insurers. The home insurance market is served by a wide range of brands; however, the underlying underwriters of these policies are more limited in number, with five participants providing 61 per cent. of market capacity in 2012 (source: ABI[56]). The individual protection market is even more concentrated, with the top five participants providing 63 per cent. of market capacity in 2012 (source: ABI[57]).

For all insurance products, banks either distribute the products on behalf of the insurer or, in some cases, act as an introducer. In the case of introductions, the insurance company can either receive referrals, or provide a sales team which operates in the bank's branches.

11.3 Insurance Market: Key Metrics

The home insurance market is the second largest general insurance market in the UK, with annual gross written premia of £6.9 billion in 2012 (source: ABI[58]) and representing 27 per cent. of total general insurance premia. Between 2007 and 2012, home insurance market premia grew at 1.0 per cent. CAGR per annum (source: ABI[59]), although recently the value of total premia appear to have fallen slightly and levels of penetration, whilst relatively high, appear to have declined. Home insurance prices can also be impacted by natural events, such as severe weather, which impact claims.

The UK life insurance market for individual protection is a large mature market with 29 million policies in force in 2012 (including both mortgage-linked and standalone policies), following growth after 2007 at 5.2 per cent. CAGR per annum. The increase in number of policies was offset by a reduction in the value of new business premia, which have fallen by 20 per cent. since 2007 and totalled £793 million in 2013 (source: ABI[60]).

11.4 Insurance Revenues and Profits: How Retail Banks Make Money from Insurance

The revenue banks generate from insurance sales (and introductions) is from commissions paid by the policy provider to the bank and/or income earned on a profit share with the insurer. For individual protection policies, banks typically receive an initial premium commission linked to the "Annual Premium Equivalent" for new business, with lower renewal commissions thereafter.

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54 Association of British Insurers: Table 2 – Personal Lines Breakdown
55 Calculated from Association of British Insurers: Appendix 2 and Summary Table 1
56 Association of British Insurers: SynThesys PRA returns (Form 20A)
57 Association of British Insurers: SynThesys PRA returns (Form 47)
58 Association of British Insurers: Table 1: UK retail revenue account (annual business)
59 Association of British Insurers: Table 1: UK retail revenue account (annual business)
60 Association of British Insurers: Summary Table 1: summary of new business premia

12 Business Banking

12.1 Introduction to Business Banking

"Business banking" is the provision of banking services to businesses, including large businesses, SMEs[61] and micro businesses[62]. TSB's business banking customer base consists mainly of small businesses with revenue of less than £500,000 and who are permitted to borrow no more than €1 million.

The financial needs of micro businesses are similar to those of personal banking customers. The core banking needs of micro SMEs businesses are: transaction banking (the ability to deposit and withdraw cash, etc.), borrowing (unsecured and secured) and saving. Micro businesses also have protection needs: to protect their businesses and themselves.

Business Current Accounts ("**BCAs**") are the most important small business product as they form the basis for a broader banking relationship. The majority of small businesses will borrow most commonly from the provider of their BCA. A BCA provides small businesses with the standard features of a PCA, often with the addition of a specialist business banking team available through branch or telephone channels. BCAs typically pay lower levels of credit interest than non-business PCAs, and charge both a fixed monthly fee of £5 to £25 and often additional transaction charges (for example, for cheque or cash processing). Many banks will offer a fee-free BCA for an initial period (e.g. 12 to 18 months). Typical loan arrangement fees are also higher for small businesses than personal banking customers.

12.2 Business Banking Distribution Channels

Small business customers typically place a significant degree of importance on branches as a channel for distribution and service and will often use branches more frequently, particularly if they need to deposit cash and cheques from their business activities.

Direct channels are also increasingly being used by small businesses. In August 2013, 67 per cent. of surveyed SMEs 'typically' used online banking, 39 per cent. 'typically' used direct contact with their branch or bank manager (including via telephone) and 32 per cent. 'typically' used their bank's telephone call centre (source: Federation of Small Businesses[63]). Most banks serve small businesses using a relationship manager, who may specialise in a specific industry sector. Some banks are investing in creating small businesses-specific online banking platforms.

12.3 The Business Banking Competitive Landscape

As at 28 March 2014, the largest four UK banks account for over 80% of UK SMEs main banking relationship (source: HM Treasury and BIS, SME finance consultation document, March 2014[64]). The market share of these banks has been broadly stable over the last three years and the OFT has previously commented that there are high barriers to entry within the SME sector. For example, BCAs require all the transactional functionality of non-business PCAs, which requires significant investment in IT and operations over a number of years, while small businesses lending sometimes requires a more sophisticated assessment of credit risk than retail lending.

12.4 UK Business Banking Market: Key Metrics

Lending to small businesses is a critical role played by banks participating in business banking activities. Small businesses use both unsecured and secured loans, though in the micro businesses market most loans tend to be unsecured. The amount of outstanding lending by UK-resident monetary financial institutions to all UK SMEs was approximately £166 billion in December 2013 (source: Bank of England[65]).

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61 The European Commission defines SMEs as enterprises with fewer than 250 employees, turnover less than €50 million and/or an annual balance sheet total less than €43 million

Source: http://ec.europa.eu/enterprise/policies/sme/files/sme_definition/sme_user_guide_en.pd

62 Micro SMEs are a subset of SMEs which have fewer than ten employees, turnover less than €2 million and/or an annual balance sheet total less than €2 million

Source: http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/

63 Federation of Small Businesses: "Voice of Small Business Survey Panel", August 2013, question 38

64 http://www.gov.uk/government/consultations/sme-finance-help-to-match-smes-rejected-for-finance-with-alternative-lenders/

65 www.bankofengland.co.uk/statistics/Documents/bankstats/current/taba8.1.xls

Deposit balances for all SMEs were £137 billion at 31 December 2013. Of this amount, £75 billion was held in BCA and £61 billion in business savings accounts. For the two years to 31 December 2013, deposits were growing at a CAGR of 5.0 per cent. per annum (source: BBA[66]).

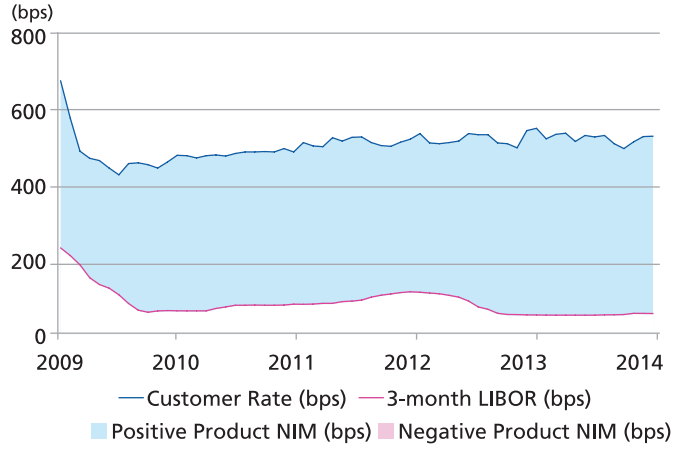
12.5 Business Banking Revenues and Profits: How Retail Banks Make Money from Business Banking

Similar to retail banking customers, banks generate Product Net Interest Income and fees and commissions income from business banking.

Customer rates for lending to SMEs fell rapidly as interest rates fell during the financial crisis, but have increased gradually since. Customer rates did not fall as much as funding costs, and consequently loan Product NIM increased. Product NIM continued to increase during 2012 and 2013 as customer rates increased and three-month LIBOR decreased. As shown in Exhibit 18[67], loan product NIM for lending to smaller SMEs has increased from 396 bps in December 2009 to 458 bps in December 2013.

Exhibit 18:

Indicative Customer Rate and illustrative Product NIM for new lending to Smaller SMEs (source: Calculated from BIS and Bank of England)



Customer rates paid on business deposit products have, in recent years, been lower than those for individuals. Consequently, SME deposits are very valuable as a source of low cost funding for banks. As illustrated in Exhibit 19[68], customer rates for SME savings have fallen considerably as a result of the reduction in interest rates. The Product NIM on SME deposits has also fallen (source: Bank of England[69]).

66 BBA: http://www.bba.org.uk/statistics/article/banks-support-for-smes-quarter-2-2013/small-business/

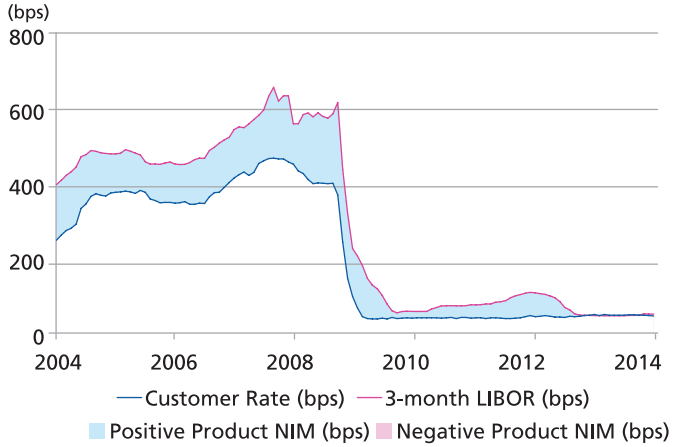
67 BIS/Bank of England: Recent trends in lending to small and medium-sized enterprises, Chart C Data series ends February 2014

68 Bank of England series CFMHSCT, CFMHSCW and IUMAAMIJ. Data series ends 28th February 2014

69 Calculated from Bank of England series CFMHSCT and IUMAAMIJ

Exhibit 19:

Customer Rate and illustrative Product NIM for Private Non-Financial Corporation (PNFC) instant access deposits (source: Calculated from Bank of England)



Business banking charges are higher than they are in the retail banking market, and this leads to higher fees and commissions income. This is, in part, because of a bank's higher cost of serving business banking customers. Lenders in the Bank of England's Credit Conditions Survey for the first quarter of 2014 reported that fees and commission for SMEs fell slightly (source: Bank of England[70]).

[70] Bank of England, "Credit Conditions Survey": http://www.bankofengland.co.uk/publications/Pages/other/monetary/ccs/ccs1310.aspx

PART IX
INTRODUCTION TO TSB

Investors should read this Part IX in conjunction with the more detailed information contained in this Prospectus, including the description of TSB's business appearing in Part X: "Information on the TSB Group".

1 Introduction

On 9 September 2013, TSB was launched as a re-branded retail bank operating in the UK with branches across England, Scotland and Wales. As at 31 March 2014, it had approximately 4.5 million retail and approximately 113,000 small business banking customers, TSB Franchise customer assets of £19.7 billion, Additional Mortgages of £3.3 billion, customer deposits of £23.3 billion and 631 branches, making it the seventh largest retail banking group in the UK by branch network.

This Part IX describes the genesis and evolution of the TSB business.

2 The TSB brand: "local banking for Britain"

In November 2009, Lloyds Banking Group announced that it had agreed the terms of the State Aid Restructuring Plan with the European Commission, including the divestment of a significant UK retail banking business (the business that is TSB today). However, the TSB story is much older than that, dating back over 200 years to 1810, when the foundations of the TSB movement were laid and the first self-supporting savings bank was established in Ruthwell, Scotland, with the purpose of helping local people, and the communities they lived in, to thrive together, values which underpin the TSB business today.

The savings bank movement and, subsequently, the trustee savings bank movement, spread rapidly across the United Kingdom. Formal unity of the various trustee savings banks came in 1975 and during the 1980s a single institution with an extensive network of branches was operating under the TSB brand throughout the UK.

When TSB launched on 9 September 2013, the TSB brand was re-launched across the UK. Following the launch, spontaneous awareness of the TSB brand grew rapidly and increased from 6 per cent. (in August-September 2013) to 33 per cent. (in March 2014). Additionally, over the same time period, total awareness of the TSB brand increased from 73 per cent. to 87 per cent.

The TSB Board intends to differentiate itself from its competitors by being a service-led business, with a unique focus on retail banking in the UK, where every penny customers deposit with TSB is used to support mortgages and loans for other TSB customers. TSB labels this approach "local banking for Britain".

For further information see Part X: "*Information on the TSB Group – Key Strengths*" and "*– Strategy*".

3 Background

HMT's financial support of Lloyds Banking Group during a period of unprecedented turbulence in the global financial markets in 2008 – 2009 was deemed by the European Commission to have constituted State aid. As a result of the European Commission decision in relation to the same, Lloyds Banking Group was required to dispose of a UK retail banking business meeting certain criteria, with the aim of bringing more competition to UK retail banking. The criteria to be met by the divestment business, which was referred to by Lloyds Banking Group as 'Verde', included a minimum number of branches and their customers, a minimum share of the PCA market in the UK and a specified proportion of Lloyds Banking Group's mortgage assets meeting certain quality thresholds, with completion of the divestment to take place before the end of November 2013.

The aim of Lloyds Banking Group's Verde programme was to build and create the divestment business to meet the agreed criteria (known within Lloyds Banking Group as the Verde "perimeter"), to separate it from Lloyds Banking Group's other businesses and ultimately to divest it within the specified timeframe. To avoid the need to obtain a new banking licence, an existing entity (then

called Lloyds TSB Scotland plc) within Lloyds Banking Group, with its own banking licence and operating history, was chosen as the corporate vehicle for the Verde business. This entity is now TSB Bank plc, and its immediate holding company is TSB Banking Group plc. The TSB Board recognises that TSB was created under the direction of the European Commission and HM Treasury with regard to recommendations from the OFT and ICB in order to be a viable and effective challenger in the UK retail banking market.

In June 2011, Lloyds Banking Group issued an information memorandum to potential bidders as part of a process for the sale of the divestment business and, in December 2011, announced that it was entering into exclusive discussions with the Co-operative Group. A period of negotiations followed but were ultimately unsuccessful, ending, in April 2013, with the withdrawal of the Co-operative Group from the sale process. At that point, Lloyds Banking Group announced its intention to pursue the divestment through an initial public offering, having maintained that option throughout the process.

As a result of the bilateral sale discussions with the Co-operative Group and subsequent preparations for an initial public offering, since 2009, the European Commission has agreed to a series of amendments to the Verde perimeter, which were formally agreed in May 2014. The Verde perimeter was also enhanced following OFT recommendations to the Chancellor of the Exchequer announced on 11 September 2013 (for further information, see "*Evolution of the TSB business: 2013 OFT recommendations*" below). The TSB business has been built and created in line with these revised requirements. The European Commission has also agreed to a revised deadline of 31 December 2015 for full divestment of Lloyds Banking Group's interest in TSB, which may be extendable to 30 June 2016 or 31 December 2016 (depending on the proportion of Lloyds Banking Group's interest in TSB that has already been divested) in the event of Disorderly Markets. The Offer represents the first step toward Lloyds Banking Group meeting its commitments in relation to full divestment.

4 Timeline

Some key milestones in TSB's story are set out below.

1810	**The foundations for the TSB movement are laid, with the establishment of the UK's first self-supporting savings bank** (see "*The TSB brand: local banking for Britain*" above)
November 2009	**Lloyds Banking Group agrees the State Aid Restructuring Plan with the European Commission and commences the construction and separation of TSB** (see "*Background*" above)
November 2009	**Darren Pope appointed to lead Lloyds Banking Group's Verde programme and subsequently, in May 2011, appointed as CFO of the Verde business (now TSB)** (see "*History of the management and governance of TSB*" below)
May 2011	**Paul Pester appointed as CEO of the Verde business (now TSB)** (see "*History of the management and governance of TSB*" below)
September 2011	**ICB issues final reporting setting out recommendations on reforms to improve stability and competition in UK banking** (see "*Evolution of the TSB business: 2013 OFT recommendations*" below)
April 2013	**Lloyds Banking Group announces its intention to divest TSB by way of an initial public offering** (see "*Background*" above)
July 2013	**Last divesting customer asset transfers into TSB Bank** (see "*Evolution of the TSB business: customer and non-customer assets*" below)
9 September 2013	**TSB launches as a re-branded bank on high streets across England, Scotland and Wales** (see "*Introduction*" above)
September 2013	**Operational separation from Lloyds Banking Group occurs** (see "*Operational and systems separation*" below)
September 2013	**OFT recommendations and enhancement of the TSB business are announced** (see "*Evolution of the TSB business: 2013 OFT recommendations*" below)

February 2014	**Equitable assignment of the Additional Mortgages from Bank of Scotland to TSB Bank takes effect** (see "*Evolution of the TSB business: 2013 OFT recommendations*" below)
March 2014	**TSB employees transfer from Lloyds Banking Group companies to TSB** (see "*Employees and pensions*" below)
May 2014	**Formal agreement of the European Commission to amendments to the Verde perimeter and revised deadline for full divestment of TSB by Lloyds Banking Group** (see "*Background*" above)
June 2014	**Announcement of the Offer**
December 2015	**Deadline for full divestment of TSB by Lloyds Banking Group** unless such deadline is extended (see "*Background*" above)

5 Evolution of the TSB business: customer and non-customer assets

5.1 Branches

5.1.1 Branch selection

The selection of TSB's 631 branches was driven by the requirements of Lloyds Banking Group's State Aid Restructuring Plan, and in particular requirements:

(a) that the business consist of at least 600 branches in total;

(b) that at least 43 per cent. of the population of England, Scotland and Wales lived within two miles of a branch as at 31 December 2010;

(c) as to the average risk-adjusted income of retail customers associated with divesting branches as at 31 December 2010; and

(d) as to the average quality of the location of branches within a retail centre and average gross ground floor area as measured in the GOAD "UK Plan Set" database as at 31 December 2010.

Lloyds Banking Group agreed with the European Commission that the entire branch networks of the businesses branded Cheltenham & Gloucester and Lloyds TSB Scotland would form part of the TSB business. The remainder of TSB's branch network was formed from some of the existing Lloyds TSB-branded branches in England and Wales. Lloyds Banking Group's agreement with the European Commission as to the branches that would be included in the divesting business would result in the amalgamation of the entirety of one existing network (the Cheltenham & Gloucester-branded branches, which were focused on savings and mortgage products and did not, until the first half of 2013, have the capability to sell PCAs) with a part of another existing network (the divesting Lloyds TSB-branded branches in England, Scotland and Wales, which were able to offer a full suite of banking products and services to retail customers).

The table below sets out the heritage of the TSB branch network (as at 31 March 2014).

Table 1: TSB branch network

Heritage	Number of branches	
	(freehold)	*(leasehold)*
Cheltenham & Gloucester	13	151
Lloyds TSB (Scotland)	80	105
Lloyds TSB (England and Wales)	67	215
Total	**160**	**471**

5.1.2 Branch transfers

In preparation for the Offer, certain assets were transferred into and out of TSB Bank through a series of transfers, including by way of banking business transfer schemes pursuant to Part VII of FSMA. On 5 March 2013, the Court of Session in Scotland approved a banking business transfer scheme pursuant to which certain assets and liabilities, including the leases of the Lloyds TSB-branded branches in England and Wales

which now form part of TSB's business, were transferred from Lloyds Bank (formerly Lloyds TSB Bank) to TSB Bank. In addition, the remainder of the leases and freehold properties that were required to be transferred to TSB Bank to complete its branch network have been transferred to it by other Lloyds Banking Group companies.

5.2 Customer assets and liabilities

5.2.1 Customer selection

Lloyds Banking Group agreed with the European Commission that the core of the business to be divested would be the banking business of customers of the agreed branches, determined on the basis of branch sort code. To this end, certain principles were agreed and applied, as at 31 December 2010, in order to identify the Verde customer perimeter. Subject to certain exceptions, the customer perimeter included:

(a) the banking business of retail customers associated with divesting heritage Lloyds TSB-branded branches in England, Scotland and Wales, together with some of the mortgages and savings accounts of customers associated with the Cheltenham & Gloucester-branded branches;

(b) additional Cheltenham & Gloucester-branded mortgage assets, which were added into the perimeter in order to ensure compliance with the requirement of the State Aid Restructuring Plan; and

(c) the banking business of branch-based charities, clubs and societies and business customers of divesting heritage Lloyds TSB-branded branches in England, Scotland and Wales whose annual turnover was less than £500,000 and who were permitted to borrow no more than €1 million from Lloyds Banking Group.

5.2.2 Customer asset and liability transfers

Certain customer assets and liabilities not forming part of the divesting business were transferred out of TSB Bank. On 1 October 2012, the Court of Session in Scotland approved two banking business transfer schemes pursuant to which certain of these assets and liabilities were transferred from TSB Bank to Lloyds Bank and Bank of Scotland. In addition, certain customer assets and liabilities forming part of the divesting business were transferred from Lloyds Bank to TSB Bank pursuant to the scheme approved by the Court of Session in Scotland on 5 March 2013. The last of the customer accounts was transferred to TSB Bank pursuant to such scheme on 15 July 2013.

6 Evolution of the TSB business: 2013 OFT recommendations

In June 2013, the Chancellor of the Exchequer asked the OFT to review the impact on competition of the proposed State aid divestments by Lloyds Banking Group (the Verde programme) and The Royal Bank of Scotland Group plc in retail and small and medium business banking in the UK, and whether any supplemental action should be taken to strengthen competition through enhancing the divestments. This followed the review in 2010 to 2011 by the ICB which was set up by HM Government to consider and make recommendations on the structure of the banking system and on how HM Government could reform it to increase competition and maintain financial stability. In September 2011, the ICB issued its final report, in which it made recommendations to enhance TSB's funding position and scale with the aim of ensuring the emergence of a strong challenger bank in the UK market.

On 11 September 2013, the OFT made certain recommendations to the Chancellor of the Exchequer in relation to the competitiveness of TSB. Lloyds Banking Group announced on the same day that it would accept the OFT's principal recommendations and that it had agreed with HM Treasury a number of measures to help enhance TSB's ability to compete and its financial strength, particularly in a low interest rate environment. Such measures included a downward revision (£20 million in total) of the costs payable by TSB under the TSA and Lloyds Banking Group's agreement to provide TSB with the "economic benefit of a portfolio of residential mortgages of approximately £4 billion, together with the associated capital, designed to enhance TSB's profitability by over £200 million in

aggregate in the first four years". The final Mortgage Enhancement Structure (pursuant to which a reduced portfolio of residential mortgages of £3.4 billion was transferred with effect from 28 February 2014) has been designed with the aim of enhancing TSB's profit by approximately £220 million over the same period (for further information see Part X: "*Information on the TSB Group – Mortgage Enhancement Structure and related funding arrangements*"). Lloyds Banking Group also agreed to provide TSB with an additional £40 million of CET1 capital to enable future customer acquisition and to develop its branch network (such capital was provided by Lloyds Bank to TSB on 19 May 2014 by way of a subscription for ordinary shares in the Company for cash – for further information, see Part XXII: "*Additional Information – Share Capital*").

Further, the OFT made a number of recommendations in relation to the TSA and the LTSA, with the aim of ensuring that the agreements give TSB the flexibility to grow and develop, including to differentiate itself in terms of strategy in the future. One of the OFT's recommendations was that an expert and independent monitoring trustee or equivalent should review the terms of the agreements with Lloyds Banking Group companies and continuing compliance with those terms. The European Commission and HM Treasury agreed a two stage process for this monitoring role:

- an independent monitoring trustee monitored the TSA, LTSA, Separation Agreement and Relationship Agreement negotiation process between Lloyds Banking Group companies and TSB and reported to the European Commission and HM Treasury on the terms of such agreements; and
- the FCA will assume the monitoring role from Admission. The FCA has appointed a skilled person pursuant to its powers under FSMA (the "**Skilled Person**") to assist it for at least the first three years from Admission. The remit of the Skilled Person includes, amongst other things, quarterly reporting on Lloyds Banking Group's and TSB's compliance with the TSA, LTSA, Separation Agreement and Relationship Agreement, as well as the observance by Lloyds Banking Group companies and TSB of the FCA's guiding principles (informed by the OFT's recommendations) in the performance of the agreements, the overall impact of the arrangements on competition between Lloyds Banking Group and TSB and their potential to distort competition in the relevant markets and various other matters relating to the relationship between Lloyds Banking Group and TSB. In addition, the Skilled Person will report on Lloyds Banking Group and TSB's observance of the principle that the arrangements between the two parties should not allow Lloyds Banking Group to adversely influence TSB's competitive position nor render TSB vulnerable to poor quality service.

7 Employees and pensions

7.1 Employees

Lloyds Banking Group agreed with the European Commission that certain of the employees of Lloyds Banking Group companies would be transferred to TSB as part of the divesting business. These employees included personnel of divesting branches and personnel related to head office, support functions and other sales channels as required. In preparation for the IPO, the employees of Lloyds Banking Group companies who were allocated to the TSB business were transferred to TSB Bank on 31 March 2014. For further information, see Part X: "*Information on the TSB Group – Employees and operational functions*".

7.2 Pensions

Employees of TSB previously participated in certain defined benefit and defined contribution pension schemes operated by Lloyds Banking Group. The participation of TSB employees in such pension schemes ceased on 31 March 2014 when their employment transferred to TSB Bank. TSB is not a participating employer in any Lloyds Banking Group pension scheme and TSB has no liability in respect of any deficit arising in any Lloyds Banking Group defined benefit pension scheme (for information on the Pensions Regulator's powers in this regard, see Part II: *"Risk Factors – TSB is within the scope of the Pensions Regulator's powers in relation to Lloyds Banking Group's defined benefit pension schemes"*). On transferring employment to TSB Bank, all TSB employees were automatically included in the new defined contribution pension scheme, TSB Pension Scheme, established by TSB to take effect on 1 April 2014. See Part XXII: "*Additional Information – Pensions*" for further information in relation to the TSB Pension Scheme.

8 Operational and systems separation

In 2009, Lloyds Banking Group began its project to separate the operations of TSB from those of the retained Lloyds Banking Group companies, a project which culminated in TSB's launch as a re-branded bank on 9 September 2013. As part of the separation project (which was undertaken through a series of steps with the aim of de-risking delivery and minimising customer disruption), Lloyds Banking Group began to separately record financial and other data relating to TSB from 2009, and TSB's customer, operational, financial and risk data were, from May 2013, segregated from Lloyds Banking Group data on Lloyds Banking Group's core banking platform, which continues to be used by Lloyds Bank to support TSB in a manner corresponding to the support that Lloyds Banking Group's retained retail banking businesses receive. In addition, a variety of non-IT functions and processes (including across finance, risk, legal, treasury, human resources, internal audit, corporate affairs, product management, procurement and supplier management and investor relations) have been established by TSB. As at and from Admission, the conduct of TSB's operations will continue to be supported by a range of banking operations services under the contractual terms and conditions of the TSA, as well as a range of services from other suppliers. It is expected that, during the term of the TSA (which will expire on 31 December 2016) TSB will migrate some of the TSA services to alternative suppliers, while a subset of the services (including IT services, payments-related services and business services) will continue to be provided by Lloyds Bank under the LTSA for a further period of up to seven and a half years (and thereafter payments-related services may be provided by Lloyds Banking Group as a bureau service on commercial terms). See Part X: "*Information on the TSB Group – Information technology and TSA/LTSA services*".

9 History of the management and governance of TSB

9.1 Background

From mid-2011, certain key members of the current TSB Board and Senior Management (including Paul Pester (the Chief Executive Officer), Darren Pope (the Chief Financial Officer) and Peter Navin (Managing Director Branch and business banking)) were formally appointed to the Verde business (now TSB) in management roles. When the State Aid Restructuring Plan was agreed with the European Commission in November 2009, Darren Pope was appointed by Lloyds Banking Group initially to lead its Verde programme to build and create, separate and ultimately divest the business.

Paul Pester's role, following his appointment in May 2011, has been to lead the completion of the Verde programme build and also to direct the development and establishment of the TSB business. This has included developing the overall strategy for TSB as an independent business, developing and launching TSB's approach to its brand (see "*The TSB brand: local banking for Britain*" above) and its customers as well as recruitment and oversight of TSB's Senior Management (whose names and roles are set out in Part XI: *"Directors, Senior Management and Corporate Governance"*). Paul, together with Darren and the Senior Management, also led the negotiations with Lloyds Banking Group regarding the terms of TSB's separation from the retained Lloyds Banking Group businesses (including the Separation Agreement and the Relationship Agreement) and the terms of the TSA and LTSA.

As described above, Darren Pope's role was initially to lead the Verde programme and he has, since May 2011, been specifically responsible for developing and running TSB's finance and treasury function and implementing TSB's internal and external financial reporting procedures. In 2010, Darren led the process to create a management information and reporting system for TSB in order to enable the oversight, monitoring and stewardship of the TSB business on a standalone basis. This system was used by Darren and the rest of the management team as a tool for identifying TSB customers and information in relation to the products that they held, compiling standalone financial information for the business, tracking the performance of its assets and liabilities and reporting into Lloyds Banking Group.

From December 2010, when the perimeter of the Verde business was established, Peter Navin was responsible for elements of the TSB branch network (as distinct from the branch networks of Lloyds Banking Group's other banking brands), and from June 2011, Peter has been responsible for the entire TSB branch network, including responsibility for performance management, the management of resources and recruitment to a budget agreed with Lloyds Banking Group and the leadership of TSB's branch-based employee population.

9.2 Governance of TSB throughout the separation process

Throughout the process of separation from Lloyds Banking Group, clear parameters were identified for the transition of governance of the TSB business from Lloyds Banking Group to the TSB Executive Directors and Senior Management:

- from the early part of 2013 until 9 September 2013, TSB had governance structures that were distinct from those of Lloyds Banking Group, operating as the fora for discussion of, and recommendations in relation to, TSB business decisions, including an executive committee, audit committee, risk committee and pricing committee. During this period, recommendations and decisions were not made by TSB in relation to certain matters, including pricing and credit;
- between formal launch of TSB on 9 September 2013 and 1 January 2014, the TSB Executive Directors and Senior Management were responsible for running TSB in accordance with the mandate set by the TSB Bank Board within certain parameters agreed with Lloyds Banking Group, including as to risk appetite. Although certain strategic decisions (including those in relation to TSB product pricing and marketing) required Lloyds Banking Group approval during this period, the TSB Executive Directors and Senior Management implemented significant marketing campaigns to support the development of the TSB brand and began to introduce differentiated products to the market; and
- from 1 January until Admission, TSB has been operating and will continue to operate within its own business plan and budget (approved by Lloyds Banking Group and within Lloyds Banking Group risk parameters), reflecting the pricing decisions and commercial strategy of the TSB Executive Directors and Senior Management. Significant operational developments during this period have included the launch of the new TSB Classic Plus account (for further information, see Part X: *"Information on the TSB Group – Strategy – Growing PCA market share to gain a market share"* below).

PART X
INFORMATION ON THE TSB GROUP

Investors should read this Part in conjunction with the more detailed information contained in this Prospectus, including the financial and other information appearing in Part XIII: "Operating and Financial Review". Where stated as at 31 December 2013, financial information in this Part has been extracted from Part XVI: "Historical Financial Information". Where stated as at 31 March 2013, financial information in this Part has been extracted from Part XVII: "Condensed Combined Interim Financial Information (Unaudited)", unless such information is stated on a pro forma basis, in which case it has been extracted from Part XVIII: "Unaudited Pro forma Financial Information". TSB operates in the UK retail banking market, although it should be noted that TSB's branches are situated in England, Scotland and Wales and it does not currently have any branches in Northern Ireland.

1 Overview

1.1 TSB is a fully functioning UK retail bank with strong capabilities:

- as at 31 March 2014, TSB had approximately 4.5 million retail and approximately 113,000 small business banking customers;
- TSB has a multi-channel, national distribution model, including 631 branches (as at 31 March 2014), with coverage across England, Scotland and Wales and a full digital (internet and mobile) and telephony capability;
- TSB's comprehensive product suite includes PCAs, savings products, mortgages, unsecured personal and business lending and insurance products; and
- TSB's service and sales capability is supported by approximately 8,600 employees.

1.2 TSB also has a simple balance sheet and comparatively low-risk financial structure overall. As at 31 March 2014, TSB had TSB Franchise customer assets of £19.7 billion and TSB Franchise customer deposits of £23.3 billion. As at the same date it also held the beneficial title to £3.3 billion (in nominal value) of Additional Mortgages, beneficial title to which was transferred by Bank of Scotland to TSB Bank with effect from 28 February 2014. Additionally, as at 31 March 2014 (on a pro forma basis) TSB's Common Equity Tier 1 Ratio was 21.6 per cent., its Total Capital Ratio was 27.1 per cent. and its Leverage Ratio was 5.6 per cent. TSB's illustrative Common Equity Tier 1 Capital Ratio on a fully IRB basis (in respect of the TSB Franchise business) is approximately 17 per cent. and Total Capital Ratio is approximately 21 per cent. TSB also benefits from a broad and (save in very limited respects) uncapped Conduct Indemnity from Lloyds Bank against losses arising out of historical conduct issues.

1.3 The TSB Board believes that TSB has substantial capacity for growth. As at 31 August 2013, TSB had approximately 6 per cent. of the retail bank branches in the UK and, as at 30 September 2013, a share of approximately 4.2 per cent. of the PCA market, which the TSB Board believes leads to opportunities to increase TSB's proportion of PCA market flow and consequently to grow the asset side of TSB's balance sheet through secured and unsecured lending. Further, TSB receives a range of IT and banking operational services from Lloyds Bank under the TSA and LTSA. The nature of TSB's operating model, together with the terms of the TSA and LTSA, allow for scalability of TSB's banking platform, including to take advantage of growth opportunities in the TSB business.

The TSB Board therefore believes that TSB has the range of capabilities and the growth potential necessary to execute its growth strategy (for further information, see "*Strategy*" below).

2 Key strengths

The TSB Board believes that the future success of its business will be driven by the key strengths set out below.

TSB'S CORE CAPABILITIES

2.1 TSB has a strong and stable customer base, has developed a strong, values-led challenger brand and is committed to offering a differentiated customer experience

2.1.1 Strong and stable customer base providing opportunities to challenge the market

The TSB Board believes that TSB has a strong and stable customer base which provides a firm foundation upon which to grow. The TSB customer base closely maps that of the

population in England, Scotland and Wales generally in terms of both income and age, and its PCA customers tend to be loyal, with 72 per cent. as at 31 January 2014 having been customers for six years or longer. These long-term customers accounted, as at the same date, for more than 85 per cent. of TSB's PCA customer deposits. Additionally, TSB's PCA market shares are generally less concentrated in areas of the UK where there are higher levels of PCA switching activity. As at 31 December 2013, TSB had a 16.8 per cent. share of the PCA market in Scotland[1] (where rates of PCA switching in 2013 were 2.7 per cent.)[2] and a 3.2 per cent. share of the PCA market in England and Wales[1] (where rates of PCA switching in 2013 were 3 per cent.)[2]. The TSB Board believes that this leads to opportunities for TSB to challenge the market, enabled by its brand.

2.1.2 Challenger brand

The TSB Board also believes that TSB has a substantive opportunity to grow in the UK retail banking market in which it operates. A key feature of the market is the sustained low levels of consumer trust in established banks (for further information see Part VIII: *"Market Overview – Background to the Retail Banking Market in the UK – Consumer Perceptions"*). The TSB Board aims to address the key concerns that customers have about banks and banking practices and thereby enhance TSB's competitive position. In an independent survey conducted in 2013 (Research YouGov, April 2013):

- 56 per cent. of respondents believed that new rules to stop banks taking too much risk, such as splitting investment and retail banking, would improve the banking sector. TSB serves only retail and small business banking customers based almost entirely in the UK, and does not conduct any investment banking activities;
- 57 per cent. of respondents believed that forcing all bankers to be professionally trained and to meet professional standards would improve the banking sector. As at 31 March 2014, approximately 48 per cent. of TSB's branch managers had already completed the Certificate in Retail Conduct of Business, and TSB is directly engaging with the Banking Standards Review;
- 65 per cent. of respondents believed that making banks more transparent would improve the banking sector. One of TSB's key brand values is transparency, and this approach is demonstrated publicly through its 'Truth and Banking' advertising campaign, through which it seeks to explain to the public in simple terms how retail banks make money, and its policy of explaining its reasoning whenever a mortgage application is denied; and
- 69 per cent. of respondents believed that capping bankers' bonuses and pay would improve the banking sector. TSB is implementing a redesigned approach to remuneration at the Executive Director level. For further information, see Part XXII: "*Additional Information – Service agreements, benefits and remuneration*".

The TSB Board believes that TSB's strong, values-led challenger brand will be important in enabling it to differentiate itself from the established banks and gain market share. Customer perception data (source: Ipsos MORI online Brand Trading, August 2013 – March 2014) indicates that banking products which are offered by different banks but have identical pricing are viewed differently by both customers and non-customers depending on the providing bank – the TSB Board believes that this data shows that brand is therefore an important differentiating factor. Prior to its launch in September 2013, TSB commissioned research to test its straightforward and transparent brand proposition; of the non-Lloyds TSB customers who responded, 50 per cent. said that they would definitely or probably apply to become a customer of TSB (assuming that TSB offered a product that they were interested in) (source: YouGov research, May 2013). Following the launch of TSB, spontaneous awareness of the TSB brand increased from 6 per cent. (in August to September 2013) to 33 per cent. (in March 2014) and total awareness increased from 73 per cent. to 87 per cent. over the same period. There have also been significant increases in the levels of consideration of TSB amongst non-customers, with consideration up from 10 per cent. in September 2013 to 13 per cent. in March 2014.

[1] TSB estimates based on market data from CACI Current and Savings Account Market Database (CSDB) excluding basic bank accounts

[2] GfK NoP Financial Research Survey, 12 months ended 31 December 2013

The TSB Board believes that this brand momentum has already led to commercial results, with new products like the Classic Plus account, constructed to be simple and transparent and reflective of TSB's brand values. Although at an early stage, the launch of the Classic Plus account has proved successful in attracting new customers (for further information, see *"Strategy"* below).

2.1.3 Customer experience

Independent research demonstrates a clear link between high levels of customer satisfaction and subsequent customer behaviour (source: Nunwood, study of 252,000 customers of a UK bank, 2012 – 2014). Dissatisfied customers were twice as likely to close their accounts as highly satisfied customers and one in five satisfied customers took out an additional banking product (as against one in eight overall). TSB's approach to customer service is founded on six principles: (i) tailoring the banking experience to customer needs in a way that feels personal; (ii) accurately setting and then meeting or exceeding expectations; (iii) acting at all times with integrity and in the best interests of customers; (iv) valuing the time and effort of customers in all interactions, making it easy for them to do business with TSB; (v) resolving issues quickly and positively; and (vi) recognising and responding to the specific situations of different customers. Through this approach TSB aims to deliver a differentiated customer experience and drive reductions in customer acquisition and retention costs as well as enabling further growth.

2.2 TSB has a comprehensive distribution and product capability

2.2.1 TSB has a robust multi-channel and national distribution model with a comprehensive service and sales capability

TSB employs a multi-channel model to address the needs of its customers:

- TSB's network of 631 branches has strong coverage of England, Scotland and Wales, is well located and comprises branches selected in order to meet the quality criteria agreed with the EC (for further information, see Part IX: "*Introduction to TSB – Evolution of the TSB Business: customer and non-customer assets – Branches*"). When TSB's branch network was established in 2010, approximately 46 per cent. of the population of England, Scotland and Wales lived within two miles of a TSB branch and, as at January 2014, TSB had branches in 89 per cent. of major retail centres;
- TSB's digital (internet and mobile) banking capability is provided by Lloyds Bank under the TSA and LTSA and is based upon the capability of Lloyds Banking Group, which is currently the largest retail bank in the UK. Between the launch of TSB on 9 September 2013 and 31 March 2014, there were approximately 77 million log-ons to its internet banking channels, approximately 30 million of which were via TSB's mobile application; and
- TSB's four telephony contact centres, which are based in the UK, receive approximately 11 million calls per year and have sophisticated "Interactive Voice Response" technology (with approximately 65 per cent. of banking calls concluded via Interactive Voice Response).

Many of TSB's customers choose to bank with it across multiple channels, with 21 per cent. of customers during the fourth quarter of 2013 using both branch and digital channels, and 9 per cent. using telephony in addition.

TSB's service and sales capability is based on that of Lloyds Banking Group, and the TSB Board believes that in this respect TSB, which has the infrastructure and many of the capabilities of a large established provider, is well placed in comparison to other challenger banks. The TSB Board believes that the combination of TSB's high quality distribution channels and operational infrastructure (see "*TSB has a robust operating platform and operating model*" below) supports its ability to offer a smooth and efficient service and sales process to its customers.

See "*Branch network and other properties/distribution channels*" below for further information on TSB's distribution channels.

2.2.2 TSB has a robust operating platform and operating model

TSB's operating platform is underpinned by a comprehensive range of banking operations services powered by the established and proven operational infrastructure and applications of Lloyds Bank under the TSA and the LTSA. As a result, TSB has access to the benefits of banking infrastructure that is based on that of Lloyds Banking Group, the UK's largest retail bank. This banking infrastructure offers robust and resilient capabilities (with 99.96 per cent. availability levels achieved in 2013) that have been tested through several economic cycles, have supported the organic and inorganic growth of Lloyds Banking Group over a number of years and have been developed and continue to be maintained with significant levels of investment and expertise. In addition, the terms of the TSA and the LTSA contain measures to provide for parity of performance with Lloyds Banking Group covering incident management processes, service recovery and change delivery.

In order to minimise operational risks, TSB's operating model, including its processes and procedures, have been based on the equivalent Lloyds Banking Group processes and procedures. Further, TSB's operational employee base, the majority of which was transferred from Lloyds Banking Group companies, has a significant degree of experience and knowledge of those processes and procedures, and the underlying Lloyds Bank systems and infrastructure used to provide the TSA and LTSA services.

For more information on the TSA and the LTSA, including the provisions in relation to exit of services in a termination scenario, see "*Information technology/TSA and LTSA services*" below and Part XXII: "*Additional Information – Material contracts – Transitional Services Agreement*" and "*Long Term Services Agreement*".

2.2.3 TSB today has a comprehensive retail banking product suite

TSB is able to provide a comprehensive range of retail banking products to meet the needs of its personal banking customers, including:

- PCAs;
- savings products;
- mortgages;
- unsecured personal lending products; and
- certain insurance products.

The TSB Board believes that TSB's ability to offer a comprehensive suite of retail banking products is a significant strength (for further information in relation to the impact this has on participants in the market, see Part VIII: "*Market Overview – Background on the Retail Banking Market in the UK – Market Participants*").

See "*Business and activities*" below for further information on TSB's product offering.

TSB'S FINANCIAL STRUCTURE

2.3 TSB is comparatively low-risk

2.3.1 TSB has a comparatively low-risk balance sheet and financial structure

Straightforward balance sheet primarily consisting of predominantly high quality customer assets and liabilities

TSB's balance sheet is simple and straightforward, with historically low-loss retail mortgages, unsecured lending products and various other non-trading assets primarily funded by strong and stable customer deposits.

As at 31 March 2014, TSB had £23.3 billion of customer deposits and, as at 31 January 2014, 72 per cent. of its PCA customers had a tenure with TSB of six years or more. The strength and stability of TSB's retail funding base currently enables it to avoid reliance on significant wholesale funding of its assets.

As at 31 March 2014, TSB had TSB Franchise mortgage assets of £17.4 billion and those assets had:

- an average Indexed LTV Ratio of 46 per cent. and only 7.7 per cent. of the mortgage book with an Indexed LTV Ratio of greater than 90 per cent. as at 31 March 2014; and
- an average AQR of 0.02 per cent. in 2013, with an AQR of 0.03 and 0.01 per cent. in 2012 and 2011 respectively.

As at 31 March 2014, TSB also had £3.3 billion of Additional Mortgages (for further information, see Part IX: *"Introduction to TSB – Evolution of the TSB Business: 2013 OFT Recommendations"*), all of which had an Indexed LTV Ratio of less than 80 per cent. on transfer to TSB (which took place with effect from 28 February 2014).

The historically low-loss nature of TSB's mortgage assets reflects the European Commission's criteria for the composition of the business to be divested by Lloyds Banking Group (as well as the various changes that have been agreed to such criteria – for further information, see Part X: "*Information on the TSB Group*").

As at 31 March 2014, TSB also had unsecured lending assets of £2.1 billion.

The TSB Board believes that, driven by the quality of its mortgage assets, TSB's balance sheet will prove to be relatively resilient against changes in economic conditions, including any likely changes in interest rates. The TSB Board further believes that the predominantly unencumbered nature of TSB's mortgage assets leave it well placed to build on its existing funding arrangements (including the RMBS Funding Facility described in *"Mortgage Enhancement Structure and related funding arrangements"* below) and to meet its future funding requirements.

Strong capital base and robust liquidity

The TSB Board believes that TSB's levels of capital and liquidity are robust and high quality and will support its ability to grow. As at 31 March 2014 (on a pro forma basis):

- TSB's Common Equity Tier 1 Ratio was 21.6 per cent.;
- TSB's Total Capital Ratio was 27.1 per cent.;
- TSB's Leverage Ratio was 5.6 per cent.; and
- TSB's Liquidity Coverage Ratio was 146 per cent.

TSB's Common Equity Tier 1 is composed solely of common equity and disclosed reserves and can fully absorb losses on a going concern basis.

TSB's illustrative Common Equity Tier 1 Capital Ratio on a fully IRB basis (in respect of the TSB Franchise business) is approximately 17 per cent. and its Total Capital Ratio is approximately 21 per cent.

The TSB Board believes that these ratios demonstrate that TSB is comparatively well placed to meet the foreseeable new capital requirements in the short to medium term from both Europe and the implementation of the recommendations of the ICB.

For further information, please see Part XVIII: "*Unaudited Pro forma Financial Information*".

Geographical and sector footprint

TSB is a retail bank focused on the needs of its customers, who are almost entirely based in the UK. The TSB Board believes that this simplicity is a significant strength against the backdrop of a retail banking market where many of the participants are undergoing costly exercises to refocus on domestic operations and core asset classes.

2.3.2 TSB benefits from significant economic protection against legacy issues

Conduct issues

Legacy conduct issues, for example PPI redress, may continue to have a significant impact on the profitability of participants in the UK retail banking market. The aggregate provisions taken by Lloyds Banking Group, The Royal Bank of Scotland, HSBC, Barclays, Santander, Nationwide, the Co-operative Bank and Clydesdale in relation to PPI and interest rate hedging product mis-selling were £7.9 billion, £10 billion and £6.6 billion in 2011, 2012 and 2013 respectively. TSB benefits from a broad and, save in certain limited respects, uncapped indemnity from Lloyds Bank against losses arising out of historical

conduct issues, giving it an economic shield against one of the most acute challenges, and highest costs, faced by other participants in the market, as well as a greater degree of certainty than its competitors that it will not, for the period and within the scope of coverage, be subject to unforeseen costs in relation to conduct issues, remedies and redress. For further information on the conduct risk indemnity protection provided by Lloyds Bank to TSB, see Part XXII: "*Additional Information – Material contracts – Separation Agreement*".

Other legacy issues

TSB also has the benefit of a range of other protections and indemnities from Lloyds Bank against legacy issues, including uncapped indemnity protection against systemic breaches of customer agreements and systems errors resulting in inaccuracies in the recording of amounts owed by or to customers, and other indemnity protection relating to historical employment and pensions issues. For further information see Part XXII: "*Additional Information – Material contracts*". Additionally, TSB no longer recognises a retirement benefit obligation in relation to the Lloyds Banking Group defined benefit pension schemes. This has had the impact of removing the entire pensions deficit from the TSB balance sheet.

2.3.3 TSB's operating model has the benefit of ongoing investment

The benefit of ongoing investments that Lloyds Banking Group makes in its operational infrastructure (for example, changes to enhance systems resilience, security or efficiency, in response to changing regulatory requirements or to introduce innovative ideas and technologies) will also be available to TSB under the terms, and for the duration, of the TSA and LTSA at no extra cost above the core service charge payable by TSB. To enable the two banks to compete independently, investments by Lloyds Banking Group in strategic or competitive benefits will only be made available to TSB following an appropriate time delay.

For more information on the TSA and the LTSA, including the provisions in relation to exit of services in a termination scenario and the apportionment of the costs of exit between Lloyds Bank and TSB, see Part XXII: "*Additional Information – Material contracts – Transitional Services Agreement*" and "*Long Term Services Agreement*".

TSB'S STRUCTURAL CAPACITY FOR GROWTH

2.4 TSB has structural capacity for growth

The TSB Board believes that TSB has substantial capacity for growth.

2.4.1 TSB's market share in PCAs is not reflective of its branch footprint

In the UK, there tends to be a strong correlation between a retail bank's PCA market share of stock and its share of retail bank branches. The TSB Board believes that TSB's current branch network provides inherent headroom for growth in its share of PCA flow – as at 31 August 2013, TSB had approximately 6 per cent. of the retail bank branches in the UK against a share of approximately 4.2 per cent. of PCA stock (as at 30 September 2013). This disparity is driven by the fact that 164 of TSB's branches are heritage Cheltenham & Gloucester-branded branches, which did not, until May 2013, have the capability to offer PCAs, and therefore on average have a significantly lower number of PCA customers than the rest of TSB's network, providing a significant number of 'new' distribution points for these products.

2.4.2 TSB's operating platform is scalable and able to support growth

The nature of TSB's operating model, together with the terms of the TSA and the LTSA, allow for scaleability of TSB's banking platform, including in order to take advantage of growth opportunities in the TSB business. Further, given Lloyds Bank will carry out a comprehensive range of banking operations services for TSB under the TSA and LTSA, TSB has access to the benefits of the banking infrastructure of a much larger established provider.

2.4.3 TSB's cost base is not expected to grow proportionally with planned growth in the business during the term of the TSA.

Under the TSA, and under the LTSA until 31 December 2017, a significant element of TSB's fixed operating costs in the period to 31 December 2017 are predictable. The services provided under the TSA and LTSA provide TSB with many of the capabilities of a much larger retail bank. During the term of the TSA, and under the LTSA until 31 December 2017, this element of the cost base is not expected to grow significantly in proportion to TSB's planned growth and business volumes. The TSB Board believes that this stability is a significant advantage in the context of its growth strategy, providing the opportunity for TSB to grow without incurring proportionately corresponding costs.

2.5 There is significant potential for TSB to generate substantially improved returns in a rising interest rate environment

The TSB business has structural features which mean that although, in the opinion of the TSB Board, the TSB balance sheet is comparatively low-risk, it is particularly sensitive to movements in interest rates, leading to low relative returns in the current interest rate environment. However, the TSB Board believes that these same structural features should lead to potential for substantially improved returns in a higher interest rate environment. In particular:

- interest rate-insensitive PCA balances form a significant part of TSB's funding. TSB makes the conservative assumption that these balances will have a maturity of five years and they are therefore invested, along with free reserves, predominantly at a rolling five-year maturity (given an average two and a half year life) using interest rate swaps. This investment strategy both stabilises and enhances returns on these balances. The TSB Board believes that as a result of the current, historically low, level of five-year swap interest rates, coupled with the probability of their rising in advance of any increase in the Bank of England base rate, means that these balances may be expected in the future to generate a higher level of revenue than they do currently; and
- TSB has a comparatively large variable-rate savings product book. As at 31 December 2013, these products earned an average customer rate of 1.2 per cent. As the Bank of England base rate increases, the profitability of these products is expected to increase (for further information see Part VIII: "*Market Overview – How Retail Banks Make Money – Net Interest Income – Interest Rate Sensitivity*" .

In addition, TSB's mortgage margins are currently low relative to the market, driven in part by the high percentage (as at 31 December 2013, at 66 per cent., or £11.7 billion, of TSB's £17.7 billion TSB Franchise mortgage assets at the same date) of capped SVR mortgages in its portfolio. These products, which were written prior to June 2010, have a rate fixed at a maximum of 2 per cent. above the prevailing Bank of England base rate, which is considerably lower than the average rate for non-rate guaranteed products in the market (3.93 per cent. above the Bank of England base rate as at 31 March 2014 (Source: Bank of England)). Assuming future rises in the Bank of England base rate, the TSB Board believes that customers will look over time to re-mortgage from their capped SVR products (typically on to fixed rate). These products will be on the then prevailing rate, which may be higher or lower margin than the current SVR rate. However, these products will revert to an uncapped reversionary rate from which TSB should benefit over time.

TSB'S MANAGEMENT AND EMPLOYEES

2.6 TSB has a strong and experienced management team

TSB has strong and experienced Executive Directors and Senior Management, with a broad range of complementary experiences as set out in Part XI: "*Directors, Senior Management and Corporate Governance*", and a clear strategy in relation to the future of TSB (see "*Strategy*" below). TSB's Executive Directors and Senior Management bring a wealth of experience and expertise to the management and operations of TSB, with an average of 21 years in the retail financial services industry and, in particular, significant experience with both established and challenger banks.

Since 2011, the Executive Directors and Senior Management have overseen the separation of TSB Bank's activities from the retained Lloyds Banking Group businesses (for further information, see Part IX: *"Introduction to TSB – History of the management and governance of TSB"*).

The Executive Directors and Senior Management have, from the launch of the TSB business, also led an employee base of approximately 8,600 employees, approximately 85 per cent. of whom were transferred from Lloyds Banking Group companies. TSB has a named branch manager for every branch, with an average of 18 years' experience with Lloyds Banking Group, and the majority of TSB's 5,215 branch-based employees (as at 31 March 2014) have a Lloyds Banking Group heritage, and are therefore highly trained, knowledgeable and experienced, and familiar with the specific needs of the customers in the communities which they serve. TSB's mortgage advisers, banking advisers and cashiers have an average of 11, 12 and 15 years' experience with Lloyds Banking Group, respectively. Despite the levels of work required during the separation process, TSB has maintained high employee engagement scores amongst its branch-based employee population. TSB's scores on the Employee Engagement Index rose from 69 per cent. in May 2013 to 78 per cent. in October 2013 (as against a UK norm of 65 per cent. as at the same date, measured by IBM across a range of industries) and, on the Leadership Index, from 70 per cent. in May 2013 to 82 per cent. in October 2013 (as against a UK norm of 59 per cent. as at the same date, measured by IBM across a range of industries).

3 Strategy

The TSB Board has three clear strategic priorities in order to build upon TSB's existing strengths to drive growth and enhance returns:

- growing PCA market share;
- accelerating asset growth by re-entering the intermediary mortgage distribution channel in early 2015; and
- deploying TSB's considerable digital banking capability in order to reduce customer servicing costs, deepen existing customer relationships and create new customer relationships.

The TSB Board intends, through the delivery of its strategic objectives, to grow the TSB Franchise balance sheet by 40 to 50 per cent. over the five-year period from the date of this Prospectus, and over that period (based on market expectations as to interest rates, regulation and the competitive environment), move towards double digit return on equity (while continuing to grow). From 2015, the TSB Board intends to control TSB's cost growth to less than three per cent per year (excluding the increase in costs under the LTSA from 1 January 2017 and the additional costs as TSB establishes its own capabilities in replacement of certain services previously provided under the TSA). While the TSB Board's clear focus is on the three organic strategic priorities set out above, it remains open to considering appropriate inorganic opportunities as they arise.

3.1 Growing PCA market share

PCAs are an important part of the TSB strategy and the TSB Board believes them to be critical to the long term success of the business. They provide a stable source of funding, with 72 per cent. of TSB's PCA customer base as at 31 January 2014 having been customers for six years or longer. Additionally, PCA customers have a higher propensity to hold additional products than customers who do not hold PCAs, with average product holdings (indexed to 100) per TSB non-PCA customer as at 19 February 2014 being 100 against 189 for PCA customers. Since the launch of TSB, its PCA acquisition performance has been strong across all of its distribution channels, with TSB's number of PCAs rising from 3.08 million in September 2013 to 3.13 million in April 2014. TSB's strong performance in acquisition has not come at the expense of quality, with the percentage of new PCAs with a credit turnover of £750 or more (one month from opening) rising from 48.0 per cent. in September 2013 to 57.5 per cent. in April 2014 and average credit scores increasing over the same period and beyond.

The TSB Board believes that despite the relative maturity of the PCA market, the introduction of the current account switch guarantee scheme may present opportunities to acquire new PCAs going forward (for further information, see Part VIII: *"Market Overview – Personal Current Accounts"*). Further, the TSB Board believes that TSB's core capabilities leave it well positioned to take advantage of this market opportunity. An independent survey (source: GfK FRS) showed that among the key reasons for customers switching their PCA away from a bank or building society were unhelpful staff (13 per cent.), queues in branches (13 per cent.) and

transaction errors (12 per cent.)[3]. The TSB Board believes that the experience of TSB's branch staff and TSB's established branch operating model and robust operating platform will be instrumental in assisting it in avoiding attrition in its PCA customer base. The same survey demonstrates that the key reasons for customers choosing to switch to a bank include convenience of branch location (34 per cent.), personal recommendation (14 per cent.) and reputation (13 per cent.). The TSB Board believes that its established and well-located branch network, strong and stable customer base and values-led challenger brand will assist it in attracting new PCA customers. For further information in relation to TSB's core capabilities, see "*Key strengths*" above.

It is a strategic priority of the TSB Board to grow TSB's market share of PCA flow in excess of its market share of branches in the UK (approximately 6 per cent. as at 31 August 2013). The TSB Board believes that this growth would bring TSB's share of PCA market stock (relative to its branch network) increasingly into line with the market norm, which tends to see a strong correlation between PCA market share of PCA stock and branch market share. The TSB Board also believes that TSB's 164 legacy Cheltenham & Gloucester-branded branches will be an important enabler of TSB's PCA acquisition strategy. These branches historically focused on mortgage and savings products and did not until May 2013 have a PCA capability and therefore constitute "new" points of distribution for these products. Additionally, the TSB Board believes that its legacy Cheltenham & Gloucester-branded branches are well located to deliver growth, being concentrated in regions with high relative levels of PCA switching activity.

The TSB Board has also planned a series of actions designed to assist TSB in delivering its growth strategy, including:

- investment in further marketing of TSB's strong, values-led brand in order to raise awareness and drive consideration of TSB amongst non-customers; and
- the development of products which resonate with customers and reflect TSB's brand values. In April 2014 TSB launched a new PCA called the Classic Plus. This product is simple and straightforward, and open to new and existing customers. The Classic Plus account offers customers an ongoing rate of interest, which does not end after an initial period and is clear and transparent, without complicated tiered rates. Initial reactions to the Classic Plus account have been encouraging, with TSB's weekly average PCA sales rising from approximately 7,300 pre-launch of the product to a peak of approximately 17,000 per week in the first three weeks post-launch (with sales of approximately 14,600 and 11,100 per week in weeks four to six and seven to nine post-launch respectively). Through mass appeal new product developments like this, the TSB Board intends to introduce the TSB brand to a wide range of potential customers in the UK.

Due to the high numbers of transactions undertaken by PCA customers, the TSB Board believes that growth in TSB's PCA market share would provide it with valuable opportunities to meet the needs of those PCA customers for other banking products, particularly unsecured lending and savings products (31 per cent. of TSB's PCA customers who had held an account for 10 years or more as at March 2014 also held a credit card with the bank, whilst 11 per cent. had a personal loan and 85 per cent. had a savings product). Such growth would also provide TSB with additional deposits and therefore low-cost funding to enable growth of its assets, via on-lending to retail and small business customers in communities across the UK.

3.2 Accelerating asset growth by re-entering the intermediary mortgage distribution channel in early 2015

TSB previously had but does not currently have a mortgage intermediary platform. It is currently unable, therefore, to access the significant proportion of the UK's retail mortgage market that is sold through intermediaries (in 2013, 54 per cent. of gross new mortgage lending (excluding further advances) was written through intermediaries (source: Bank of England/Council of Mortgage Lenders)). It is a strategic priority of the TSB Board to utilise the mortgage intermediary platform that Lloyds Bank has undertaken to provide to TSB under the Mortgage Intermediary Platform Build Agreement from 9 January 2015, in order to

[3] GfK NoP Financial Research Survey, 12 months ended 31 December 2013, All Switching Current Account in the last 12 months

supplement its own direct lending distribution channels, and access the high proportion of the market sold through intermediaries. The platform that Lloyds Bank has undertaken to provide to TSB is a replica of the market-leading Lloyds Banking Group intermediary platform, and TSB intends to develop a proposition that is attractive to both the underlying customer and the intermediary, competitive on pricing, focused on service and with a mix of products that is reflective of the overall market mix. For further information on Lloyds Bank's agreement to provide TSB with a mortgage intermediary platform, see Part XXII: "*Additional Information – Material Contracts – Mortgage Intermediary Platform Build Agreement*".

The TSB Board believes that in order for TSB to be successful in the intermediary mortgage market, it will be critical to form relationships with key intermediaries. Between January and November 2013, 10 key accounts were responsible for nearly 85 per cent. of lending undertaken in the sector (source: Touchstone). TSB has already had a positive response from some of the largest intermediaries, and the TSB Board intends to ensure that TSB's proposition is set up to respond to the key needs of intermediaries, providing:

- quick and reliable decisions;
- consistent and high quality service;
- personal relationship management and knowledgeable agents;
- a broad and competitive product range with tailored fees, rates and incentives; and
- an industry-recognised stable platform, already widely used.

In the medium term, TSB aims to grow gross new lending through the intermediary channel to approximately £4 billion per year, which the TSB Board believes will represent less than 3 per cent. of gross new lending through this channel in the UK. The TSB Board also aims to grow TSB's mortgage assets through direct channels and unsecured personal lending primarily to its PCA customers in order to achieve 40 to 50 per cent. growth in its TSB Franchise balance sheet over the five year period following Admission.

3.3 Deploying TSB's considerable digital banking capability in order to reduce customer servicing costs, deepen existing customer relationships and create new customer relationships

The TSB Board believes that a digital customer service capability is and will increasingly prove to be a critical service factor for banking customers in the UK and a key channel for engaging with customers. In a 2013 sample survey of UK adults aged 18-35, PCA holders rated "good internet banking" as their "most valued banking service" (57 per cent.), ranking ahead of factors such as "good interest rate on savings" (44 per cent.) and "high quality service" (36 per cent.) (source: TNS, Current accounts – the big bang? (2013)). Mobile banking is also a rapidly growing feature of the market across the industry – GfK's Financial Research Survey estimated that approximately 8.2 million banking customers across England, Scotland and Wales used mobile devices to manage their bank accounts (source: GfK NOP Financial Research Survey, three months ended September 2013, All Current Account holders). Between launch of TSB on 9 September 2013 and 28 April 2014, there were approximately 460,000 downloads of TSB's mobile banking application.

TSB has a significant customer base that is engaged with its digital channels, which are based on that of Lloyds Banking Group, the UK's largest retail banking group. As at 31 December 2013, its high quality internet banking channel had approximately 1.83 million registered users, amounting to 41 per cent. of its total customer base as at the same date.

The TSB Board aims to leverage TSB's high quality and scalable digital banking channel in order to:

- reduce the costs associated with servicing in comparison with other distribution channels;
- create more new customer relationships. The TSB Board believes in particular that an opportunity exists for TSB to drive more new PCA relationships through online channels (from 1 January 2014 to 26 March 2014, 10 per cent. of TSB's new PCAs were acquired through digital channels as against 34 per cent. of new savings products). The TSB Board aims to at least double TSB's digital PCA market share of flow through product offerings

like the new Classic Plus account which have a broad appeal as well as through investment in its public website and in optimising its mobile applications processes; and

- utilise the opportunities that exist to meet more customer needs. As at 31 December 2013, the average product holding of TSB customers who were active digital banking users was almost double that of customers who were not registered for digital banking. In addition, new TSB customers who register for digital banking have a much higher propensity than those who do not register to open an additional product shortly after first becoming a customer. The TSB Board aims to increase the digital activity of new customers over time by ensuring that branch and telephony employees are enabled to assist in registering customers for digital channels (currently approximately 9,400 customers register in branch each month), thereby driving a more integrated multi-channel experience.

3.4 Strategic investment

The TSB Board plans to incur operating expenses of approximately £50 million per year over the next five years in connection with investment in the delivery of its strategic objectives. This investment is expected to focus on:

- product propositions, to enable TSB to offer products that meet emerging customer needs;
- branch network, including refurbishment, relocations and strategic new branch openings;
- employee and customer experience;
- branch servicing model;
- digital (internet and mobile) channels, with a specific focus on service;
- business operating model, with a focus on simplification; and
- brand.

4 Business and activities

TSB offers a range of banking services and products to individuals and predominantly 'micro' business banking customers throughout the UK. As at 31 March 2014, TSB had approximately 4.5 million retail customers and approximately 113,000 small business banking customers.

4.1 Deposits

4.1.1 PCAs

Overview

As at 31 March 2014, TSB had approximately 3.09 million PCA customers and £6.1 billion of PCA customer deposits.

For most retail customers, a PCA is at the core of their overall relationship with a bank. PCAs provide retail banks with loyal customers and a source of resilient, low-cost funding.

Whilst TSB offers attractive rates of interest on qualifying PCA balances held on some of its PCA products (including the Classic Plus account), in common with some other market participants, the majority of its PCA deposits are non-interest bearing.

Table 1: Breakdown of PCA customer deposits held by TSB as at 31 March 2014.

PCA Deposits	As at 31 March 2014 (unaudited)	
	(£ billions)	*(percentages)*
Interest bearing	2.3	38
Non-interest bearing	3.8	62
Total	**6.1**	**100**

Source: TSB internal data as at 31 March 2014

Customer needs

The TSB Board believes that customers have the following three core underlying needs from a PCA:

- ***Transact*** – to enable them to pay for goods and services securely in store and online and to enable them to pay their monthly bills and other outgoings;
- ***Borrow*** – to borrow through a planned overdraft when money is tight or for unexpected expenditures and through unplanned overdrafts for important expenses in an emergency, such as rental and mortgage payments; and
- ***Budget*** – to enable them to budget and organise their finances.

The TSB Board also believes that in choosing a PCA provider, customers have high regard to the extent to which they perceive a bank as likely to offer safe custody of their deposits.

Further, the TSB Board believes that customers will require access to a range of different PCAs, which will meet their differing personal circumstances and priorities.

Meeting customer needs

TSB focuses on helping its customers choose a product that meets their needs and requirements for transacting, borrowing and budgeting. To achieve this, TSB offers its retail customers:

- access to a range of standard PCAs, including full-service PCAs and a range of PCAs designed to meet the needs of particular customer groups; and
- the opportunity, open to existing PCA customers, to upgrade their standard PCA online to a range of AVAs which provide benefits such as roadside assistance, travel and mobile phone insurance and preferential overdrafts to customers, in exchange for a monthly fee.

Benefits to TSB arising from the PCA business

TSB generates the following benefits from its PCA business:

- PCAs tend to provide a resilient source of funding, at a low cost relative to wholesale funding costs;
- rate insensitive PCA balances are invested by TSB predominantly in a rolling series of five-year interest rate swaps. This investment strategy "reflects" the assumed behavioural maturity of these balances and both stabilises and enhances returns;
- deposits held in PCAs are lent by TSB to households and local businesses across the UK. TSB charges interest on these loans and typically the interest charged on the loans is greater than the interest, if any, paid by TSB on the average PCA deposits;
- TSB charges a higher fee for the benefits that it provides under AVAs than the cost it incurs for providing such benefits;
- TSB receives fees on all purchases customers make using their debit cards and also earns fees on certain other types of customer payments (such as CHAPS payments); and
- the OFT has previously concluded that PCAs are an important 'gateway' product, and the TSB Board believes that they provide valuable opportunities to provide customers with a range of other banking products and services.

4.1.2 Savings accounts

Overview

As at 31 March 2014, TSB had £16.4 billion of savings account customer deposits.

Savings accounts typically offer customers higher interest rates on deposits than PCAs. Savings accounts can offer a fixed interest rate for a fixed term, or a variable interest rate

(which may change at the discretion of the bank but often moves in response to changes in the Bank of England base rate). Variable rate savings accounts may also include a "bonus" rate on top of the standard variable deposit rate for a specified term. For further information see Part VIII: "*Market Overview – Savings Accounts*". Deposits held with savings accounts can either be instant access (where customers can withdraw the deposits at any time) or be term deposits (where customers can only withdraw deposits without penalty at the end of the term).

Customer needs

The TSB Board believes that customers have the following two core underlying needs from a savings account:

- ***Budget and save*** – to enable them to budget, save and organise their finances; and
- ***Earn*** – to enable them to earn a rate of return from the interest paid on these products.

Meeting customer needs

To meet the customer need described above, TSB offers its retail customers:

- access to a range of fixed and variable rate ISAs (individual savings accounts);
- access to a range of fixed term savings accounts; and
- access to a range of instant access savings accounts.

The following table sets out TSB's savings account book by account type.

Table 2: Breakdown of savings deposits held by TSB as at 31 March 2014.

Savings Deposit	As at 31 March 2014 (unaudited)
	(percentages)
Instant access	67
Fixed	6
ISA Variable rate	18
ISA Fixed	9
Total	**100**

Source: TSB internal data as at 31 March 2014

Benefits to TSB arising from the savings business

TSB generates the following benefits from its savings account business:

- deposits held in savings accounts are lent by TSB to households and local businesses across the UK. TSB charges interest on these loans and typically the interest charged on the loans is greater than the interest paid by TSB on the deposits; and
- savings deposits, and in particular fixed term deposits due to their longevity, are an important source of stability for TSB's funding base.

4.2 Residential mortgages and unsecured lending

4.2.1 Residential mortgages

Overview

The information in this paragraph 4.2.1 in relation to TSB's residential mortgage business excludes information in relation to the Additional Mortgages. For further information on the Additional Mortgages, see *"Mortgage Enhancement Structure and related funding arrangements"* below.

As at 31 March 2014, TSB had total TSB Franchise mortgage assets of £17.4 billion.

During the year ended 31 December 2013, TSB's gross new mortgage lending amounted to £1,393 million (which does not include further advances) and net repayments were £937 million. All of TSB's new residential mortgage lending is advanced under the TSB brand.

TSB's residential mortgage portfolio consists solely of residential mortgage loans to individuals secured on residential properties located in the UK. The majority of TSB's residential mortgage loans are fully secured by way of a first ranking charge on the residential property to which the mortgage loan relates on terms which allow for the repossession and sale of the property if the borrower fails to comply with the terms of the loan.

TSB offers both mainstream residential mortgage lending (where the borrower is the owner and occupier of the mortgaged property) and buy-to-let lending (where the borrower intends to let the mortgaged property). In common with other residential mortgage lenders in the UK, TSB does not currently offer mortgages to borrowers who self-certify their income or who have adverse credit histories (sub-prime). However, unlike many lenders, TSB also has no historical self-certification or sub-prime business in its mortgage portfolio.

The following table sets out TSB's residential mortgage loans, broken down by type, as at 31 March 2014.

Table 3: Breakdown of TSB's residential mortgage loans as at 31 March 2014

Product Type	**As at 31 March 2014 (unaudited)**	
	(£ billions)	*(percentages)*
Mainstream	15.1	87
Buy-to-let	2.3	13
Total	**17.4**	**100**

Source: TSB internal data as at 31 March 2014

The following table sets out the geographical distribution of TSB's residential mortgage loans as at 31 March 2014. TSB's residential mortgage lending is particularly concentrated in Scotland, the South East of England and London.

Table 4: Geographical analysis of TSB's residential mortgage loans as at 31 March 2014

Region	**As at 31 March 2014 (unaudited)**
	(percentages)
Scotland	24.1
South East	18.5
London	16.8
South West.	10.4
West Midlands	7.5
North West	5.8
Yorkshire and Humber	4.9
Other	12.0
Total	**100**

Source: TSB internal data as at 31 March 2014

As at 31 March 2014, TSB's mortgage assets had an average Indexed LTV Ratio of 46 per cent. and only 7.7 per cent. of the mortgage book had an Indexed LTV Ratio of greater than 90 per cent. For further information on the quality of TSB's mortgages, see *"Key strengths – TSB is comparatively low-risk"* above.

TSB does not currently participate in the 'Help to Buy' scheme, under which the Government provides a guarantee to lenders of up to 15 per cent. of a loan's value. The Help to Buy scheme has already improved the availability of higher LTV mortgages in the

market, but none of TSB's higher Indexed LTV mortgages have the benefit of this Government guarantee.

Customer needs

At the most basic level, the majority of customers require residential mortgage loans to be in a position to buy their home. Residential mortgage customer needs can broadly be split into four groups: first time buyers, home movers, re-mortgagers and those seeking a further advance. The buy-to-let mortgage market forms a fifth category.

Factors which are important to customers when they are applying for residential mortgages include whether they will be able to afford the monthly repayments, the level of deposit that they will be able to provide and their requirements as to certainty of the interest rate applicable.

Meeting customer needs

TSB currently offers both fixed rate and tracker rate mortgage loans. Fixed rate mortgage loans give the customer certainty in relation to the amount of interest payable due on a monthly basis. Tracker rate mortgage loans allow customers a variable payment structure that follows movements in interest rates.

Fixed rate mortgage loans have a set rate for an initial set period, after which the rate reverts to TSB's SVR (for mortgages applied for before 1 June 2010) or TSB's HVR (for mortgages applied for on or after this date). TSB's SVR is guaranteed to be no more than 2 per cent. above the prevailing base rate, and TSB's HVR, 3.99 per cent. as at 31 March 2014, is set at TSB's discretion. TSB's fixed rate mortgage loans currently offer a term of two or five years and as at 31 March 2014, the weighted average front book gross customer rate is 3.48 per cent., including Base Rate.

Tracker rate mortgages have a set methodology for determining a variable rate for an initial set period, after which, as with TSB's fixed rate mortgages, the rate reverts to TSB's SVR or HVR, as applicable. TSB's tracker rate mortgage loans currently offer a term of two years at a variable rate that is a fixed percentage above the Bank of England's base rate. The fixed percentage above the Bank of England's base rate is largely determined by the LTV Ratio of the mortgage in question.

The table below sets out TSB's residential mortgage loans, broken down by interest type, as at 31 March 2014.

Table 5: Breakdown of residential mortgage loans by interest type as at 31 March 2014

Product	As at 31 March 2014 (unaudited)	
	(£ billions)	*(percentages)*
SVR	11.3	65
Fixed	2.8	16
Tracker	2.1	12
HVR	1.2	7
Total	**17.4**	**100**

TSB offers repayment and interest-only mortgages. Customers with repayment mortgages pay off both interest and capital, usually on a monthly basis. Customers with interest-only mortgages pay off only the interest, usually on a monthly basis, the intention being that the amount saved is re-invested in a repayment vehicle which is used to repay the capital at the expiry of the mortgage term.

The table below sets out TSB's residential mortgage loans, broken down by repayment type as at 31 March 2014.

Table 6: residential mortgage loans by repayment type as at 31 March 2014

Repayment type	As at 31 March 2014 (unaudited)
	(percentages)
Repayment	54.7
Interest only	45.3
Total	**100**

Source: TSB internal data as at 31 March 2014

Benefits arising to TSB from the residential mortgage loans business

TSB generates the following benefits from its residential mortgage loans business:

- TSB charges interest on its mortgage loans which generates income;
- TSB charges fees on its mortgage loans, which contribute to covering the costs associated with setting up, maintaining and closing down accounts;
- to reduce the costs incurred by TSB in connection with the early repayment of residential mortgage loans, in common with other residential mortgage lenders in the UK, TSB imposes early repayment charges on certain of its residential mortgage products. The early repayment charges apply for repayments made prior to the expiration of a fixed rate or tracker rate for a particular product; and
- the TSB Board believes that residential mortgage loans provide opportunities to provide customers with other related products, for example, insurance.

4.2.2 Unsecured lending

Overview

The unsecured lending products offered to retail customers by TSB consist of unsecured personal loans, credit cards and overdrafts.

The following table sets out TSB's retail unsecured lending balances split by type of product as at 31 March 2014.

Table 7: TSB's retail unsecured lending balances, split by type of product as at 31 March 2014

Product type	As at 31 March 2014 (unaudited)	
	(£billions)	*(percentages)*
Personal loans	1.3	62
Credit cards	0.5	24
Overdrafts	0.3	14
Total personal unsecured lending balances	**2.1**	**100**

Source: TSB internal data as at 31 March 2014

Unsecured personal loans

As at 31 March 2014, TSB's unsecured personal lending portfolio was £1.3 billion.

TSB's unsecured personal loan portfolio consists of fixed rate lending to customers who have an existing relationship with TSB, 'Graduate Loans' for customers who require assistance with their finance following graduation and an 'Additional Borrowing' facility for customers who already have an unsecured personal loan with TSB.

There is a greater risk of loss for TSB on unsecured personal lending than there is on residential mortgage lending due to the fact that TSB holds no security that can be enforced if the customer defaults on the loan. As a result, the interest rates on TSB's unsecured personal loans are higher than the interest rates on TSB's residential mortgage loans (with an average interest rate of 12.5 per cent. as against 2.8 per cent. for TSB's residential loans).

Credit cards

As at 31 March 2014, TSB's credit card portfolio contained receivables of £0.5 billion.

As at 31 December 2013, TSB had approximately 734,400 credit card accounts, of which 468,400 were active during December 2013 (in that the relevant account recorded a debit or credit or carried a balance during that period).

PCA Overdrafts

TSB also offers both planned and unplanned overdrafts to its PCA customers. Planned overdrafts are overdrafts that have been formally agreed to by TSB. Unplanned overdrafts are overdrafts that have not been formally agreed to by TSB and occur where a PCA holder pays or withdraws money from their PCA in excess of their credit balance or the amount of their planned overdraft.

Customer needs

The TSB Board believes that customers have different needs for unsecured lending products:

- unsecured personal loans allow customers to borrow an agreed sum of money for a specified period of time. These products are often used to fund specific one-off larger scale purchases; and
- cards provide customers with two services: a means of making payment and a revolving credit facility. These products are often used for day-to-day financial management.

Meeting customer needs

TSB meets the needs of its customers through its broad range of unsecured lending products:

- a range of fixed rate personal loans available for terms of one to seven years with a value of £1,000 to £25,000; and
- a range of credit cards, including rewards credit cards.

Benefits to TSB arising from the unsecured lending business

TSB generates the following benefits from its unsecured lending business:

- TSB charges interest on the outstanding balance of its unsecured lending products, which generates income;
- to reduce the costs incurred by TSB in connection with the early repayment of unsecured personal loans, in common with some other lenders, TSB imposes early repayment charges on certain of its unsecured loan products, and also imposes late payment fees on certain of its credit cards;
- TSB receives fees on all purchases customers make using their credit cards; and
- TSB charges PCA holders interest on planned and unplanned overdrafts and charges fees associated with overdraft usage.

Customer application assessment process for residential mortgage loans and unsecured lending

As part of its application process, TSB uses its considerable experience to consider various factors (including a potential customer's credit score and the results of an affordability

calculation) before deciding the amount of money it is prepared to advance to a customer under a residential mortgage or unsecured loan or the credit limit it is prepared to offer on a credit card.

4.3 Insurance products

Overview

TSB currently offers, through its branches, a home and contents insurance product which is administered and underwritten by Lloyds Banking Group companies. TSB has also recently entered into an agreement with Legal & General to offer life and critical illness insurance products to TSB customers from July 2014.

Customer needs

Insurance products provide customers with cover and security for specific events. Where such an event arises or takes place the insurer agrees to pay for the financial consequences of the event within pre-agreed limits.

Meeting customer needs

TSB currently offers, through branches, TSB Home Solutions Insurance, a five star Defaqto rated home and contents insurance product, inclusive of legal expenses and an emergency helpline service. This product is administered by Lloyds Bank Insurance Services Limited ("**LBIS**") and underwritten by Lloyds Bank General Insurance limited ("**LBGI**"). TSB distributes TSB Bank Home Solutions Insurance under a General Insurance Distribution Agreement with LBIS. For further information see Part XXII: *"Additional Information – Material Contracts – General Insurance Distribution Agreement"*.

TSB also recently entered into an agreement with Legal & General pursuant to which TSB will, from July 2014, refer customers who wish to purchase life and critical illness insurance products to Legal & General. The agreement with Legal & General will allow TSB customers to purchase critical illness, whole of life, term and decreasing term assurance and income protection products over the telephone, with TSB branches referring customers to a team of Legal & General financial advisers dedicated to TSB customers.

The TSB Board will review TSB's insurance offering regularly in order to identify opportunities to further meet its customers' needs.

Benefits to TSB arising from the insurance business

In return for offering home and contents insurance products provided by LBIS, TSB receives a fee commission and profit share.

In return for referring customers who wish to purchase life and critical illness insurance products from Legal & General, TSB receives a fee commission.

4.4 Business banking

Overview

TSB does not have a full service business banking offering and its business banking products, services and IT capability are geared toward meeting the basic banking needs of 'micro' business banking customers (which TSB defines as business banking customers with a revenue of less than £500,000 and borrowing no more than €1 million). TSB business banking business accounted for 2.3 per cent. of TSB's net interest income during the three months ended 31 March 2014. TSB offers a range of products aimed at meeting the needs of its business banking customers, in the form of BCAs, savings products and secured and unsecured lending products. As at 31 March 2014, TSB had business customer assets of £313 million and business customer liabilities of £787 million (of which £667 million were BCA deposits and £120 million were savings deposits) although these balances may be subject to customer attrition where customers seek a less basic business banking service.

5 Branch network and distribution channels

5.1 Overview

TSB has an extensive and well-located branch network with strong coverage of England, Scotland and Wales and a depth of employee experience, an established on-shore telephony platform and high quality internet and mobile capabilities based on that of Lloyds Banking Group, the UK's largest retail bank. The TSB Board believes that this high quality, multi-channel customer service and distribution network allows TSB to serve the needs of its customers in a manner that is consistent with its focus on customers and local communities and its commitment to the values of transparency and fairness.

5.2 Branch banking

TSB is the seventh largest retail banking group in the UK by branch network with 631 branches (as at August 2013) amounting to approximately 6 per cent. of the retail branches in the UK (as at 31 August 2013). The branches were selected, from legacy Cheltenham & Gloucester-branded (164 branches in total) and Lloyds TSB-branded (467 branches in total) branches operated by Lloyds Banking Group, on the basis of the criteria set out in Part IX: *"Introduction to TSB – Evolution of the TSB business: customer and non-customer assets"* and are well-located, with approximately 46 per cent. of the population of England, Scotland and Wales living within two miles of a TSB branch as at December 2010 when the branch network was established. As at January 2014, TSB had branches in 89 per cent. of major retail centres in Britain.

The TSB Board believes that TSB's extensive and well-located branch network:

- has played and will continue to play a key role in TSB's ability to meet the needs of its customers in local communities across the UK; and
- will continue to provide an important source of customer acquisition and deposit and asset growth. During January and February 2014, 88 per cent. of TSB's new PCAs, 85 per cent. of TSB's mortgage applications and 71 per cent. of TSB's new unsecured personal loan sales were generated in branches.

The TSB Board believes that its branches have features which are attractive to retail customers and, on average, are of a sensible size (that is, are not excessively large and therefore costly or too small). As at October 2013, the average size of a TSB branch was 220 m^2 (source: GOAD data, October 2013), at the mid-point of its peer group and the location quality of TSB branches was in line with peers. 58 per cent. of TSB branches have been classified as "retail branches" (meaning glass-fronted) and 24 per cent. of branches have been classified as "open-plan" (meaning that there is no separating screen between the customer and the cashier), both of which the TSB Board believes to be attractive features for customers. The branch network also offers 831 branch-located ATMs.

The majority of TSB's 5,215 branch-based staff were transferred from Lloyds Banking Group companies, providing TSB customers with a significant degree of consistency in their local branch and a depth of experience in the network. As at March 2014, the average tenure of branch-based employees was 15 years, the average tenure of branch managers was 18 years and the average tenure of branch-based mortgage advisers, banking advisers and cashiers was 11 years, 12 years and 15 years respectively, in each case in experience with Lloyds Banking Group.

5.3 Optimisation of branch operation and customer service

The TSB Board believes that the needs of its customers will be best met, and that levels of customer service and experience will be optimised, by ensuring operational consistency across its customer services and distribution channels.

As part of this drive for consistency, the TSB Executive Directors and Senior Management have implemented a multi-stage programme in order to integrate its 164 heritage Cheltenham & Gloucester-branded branches with its heritage Lloyds TSB-branded branches into a single cohesive network. The integration programme consisted of two key aspects: (i) the re-branding of the heritage Cheltenham & Gloucester-branded branches to TSB branding and the introduction of the functionality required to provide banking products not previously available

in those branches (principally PCAs and unsecured lending products); and (ii) an extensive programme of employee training designed to ensure that all branch staff offer consistent customer service across TSB's full product range (including those products not historically available in the heritage Cheltenham & Gloucester-branded branches). Specifically:

- various technical and physical changes to the heritage Cheltenham & Gloucester-branded branches have been implemented, including upgrades to security measures, the introduction of chip & pin technology, the replacement of 157 counter positions and the introduction of PCA and unsecured lending capability. During 2014, ATMs were rolled out across selected heritage Cheltenham & Gloucester-branded branches that did not previously host them; and
- approximately 73,000 training hours took place and staff transferred between branches in order to equip heritage Cheltenham & Gloucester-branded branch-based employees with the skills to provide and service the expanded product range, including PCAs. A single unified management team across all of the TSB branches was also created.

This programme has resulted in TSB having 164 "new" points of distribution for PCAs. Total sales productivity in legacy Cheltenham & Gloucester-branded branches is improving, with productivity equivalent to 54 per cent. of that of the legacy Lloyds TSB-branded branches in February 2014 against 31 per cent. in February 2013 and 40 per cent. in October 2013. PCA productivity has grown rapidly, from zero per cent. of that of the legacy Lloyds TSB-branded branches in February 2013 to 78 per cent. in February 2014. Transactional productivity has doubled, from 17 per cent. of that of the legacy Lloyds TSB-branded branches in August 2013 to 35 per cent. in February 2014. Following the TSB launch, the performance of its legacy Lloyds TSB-branded branches has also been strong, with new business doubling from June 2013 to October 2013 and mortgage productivity increasing by 39 per cent. between July 2013 and February 2014.

The TSB Board also aims to ensure that the TSB branch network is operated and managed on a unified basis with a single set of standards and performance metrics (known collectively as "One Best Way") and reporting lines. Each branch is treated on a consistent basis, regardless of whether the branch is a legacy Lloyds TSB- or Cheltenham & Gloucester-branded branch. "One Best Way" is monitored through processes of individual annual branch review against common standards, and is designed to result in consistency in customer service across the network of products, procedures and policies. ATM services and functionality are also centrally monitored for operational consistency and performance, in line with the "One Best Way" initiative. The TSB Board believes that the increased productivity of, and activity in, TSB's branch network has been achieved while maintaining high levels of customer service – TSB is one of the top two brands for customer satisfaction of branch service in Britain[4] and customers continue to score highly when asked if they would recommend TSB[5].

5.4 Digital

TSB provides a mature and sophisticated digital banking capability based on the capability of Lloyds Banking Group, the UK's largest retail bank, and offering a wide range of products through internet and mobile banking. As at 31 December 2013, TSB had approximately 1.83 million registered digital banking users. Between September 2013 and March 2014, there were approximately 77 million log-ons to TSB's digital banking services (over 30 million of which were made via TSB's mobile banking application).

5.5 Telephony

TSB also provides a full-service telephone banking capability with four telephony contact centres, based on Lloyds Banking Group operations to ensure stability and consistency of performance and functionality and focused on a wide range of areas of customer servicing and product sales. TSB's telephony channel functions 24 hours a day, 365 days a year and is staffed by 926 employees with an average of seven years' experience with Lloyds Banking Group.

[4] GfK NoP Financial Research Survey six months ended March 2014, Main Current Account customers extremely/very satisfied with branch service

[5] TSB internal data

This telephony capability is operated using Lloyds Bank-owned systems and infrastructure provided to TSB under the TSA and includes established automated, self-verification and "Interactive Voice Response" functionality.

TSB's telephony centres are located on-shore in the UK in four contact centres (in Sunderland, Swansea, Gloucester and Edinburgh (small business banking only)). Collectively, these contact centres receive approximately 11 million calls a year and are subject to rigorous monitoring and quality assessment. TSB has also introduced local rate telephone numbers in order to further enhance the customer experience of its telephony channel.

The TSB Board believes that its full service telephone banking capability (alongside its digital capability) brings with it opportunities to reduce the costs associated with sales and servicing its customers through branches and to free up capacity in those branches to meet more customer needs.

6 Employees and operational functions

6.1 Employees

TSB has approximately 8,600 employees, who are of vital importance to its business. Approximately 85 per cent. of its employee base has a Lloyds Banking Group heritage and is therefore experienced and knowledgeable in relation to TSB's systems and processes, which were created as a replica of Lloyds Banking Group's capability. TSB's branch managers have, on average, over 18 years' experience with Lloyds Banking Group and TSB and the majority of TSB branch employees have a Lloyds Banking Group heritage and are therefore familiar with the specific needs of the communities which they serve.

TSB aims to achieve high levels of employee satisfaction and engagement by ensuring that all employees understand, and are engaged in, TSB's aim of pioneering "local banking for Britain" and the delivery of its strategic objectives. TSB's employee engagement scores are high – for further information, see "*Key Strengths – TSB has a strong and experienced management team and employee base that are dedicated and committed to the success of TSB*" above.

TSB's remuneration strategy in relation to branch-based employees is focused on ensuring excellent customer service in every interaction, and for that reason is targeted towards rewarding customer service. None of the variable elements of branch-based employees' remuneration is directly linked to sales performance.

6.2 Employee functions

TSB's employee base carries out a broad range of functions, broadly split into four groups:

- branch and business banking;
- customer operations, including property, operations, customer relations, branch network design and operational support, telephony, procurement and supplier management, IT and business change;
- products and marketing, including customer brand and marketing, digital and products; and
- head office functions, or the 'corporate core', including finance, treasury, risk, fraud and underwriting, HR, legal, audit, corporate affairs, communications and the executive team.

In addition to TSB's telephony centres (for further information, see "Telephony" above), TSB has three operations sites in Sheldon, Gloucester and Edinburgh and has four head office sites in London, Edinburgh, Bristol and Gloucester. In addition, TSB has a small operation function in Bangalore through a third party outsourcing provider.

The table below sets out TSB's employee base by function as at 31 March 2014.

Table 8: Employee base by function as at 31 March 2014

Function	Number of employees (as at 31 March 2014)
Branch and business banking	
Branch network	5,215
Business banking	138
Customer operations	
Property	18
Operations	573
Customer relations	116
Branch network design and operational support	82
Telephony	926
Procurement and supplier management	22
IT	16
Business change	104
Products and marketing	
Customer brand and marketing	70
Digital	23
Products	84
Head office functions	
Finance	295
Treasury	55
Risk	442
Fraud and underwriting	213
HR	125
Legal	15
Audit	18
Corporate affairs	21
Communications	11
Executive	18
Total	**8,600**

7 Information technology/TSA and LTSA services

TSB's information technology department is organised into three functions: Service Management, Enterprise Architecture and IT Strategy.

As at and from Admission, TSB will continue to receive from Lloyds Bank a range of banking operations services under the TSA until 31 December 2016, including:

- IT services, including to support TSB's bank branches, internet, mobile and telephone banking, ATM network and head office and operations functions;
- payments-related services, including card processing, electronic payments processing and cheque clearing; and
- a range of other operational services, including, for example, to support TSB's finance function, ATM maintenance, print and mail services and cash in transit services.

A subset of these services (including IT services, payments related services and print and mail services) will continue to be provided by Lloyds Bank for a further period from 1 January 2017 for up to seven and a half years under the LTSA. Thereafter, payment services may be provided by Lloyds Banking Group as a bureau service on commercial terms. In addition to the TSA services, for a limited period following Admission (which is expected to be no more than three months) Lloyds Bank will continue to provide to TSB certain operational services (namely, loans processing, digital services and internal mail/courier services), in the same manner and charged in the same way as in the six month period immediately prior to Admission.

While the services that TSB receives from Lloyds Bank under the TSA and LTSA support the day-to-day operation of TSB's business, the TSB Board believes that the arrangements do not detract from TSB's ability to operate, compete and deliver its strategic objectives as a standalone business. In

particular, the TSA and LTSA permit TSB to effect strategic changes to differentiate TSB's offering in the markets in which it currently operates (for example, to develop and launch new products and services) and to effect changes appropriate to TSB's business and risk profile in order to comply with applicable law and regulations and TSB's risk appetite from time to time.

In addition, under the Mortgage Intermediary Platform Build Agreement, Lloyds Bank has undertaken to complete the build of a mortgage intermediary platform for use in providing IT services related to that platform to TSB under the TSA and LTSA. For further information, see Part XXII: "*Additional Information – Material contracts – Mortgage Intermediary Platform Build Agreement*".

Under the TSA and LTSA:

7.1 Lloyds Bank has committed to providing services to quantitative targets and service levels that reflect those adopted internally by Lloyds Bank for its own retail banking businesses, with service credits payable for a failure to meet specified service levels in a given month (for IT services during the TSA period and a wider range of services during the LTSA period). A defined incident management process will be followed by Lloyds Bank in managing service-related incidents and outages. Various non-financial remedies are also available for service failures (including the recovery of service failures in accordance with a defined process, a right to require Lloyds Bank to implement a remediation plan, and in severe scenarios, a right to initiate enhanced co-operation to give TSB greater influence over Lloyds Bank's remediation steps);

7.2 TSB will pay a core service charge monthly in arrears that includes an agreed baseline of service volumes set by reference to the balances and assumed customer behaviours in TSB's agreed 2014 to 2017 business plan. The agreed TSA core service charge is £92 million per year. The agreed LTSA core service charge is £187 million per year. These charges are inclusive of VAT and will be adjusted annually to reflect inflation calculated using the UK RPI. The TSA core service charge is expected to be £95 million in 2014 (including an adjustment to the £92 million base charge for pass-through costs), and, assuming annual inflation of three per cent., £98 million in 2015, £100 million in 2016. Assuming the same rate of inflation, the LTSA core service charge is expected to be £204 million in 2017. Additional amounts are payable for increases in service volumes over and above those set by reference to TSB's agreed 2014 to 2017 business plan (except for the IT services during the term of the TSA) based on agreed unit charges and cost drivers. A proportion of certain third-party charges for telephony, card processing and other consumables will be charged to TSB on a pass-through basis, with no mark-up, as will any increase in Royal Mail rates for inputs used by Lloyds Bank in providing the services. The core service charge will be reduced on a pro-rated basis where a service exits before the planned expiry date. In addition to the core service charge, service changes or projects that TSB initiates will be charged on the basis of an agreed rate card;

7.3 TSB will have the right to initiate, at its own cost, projects or changes to the services to support TSB's own competitive strategy, for example, changes to product pricing and other non-price product features and the launch of new products. TSB has agreed that during the TSA period its ability to initiate certain defined service changes that would require significant re-engineering of the underlying IT and operations infrastructure (for example, a change to TSB's banking licence structure, overseas expansion by TSB or material changes to the corporate core functionality, process or systems) should be restricted; however, these restrictions do not apply if TSB requires such a service change in order to meet any changes in applicable laws or regulations or if TSB can reasonably demonstrate that such changes are necessary for TSB to continue to operate its business in the same manner (in all material respects) should the Scottish people vote for independence in the upcoming referendum;

7.4 TSB will receive the benefits of the continuing investment that Lloyds Bank will make into its own IT systems and infrastructure which will be used to provide services to TSB under the TSA and LTSA, including changes to enhance systems resilience or security, new customer features and ad hoc enhancements to meet changes in applicable laws and regulations. To enable independent competition by the two banks, the deployment of some of these service enhancements for TSB (other than those required to meet changes in applicable laws or regulations) may be deferred by Lloyds Bank for an appropriate period of time;

7.5 Lloyds Bank will be obliged to maintain technical and organisational measures to guard against the unauthorised or unlawful sharing of TSB's data by Lloyds Bank and of Lloyds Bank's data by TSB, including systems-level measures where appropriate. Each party will also comply with an information security policy as well as an information sharing protocol to control the sharing of sensitive business information in the context of the servicing relationship to avoid breaching competition law;

7.6 TSB will be provided with regular reports on various aspects, including service performance, risks, invoicing issues and items escalated for resolution, to enable ongoing monitoring by TSB of service performance and related matters under the contracts. There are also rights for TSB's external auditors (who may be accompanied by TSB's internal audit team, subject to certain conditions) and regulators to audit Lloyds Bank's compliance with the TSA and LTSA and obtain access to relevant underlying information, premises, systems, processes and personnel involved in service provision;

7.7 TSB will have the right to terminate the TSA or LTSA in a range of circumstances, including: (i) for convenience at any point during the term of the relevant agreement (subject to any minimum period of notice); (ii) where TSB Bank or Lloyds Bank is acquired by another FCA regulated bank; or (iii) for Lloyds Bank's material breach, persistent service failures or insolvency. Lloyds Bank may only terminate if required to do so by a regulatory authority or by law, or for the non-payment of material charges by TSB;

7.8 there are provisions to support the exit of services in a termination scenario. As exit is anticipated to take at least three years (and potentially longer) to complete, the exit phase is therefore planned to commence no later than three years before the end of the LTSA term, or earlier if either party exercises its termination rights (as described in paragraph 7.7 above). The TSA and LTSA each identifies at a high level the respective responsibilities of Lloyds Bank and TSB in relation to exit. Due to the criticality of the IT services, Lloyds Bank and TSB have defined in advance some specific exit options for TSB, namely: (i) the creation of a cloned and carved-out set of IT systems which would be transferred to a third party provider to operate on TSB's behalf (the "**carve-out option**"); (ii) the migration of TSB's data to the IT systems of a third party service provider; or (iii) the migration of TSB's data to the IT systems of another financial institution with whom TSB enters into a merger or acquisition. The TSA provides a mechanism for the parties to continue to define and agree their respective obligations under the carve-out option in detailed technical and commercial exit plans during the 12 month period following Admission; these carve-out plans will be reviewed and (if necessary) updated annually during the remainder of the TSA and LTSA. If TSB were to choose to exit the IT services via the carve-out option, Lloyds Bank would assume the cost of creating and transferring the clone, subject to a £50 million contribution from TSB. If TSB chose to exit the IT services via one of the migration options, Lloyds Bank has agreed to make a £450 million contribution to TSB's costs of undertaking the migration, and TSB may elect to spend some or all of the £450 million obtaining exit assistance services from Lloyds Bank. With the exception of the carve-out option, Lloyds Bank has agreed to support the exit of the services (including both IT and non-IT services) on a time and materials at cost basis;

7.9 as Lloyds Bank is committed under the TSA and LTSA to providing services to TSB until they have successfully exited to successor service providers, to incentivise the timely completion of exit, a charges ratchet mechanism applies for any service provision beyond the agreed expiry date of each service. The carve-out option for exiting the IT services is dependent in part on each of Lloyds Bank and TSB entering into a separate agreement with the successor operator for build services (in the case of Lloyds Bank's agreement) and for run-state services (in the case of TSB's agreement). Accordingly, an additional pricing adjustment mechanism applies to disincentivise delay by either party in concluding its agreement with the successor operator by one and a half years before the end of the LTSA term; and

7.10 Lloyds Bank will be obliged to maintain measures to minimise the possibility of any interruption in the TSA and LTSA services.

For a summary of the material provisions of the TSA and LTSA, see Part XXII: "*Additional Information – Material contracts – Transitional Services Agreement*" and Part XXII: "*Additional Information – Material contracts – Long Term Services Agreement*".

8 Capitalisation, liquidity and sources of funding

8.1 Capitalisation

The TSB Board believes that TSB is well capitalised and that its capital levels are robust and meet the requirements set by the PRA as well as providing sufficient capital to grow the business. As at 31 March 2014 on a pro forma basis (see Part XVIII: *"Unaudited Pro forma Financial Information"*):

- TSB's Common Equity Tier 1 Ratio was 21.6 per cent.;
- TSB's Total Capital Ratio was 27.1 per cent.; and
- TSB's Leverage Ratio was 5.6 per cent.

The TSB Board believes that these ratios demonstrate that it is comparatively well placed to meet the new capital requirements from both Europe and the implementation of the recommendations of the ICB.

The table below sets out TSB's total capital, split by type of capital, as at 31 March 2014 on a pro forma basis (see Part XVIII: "*Unaudited Pro forma Financial Information*").

Table 9: TSB's total capital by type as at 31 March 2014 on a pro forma basis (extracted from Part XVIII: "Unaudited Pro forma Financial Information")

Total Capital Resources	**As at 31 March 2014 (on a pro forma basis)**
	(£ millions)
CET1	1,481
Tier 2	384
Total	**1,865**

The table below sets out the composition of TSB's CET1 capital, as at 31 March 2014 on a pro forma basis. None of TSB's CET1 capital consists of innovative capital securities and it can fully absorb losses on a going concern basis.

Table 10: Composition of TSB's CET1 capital as at 31 March 2014 on a pro forma basis (extracted from Part XVIII: "Unaudited Pro forma Financial Information")

Total Capital Resources	**As at 31 March 2014 (on a pro forma basis)**
	(£ millions)
Shareholders' equity (TSB Bank plc)	1,495
Excess expected loss deduction	(14)
Total	**1,481**

TSB's Tier 2 capital includes Tier 2 Securities that were settled by Lloyds Bank on 1 May 2014 for net proceeds of £383 million and currently remain 100 per cent. owned by Lloyds Bank. The TSB Board believes that the Tier 2 Securities are fully compliant in all material respects with the requirements of the Capital Requirements Regulation. TSB's Tier 2 capital also includes an adjustment of £1 million for excess expected loss.

TSB has secured approval from the PRA to apply IRB methodologies and credit risk weightings to the TSB Franchise mortgage assets and will adopt a standardised basis for the Mortgage Enhancement and personal unsecured assets from Admission in order to determine its minimum levels of capital. However, TSB intends to secure IRB treatment on substantially all TSB Franchise assets by the end of 2015, which remains subject to PRA approval. TSB's illustrative Common Equity Tier 1 Capital Ratio on a fully IRB basis (in respect of the TSB Franchise business) is approximately 17 per cent., its Total Capital Ratio is approximately 21 per cent. and its Leverage Ratio is approximately 5 per cent. These ratios comfortably exceed the

TSB Board's approved risk appetite, which is a 16 per cent. Common Equity Tier 1 Capital Ratio, a 20 per cent. Total Capital Ratio and a 4 per cent. Leverage Ratio.

For further information in relation to TSB's capital, see Part XVIII: "*Unaudited Pro forma Financial Information*".

8.2 Liquidity

Liquidity is held by TSB in a range of qualifying assets. TSB's liquidity (£2.0 billion as at 31 March 2014 on a pro forma basis) consists of cash on deposit with the Bank of England. TSB has levels of liquidity that are in excess of those required by the PRA and the requirements of Basel III. On a pro forma basis, as at 31 March 2014, TSB had a Liquidity Coverage Ratio of 146 per cent.

For further information in relation to TSB's liquidity, see Part XVIII: "*Unaudited Pro forma Financial Information*".

8.3 Sources of funding

The majority of TSB's funding for its customer assets is generated through customer liabilities in the form of PCA and savings deposits. The TSB Board views the generation and maintenance of its retail deposit funding base as a key part of its strategy over the short to medium term, although TSB does intend to undertake future RMBS issuances to further diversify its funding mix.

In addition, TSB has the benefit of the following sources of funding:

- CET 1 capital of £1,481 million (on a pro forma basis as at 31 March 2014);
- Tier 2 Securities that were settled by Lloyds Bank on 1 May 2014 for net proceeds of £383 million, the proceeds of which issue were downstreamed by the Company to TSB Bank by way of a tier 2 instrument on similar terms to the Tier 2 Securities on 1 May 2014 (for further information on the terms of the Tier 2 Securities, see Part XXII: "*Additional Information – Material contracts – Tier 2 Subscription Agreement*"); and
- the RMBS Funding Facility, which has a total committed borrowing base of up to £2.5 billion (or, if lower, the aggregate outstanding balance of the Additional Mortgages from time to time).

9 Intellectual property

TSB Bank is the owner of the trade marks TSB, Cheltenham & Gloucester and C&G, amongst others. The TSB trade mark is registered in the United Kingdom and is key to the success of TSB in the United Kingdom. TSB Bank has permitted Lloyds Banking Group to use the TSB trade mark as part of the Lloyds TSB trade mark for a period of three months following Admission in respect of the whole of Lloyds Banking Group's business in the United Kingdom, until October 2016 in relation to payment cards and in relation to certain other items until such items are replaced. The Cheltenham & Gloucester and C&G trade marks are also registered in the United Kingdom. However, although TSB does not currently write new business under these trade marks, TSB Bank has permitted Lloyds Banking Group to continue using the Cheltenham & Gloucester and C&G trade marks in relation to products and services which were originated under these trade marks prior to Admission, until all such products and services mature. After all savings deposit products and services have matured, which is currently expected to be in December 2017, TSB is permitted to start using the Cheltenham & Gloucester and C&G trade marks in relation to savings deposit products, subject to obtaining all necessary regulatory approvals.

10 Mortgage Enhancement Structure and related funding arrangements

10.1 Lloyds Banking Group's obligations to deliver the Mortgage Enhancement Structure

The Mortgage Enhancement Structure has been designed in order to meet Lloyds Banking Group's obligations under its State aid commitments, as amended in this respect following the September 2013 recommendations of the OFT in relation to TSB's competitiveness and financial strength (for further information on the OFT's recommendations, see Part IX: "*Introduction to TSB – Evolution of the TSB business: 2013 OFT recommendations*"). In

particular, it was a requirement of Lloyds Banking Group's State aid commitments that TSB would be strengthened financially through the transfer of the economic benefit[6] of a portfolio of residential mortgages, with the aim of enhancing TSB's profitability by approximately £220 million in aggregate in the four years from (and including) 2014 (the "**Profit Objective**"). Lloyds Banking Group is not required to guarantee or underwrite, and has not guaranteed or underwritten, the profit streams contemplated in the Profit Objective.

10.2 Delivery of the Profit Objective

The Mortgage Enhancement Structure has been designed in a manner that is intended to deliver the Profit Objective through income from the Additional Mortgages portfolio (less costs associated with the portfolio, including the cost to TSB of the partial funding of the portfolio through the RMBS Funding Facility). The RMBS Funding Facility is described at *"RMBS Funding Facility"* below.

10.3 Selection of the Additional Mortgages portfolio

The Additional Mortgages were selected with the aim of achieving the Profit Objective under certain assumptions which were used in the modelling undertaken for the transaction (including as to attrition rates in each of the products in the portfolio, as to product switching behaviour, as to Bank of England base rate and three-month LIBOR rates and as to margin delivered on each of the products in the portfolio), whilst remaining within TSB's risk appetite. The Additional Mortgages selected and transferred had a total value at transfer of £3.4 billion, lower than the £4 billion pool initially envisaged by the September 2013 recommendations of the OFT, due in part to the decision to retain Product Switches (as defined below) in the portfolio throughout the life of the transaction. The breakdown of the Additional Mortgages portfolio is described in further detail at *"Breakdown of the Additional Mortgages"* below.

10.4 Further advances

Under the Mortgage Sale Agreement, Bank of Scotland has agreed with TSB Bank that Bank of Scotland may grant advances of further money (each a "**Further Advance**") to borrowers under existing Additional Mortgages upon request from the borrower.

Bank of Scotland has agreed to repurchase any Additional Mortgages that are the subject of a Further Advance at their fair value.

10.5 Product switches

Under the Mortgage Sale Agreement, Bank of Scotland and TSB Bank have agreed that prior to the occurrence of a perfection event, Bank of Scotland may grant requests by borrowers under existing Additional Mortgages to vary certain financial terms or conditions of such Additional Mortgages (a "**Product Switch**").

To the extent a Product Switch necessitates a payment by the lender to the borrower or any third party, then the responsibility for such payment rests solely with Bank of Scotland.

Additional Mortgages that are the subject of a Product Switch are not required (subject to remote exceptions) to be repurchased by Bank of Scotland.

10.6 Equitable transfer and servicing of the Additional Mortgages portfolio

In order to effect the transfer of the economic benefit of the Additional Mortgages from Bank of Scotland (the transferring entity within Lloyds Banking Group) to TSB Bank, the Additional Mortgages were equitably assigned by Bank of Scotland to TSB Bank on 4 March 2014 (with effect from 28 February 2014), pursuant to the Mortgage Sale Agreement, for a consideration equal to the fair value of the Additional Mortgages.

Additionally, pursuant to the Mortgage Servicing Agreement, Bank of Scotland has agreed to service the Additional Mortgages, including all aspects of the customer relationship, in return for the payment by TSB Bank of a servicing fee.

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[6] Legal title in the Additional Mortgages has remained and will remain with Bank of Scotland unless a perfection event occurs (namely an insolvency event in relation to Bank of Scotland or specified material breach by Bank of Scotland of its obligations under the Mortgage Sale Agreement or following termination of the appointment of Bank of Scotland as servicer under the Mortgage Servicing Agreement at the option of the Purchaser). Unless and until any such perfection event occurs, the Additional Mortgage customers remain customers of Bank of Scotland.

10.7 Put and call options

Under the Mortgage Sale Agreement, TSB Bank may require Bank of Scotland to repurchase the equitable interest in the Additional Mortgages at any time at fair value.

Additionally, Bank of Scotland may require TSB Bank to sell its equitable interest in the Additional Mortgages back to Bank of Scotland in certain circumstances at fair value (the "**Call Option**"). In order to determine the triggers for such Call Option, the Mortgage Sale Agreement provides for a concept of deemed profit earned by TSB Bank from the Additional Mortgages ("**Deemed Profit**"), calculated on the basis set out in the Mortgage Sale Agreement (the "**Deemed Profit Calculation**") rather than a calculation of actual profit (which would be impacted by TSB's actions outside the scope of the terms of the Mortgage Enhancement Structure). Deemed Profit is designed as a proxy for the profit that TSB Bank would have achieved if the Mortgage Enhancement Structure was isolated from the actions of TSB and the risks in TSB's business not contemplated by the Mortgage Sale Agreement or the Mortgage Servicing Agreement, and includes, amongst other things, adjustments for an assumed total funding cost representing TSB's expectations as to the proportion of funding to be provided by Lloyds Bank pursuant to the RMBS Funding Facility and by TSB from sources other than the RMBS Funding Facility. Pursuant to the terms of the Mortgage Sale Agreement, Bank of Scotland may exercise its Call Option, provided that:

- TSB Bank has made a Deemed Profit of at least £230 million (the "**Deemed Profit Trigger**"); and
- either:
  - (i) at least £30 million of such Deemed Profit has been or was made in 2017 (the "**2017 Deemed Profit Trigger**"); or
  - (ii) the Call Option is exercised on or after 31 December 2017.

The Call Option cannot be exercised in circumstances where the effect on TSB Bank of the repurchase by Bank of Scotland at fair value would result in the Deemed Profit falling below the Deemed Profit Trigger or (where applicable) the Deemed Profit in 2017 falling below the 2017 Deemed Profit Trigger. The Deemed Profit Calculation includes, among other things, the cost of unwinding the hedging associated with the transaction.

Although, therefore, there is no guarantee that the Profit Objective will be achieved at the time of any exercise by Bank of Scotland of the Call Option, the Deemed Profit Trigger is higher than the Profit Objective (giving TSB Bank potential upside).

For further information on the terms of the Mortgage Sale Agreement and the Mortgage Servicing Agreement, see Part XXII: "*Additional Information – Material contracts – Mortgage Enhancement Agreements*".

10.8 Breakdown of the Additional Mortgages

All of the Additional Mortgages had an Indexed LTV Ratio of less than 80 per cent. on transfer to TSB Bank (which took place with effect from 28 February 2014). The table below sets out the Additional Mortgages, broken down by product, as at 31 March 2014.

Table 11: Breakdown of Additional Mortgages by product as at 31 March 2014

Product	As at 31 March 2014 (unaudited)	
	(£ billions)	*(percentages)*
Mainstream	2.8	85
Buy-to-let	0.5	15
Total	**3.3**	**100**

The table below sets out the Additional Mortgages, broken down by interest type as at 31 March 2014.

Table 12: Additional Mortgages by interest type as at 31 March 2014

Interest type	As at 31 March 2014 (unaudited)	
	(£ billions)	*(percentages)*
Mortgage Enhancement Variable Rate	1.8	56
Tracker	1.3	39
Fixed	0.2	5
Total	**3.3**	**100**

Source: TSB internal data as at 31 March 2014

10.9 RMBS Funding Facility

The consideration for the purchase of the Additional Mortgages was part-funded by TSB through an unsecured funding facility provided by Lloyds Bank at a rate of interest equal to three-month LIBOR. This unsecured funding facility was refinanced by TSB (with effect from 2 June 2014, when the unsecured funding facility was repaid) principally through the RMBS Funding Facility. Broadly, the RMBS Funding Facility is a securitisation structure backed by a portfolio of TSB mortgages pursuant to which Lloyds Bank and TSB Bank provide senior funding (Lloyds Bank on a committed basis) to a special purpose vehicle established by TSB ("**TSB RMBS SPV**") up to a total aggregate amount of £2.5 billion (or, if lower, the aggregate outstanding balance of the Additional Mortgages remaining with TSB from time to time). The aggregate amount available for drawdown under the RMBS Funding Facility is also subject to a borrowing base test. Credit enhancement, which is subordinated to (and which supports) the senior funding, is provided by TSB Bank. In designing and agreeing the terms of the RMBS Funding Facility, Lloyds Bank and TSB have looked to maximise the flexibility and certainty of funds for TSB, while remaining within the credit and other risk parameters of both parties. The RMBS Funding Facility is designed to provide flexibility in the amount of funding provided from time to time by Lloyds Bank during the commitment period, by permitting the repayment and re-drawing of such funding.

The commitment of Lloyds Bank to advance funds is scheduled to terminate and any funding provided by Lloyds Bank under the RMBS Funding Facility is scheduled to amortise from 17 December 2018, subject to earlier termination and amortisation (which may be triggered by the occurrence of certain limited events).

For information on the terms of the agreements entered into between, *inter alia*, Lloyds Bank and TSB Bank in connection with the RMBS Funding Facility (the "**RMBS Funding Facility Agreements**"), see Part XXII: *"Additional Information – Material contracts – RMBS Funding Facility Agreements"*.

11 Relationship with Lloyds Banking Group

As set out in Part IX: "*Introduction to TSB*", in preparation for the Offer, Lloyds Banking Group and TSB have undertaken a number of steps to separate their businesses and establish an arms'-length relationship, including on the basis of the following agreements:

11.1 the TSA, under which Lloyds Bank will provide certain IT and operational services to TSB, on a limited transitional basis, for a term of up to 31 December 2016 (see Part XXII: "*Additional Information – Material contracts – Transitional Services Agreement*");

11.2 the LTSA, under which Lloyds Bank will, from 1 January 2017, provide certain IT and operational services to TSB, on a longer term basis, for a term of up to seven and a half years (see Part XXII: "*Additional Information – Material contracts – Long Term Services Agreement*");

11.3 the Mortgage Intermediary Platform Build Agreement, under which Lloyds Bank has undertaken to complete the build of a mortgage intermediary platform for use in providing IT services to TSB (see Part XXII: "*Additional Information – Material contracts – Mortgage Intermediary Platform Build Agreement*");

11.4 the Relationship Agreement, which will regulate, in part, the degree of control that the Parent and its associates may exercise over the management of TSB. The principal purpose of the Relationship Agreement is to ensure that TSB is capable at all times of carrying on its business independently of the Parent and its associates as required by the Listing Rules (see Part XXII: "*Additional Information – Material contracts – Relationship Agreement*");

11.5 the Separation Agreement, which governs the separation of TSB from the Lloyds Banking Group retained businesses and certain aspects of the relationship between TSB and Lloyds Banking Group, including (amongst other things) the allocation of certain pre-Admission liabilities, including liability for breach of law and regulation and customer terms and conditions, and puts certain restrictions on Lloyds Banking Group in relation to marketing to TSB customers and opening new branches near TSB branches (see Part XXII: "*Additional Information – Material contracts – Separation Agreement*");

11.6 the Tax Separation Deed, which regulates certain aspects of the mechanics of the separation of TSB Group companies from any tax groups to which they are a party with other Lloyds Banking Group companies, governs co-operation between the TSB Group companies and the Lloyds Banking Group companies following Admission in relation to tax matters, and allocates tax related liabilities and benefits as between Lloyds Banking Group and the TSB Group (see Part XXII: "*Additional Information – Material contracts – Tax Separation Deed*"); and

11.7 the General Insurance Distribution Agreement, pursuant to which TSB distributes a home and contents insurance product provided by LBIS (see Part XXII: *"Additional Information – Material contracts – General Insurance Distribution Agreement"*).

In addition, as set out in "*Capitalisation, liquidity and sources of funding*" above, Lloyds Bank provided capital and funding to TSB in the form of:

11.8 Tier 2 Securities that were settled by Lloyds Bank on 1 May 2014 for net proceeds of £383 million (for further information on the terms of the Tier 2 Securities – see Part XXII: "*Additional Information – Material contracts – Tier 2 Subscription Agreement*"); and

11.9 the RMBS Funding Facility, which has a total facility limit of up to £2.5 billion (or, if lower, the aggregate outstanding balance of the Additional Mortgages from time to time) (for further information, see "*Mortgage Enhancement Structure and related funding arrangements – RMBS Funding Facility*" above).

PART XI
DIRECTORS, SENIOR MANAGEMENT AND CORPORATE GOVERNANCE

Directors

The following table lists the names, positions and ages of the Directors and the Prospective Non-executive Director:

Name	Age	Position	Date appointed
Will Samuel	62	Chairman	7 March 2014
Paul Pester	50	Chief Executive Officer	31 January 2014
Darren Pope	48	Chief Financial Officer	31 January 2014
Norval Bryson	65	Non-executive Director	31 January 2014
Mark Fisher[1]	54	Prospective Non-executive Director	—
Godfrey Robson	67	Non-executive Director	31 January 2014
Sandra Dawson	68	Senior Independent Director	16 May 2014
Philip Augar	62	Independent Non-executive Director	16 May 2014
Alexandra Kinney Pritchard	56	Independent Non-executive Director	16 May 2014
Stuart Sinclair	60	Independent Non-executive Director	16 May 2014
Polly Williams	48	Independent Non-executive Director	16 May 2014

Senior Management Team

The Company's current Senior Management, in addition to the Executive Directors listed above, is as follows:

Name	Age	Position
Neeta Atkar	48	Chief Risk Officer
Susan Crichton	56	General Counsel and Company Secretary
Ian Firth	55	Treasurer
Nigel Gilbert	58	Chief Marketing and Communications Officer
Rosemary Hilary	59	Audit Director
Rachel Lock	43	Human Resources Director
Peter Navin	51	Branch and Business Banking Director
Helen Rose	49	Chief Operating Officer

Will Samuel – Chairman

Having worked over 35 years in merchant banking and corporate finance, Will brings a wealth of expertise of the banking sector and regulatory environment to his role as Chairman of TSB.

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, when he stepped down prior to his appointment as Non-Executive Chairman of TSB.

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.

In addition to his role as Chairman of TSB, Will serves as the Chairman of Howden Joinery Group (formerly MFI Furniture Group) and Chairman of Ecclesiastical Insurance Group since 2006.

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.

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[1] Mark Fisher has been appointed to the TSB Board conditional upon, and from the date of, receipt of PRA approvals.

Paul Pester – Chief Executive Officer

Having spent six years working for Sir Richard Branson as the Group CEO at Virgin Money and the past six years working for António Horta-Osório, first at Santander UK and then at Lloyds Banking Group, Paul brings a unique mix of skills to his role as CEO of TSB.

After receiving his degree from Manchester University and a doctorate from Oxford University, Paul spent 10 years in management consultancy, the majority of those years being spent at McKinsey & Company. Paul took up his first senior executive role as the Group CEO at Virgin Money in 2000. Having established the business in the UK, Australia and South Africa, Paul moved to Lloyds TSB as the Managing Director of Consumer Banking in 2005.

Paul joined Santander UK in 2008 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.

In 2010 Paul joined Lloyds Banking Group where he took up the role of Managing Director of Consumer Banking and Payments. In 2011 Paul was appointed CEO of the Verde programme through which he led the development and establishment of the new TSB Bank within Lloyds Banking Group. In 2013 Paul was appointed as CEO of TSB Bank.

Darren Pope – Chief Financial Officer

Darren is a qualified accountant with over 25 years of experience in the financial services industry, the majority of which has been spent in retail financial services.

Darren started his career in Corporate Development at Prudential plc where he was initially an M&A specialist and subsequently became part of the team that 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, savings and mortgage provider's UK Finance Director following its 2000 IPO.

Darren moved to 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 in 2009 where he led all aspects of the programme before moving into the CFO role in 2011.

Norval Bryson – Non-Executive Director

Norval is a Fellow of the Faculty of Actuaries. He has previously been a member of the Disciplinary Board for the Actuarial Profession and a member of the Actuarial and Accountancy Disciplinary Board of the FRC.

He is currently Deputy Chairman for Scottish Widows Group Limited. He is also currently Deputy Senior Governor of the Court of the University of St. Andrews and a Trustee of the Church of Scotland Investment Trust. He previously worked at the Scottish Provident Institution where he held various positions including Deputy Group Managing Director and Group Finance Director.

Mark Fisher – Prospective Non-Executive Director[1]

Mark is a career banker, having joined NatWest in 1981. He was previously Retail Finance Director and subsequently Chief Retail Operating Officer of NatWest (prior to its acquisition by The Royal Bank of Scotland Group), and from 2000 was the Chief Executive of The Royal Bank of Scotland Group's Manufacturing division. In 2006 Mark became a Director of The Royal Bank of Scotland Group. Prior to joining Lloyds Banking Group as its Director of Group Operations in March 2009, Mark was Chief Executive Officer of ABN AMRO and, from November 2007, Chairman of ABN AMRO's Managing Board.

Mark was appointed to the TSB Board on 6 June 2014 conditional upon and from the date of receipt of PRA approvals. He has a first class honours degree in Mathematics and an MBA from Warwick Business School.

Godfrey Robson – Non-Executive Director

Godfrey is a Senior Policy Advisor for the International Centre for Alcohol Policies and is also a contributing author to various publications on health and related aspects of public policy.

He was previously Under Secretary of Economic and Industrial Affairs for the Scottish Office where he lead responsibility on all industry policy including the financial sector. He was also previously Chairman of Frontline Consultants and a Director and Trustee of Caledonia Youth.

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1 Mark Fisher has been appointed to the TSB Board conditional upon, and from the date of, receipt of PRA approvals.

Sandra Dawson – Senior Independent Non-Executive Director

Sandra was KPMG Professor of Management Studies at Cambridge Judge Business School from1995 to 2013, and Director of the School from 1995 to 2006.

She is currently a Non-Executive Director of Winton Capital Group, DRS plc, a Trustee/Non-Executive Director of the Institute for Government and Social Science Research Council USA and a member of the UK-India Round Table.

She has previously been a Non-Executive Director at the Financial Services Authority and Barclays plc.

Philip Augar – Independent Non-Executive Director

Philip has been commenting on banking and other topical issues since 2000, the year he left Schroders plc in order to write. During his twenty year career in the City, he led NatWest's global equity and fixed income division and was Group Managing Director at Schroders with responsibility for the securities business. He is also a Member of KPMG's Public Interest Committee.

Philip has previously held a variety of Non-Executive positions including Non-Executive Board Member at the Home Office and the Department for Education and adviser on the banking crisis to the Scottish Parliament.

Alexandra Kinney Pritchard – Independent Non-Executive Director

Alexandra (Sandy) was previously a Senior Partner at PricewaterhouseCoopers LLP (Head of European Strategic Performance Improvement).

She is currently a Non-Executive Director for MBNA and has previously been a Non-Executive Director at Irish Life and Permanent Group Holdings, Skipton Building Society and the Financial Services Compensation Scheme.

Stuart Sinclair – Independent Non-Executive Director

Stuart was President and Chief Operating Officer of Aspen Insurance Holdings Ltd (2006-2008) and prior to this held senior positions at General Electric Co and Royal Bank of Scotland Group plc. He is also the Senior Independent Non-Executive Director at Swinton and a Non-Executive Director at QBE, Provident Financial Plc and Prudential Health Ltd.

Polly Williams – Independent Non-Executive Director

Polly, a chartered accountant, is a former Partner at KPMG LLP. She resigned from her partnership in 2003 and since then has taken on a number of Non-Executive Directorship roles, including at Worldspreads Group plc, APS Financial Limited and Z Group plc.

She is currently Chairman of the National Counties Building Society and a Non-Executive Director at Daiwa Capital Markets Europe and Scotiabank Ireland Limited.

Neeta Atkar – Chief Risk Officer

Neeta joined Lloyds Banking Group in 2007 and, prior to joining TSB, was Lloyds Banking Group's Financial Crime & Operational Risk Director, responsible for setting Lloyds Banking Group's risk appetite, high level policies and strategies for financial crime and operational risk.

Neeta started her career at the Bank of England. During her 10 years there, she undertook a variety of roles, including responsibility for supervising banks, roles in the Bank of England's own banking department and policy roles representing the Bank of England in Basel. She moved to the Financial Services Authority on its creation, before leaving to join one of the big four consultancy firms where she worked with a number of financial services clients on a wide range of regulatory, governance and credit risk projects. Thereafter, Neeta worked at the Abbey National, being involved in the project to become compliant with the Basel II credit risk requirements, before working in the insurance industry becoming the Group Operational Risk Director at Royal & Sun Alliance.

Susan Crichton – General Counsel and Company Secretary

Susan joined TSB in January 2014. She is a solicitor who has worked in-house, primarily in the retail financial services industry for over 25 years.

Prior to joining TSB she was general counsel at the Post Office where she was instrumental in the separation of the Post Office from the Royal Mail in order to facilitate the Royal Mail IPO. In addition to her role as General Counsel for the Post Office, Susan established the Company Secretariat and had oversight of the function following the Post Office's separation from Royal Mail. Whilst at the Post Office, she also managed several State Aid applications. Prior to that role, Susan spent time with Skandia/Old Mutual and nine years with GE Money where she was general counsel for Europe, the Middle East and Africa.

Ian Firth – Treasurer

Ian started his career at Barclays, where he held a variety of roles, including Chief Dealer and Head of Funding. He also gained international experience, having headed Barclays' Asia Pacific Markets Division. He joined Lloyds TSB Bank in 1999, where his roles included Managing Director of Lloyds' Treasury and Trading business. Ian was appointed Treasurer of TSB Bank in 2012, and has responsibility for the management of TSB's balance sheet. Ian was a director of the Scottish Widows Global Liquidity Fund, with responsibility for representing Lloyds Banking Group's interest in the fund until early 2014 when Lloyds Banking Group elected to sell Scottish Widows Investment Partnership, and was, for many years, a member of the Bank of England's Money Market Liaison Group.

Nigel Gilbert – Chief Marketing and Communications Officer

Prior to joining TSB, Nigel held the position of Virgin Media's first Chief Marketing Officer before moving on to become Key Projects Director for Virgin Management. Before his time at Virgin, Nigel was Lloyds TSB's Group Marketing Director where he led the reinvigoration of the Lloyds TSB brand with the iconic customer proposition 'for the journey'.

Rosemary Hilary – Audit Director

Rosemary joined TSB Bank in October 2013. Before that, she held a number of senior regulatory roles at the Financial Services Authority and then the Financial Conduct Authority, including Head of Internal Audit, Head of Risk Review, Head of Authorisations and ten years as a front line supervisor. Prior to that Rosemary worked for Girobank where she ran the Treasury Back Office function, before joining the Bank of England where she worked as a banking supervisor and also developed an oversight function in the Bank of England's dealing room.

Since 2009, Rosemary has been a Trustee of the Board of Shelter, where she is also a member of the Audit, Risk and Finance Committee and the Remuneration Committee. Rosemary is also a member of the MBA Advisory Board at Cass Business School, and is a qualified accountant with a first class honours degree from Manchester University (UMIST).

Rachel Lock – Human Resources Director

Rachel joined Lloyds Bank in 1986 and worked through the ranks having held a number of different Business and HR positions. Before joining TSB, Rachel was HR Director for Lloyds Banking Group's Corporate Functions, working closely with a number of the executive team.

Rachel joined the TSB team in 2012 and has led the creation of TSB's new HR function.

Peter Navin – Managing Director, Branch and Business Banking

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

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

Helen Rose – Chief Operating Officer

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

In 2005, Helen joined Lloyds TSB as Finance Director for the Community Bank. She subsequently joined Lloyds TSB's retail board and was responsible for leading the integration of the Retail Divisions of Lloyds TSB and HBOS. She joined Verde in 2011 as COO to lead the development and build of TSB as a new multi-channel challenger bank on the British high street. Following completion of the build programme, Helen now has responsibility for operations, payments, telephony, IT, customer relations, property, branch network design and operational support, procurement and change teams.

Corporate governance

UK Corporate Governance Code

The Board is committed to the highest standards of corporate governance. As of the date of this Prospectus, and on and following Admission, the Board complies and intends to continue to comply with the requirements of the UK Corporate Governance Code. The Company will report to its shareholders on its compliance with the UK Corporate Governance Code in accordance with the Listing Rules.

As envisaged by the UK Corporate Governance Code, the Board has established an Audit Committee, a Nomination Committee and a Remuneration Committee and has also established a Risk Committee. If the need should arise, the Board may set up additional committees as appropriate.

The UK Corporate Governance Code recommends that at least half the board of directors of a UK-listed company, excluding the chairman, should comprise non-executive directors determined by the Board to be independent in character and judgement and free from relationships or circumstances which may affect, or could appear to affect, a director's judgement. As of the date of this Prospectus, the Board consists of eight Non-Executive Directors (including the non-executive Chairman) and two Executive Directors. In addition, Mark Fisher has been appointed as a Non-Executive Director conditional upon, and from the date of receipt of PRA approvals. The Company regards all of the Non-Executive Directors, other than Norval Bryson and Godfrey Robson, as "independent non-executive directors" within the meaning of the UK Corporate Governance Code and free from any business or other relationship that could materially interfere with the exercise of their independent judgement. In addition, the Company does not regard the Prospective Non-executive Director as an "independent non-executive director" within the meaning of the UK Corporate Governance Code.

The UK Corporate Governance Code recommends that the board of directors of a company with a premium listing on the Official List of the FCA should appoint one of the non-executive directors to be the senior independent director to provide a sounding board for the chairman and to serve as an intermediary for the other directors when necessary. The senior independent director should be available to shareholders if they have concerns which contact through the normal channels of the CEO has failed to resolve or for which such contact is inappropriate. Sandra Dawson has been appointed Senior Independent Director.

The UK Corporate Governance Code further recommends that directors should be subject to annual re-election.

Audit Committee

In accordance with the requirements of the UK Corporate Governance Code, the Audit Committee is made up of at least three members who are all independent Non-Executive Directors and includes one member with recent and relevant financial experience. The Audit Committee is chaired by Polly Williams, an independent Non-Executive Director and its other members are Alexandra Kinney Pritchard and Stuart Sinclair. The Audit Committee will normally meet at least four times a year at the appropriate times in the reporting and audit cycle. The committee has responsibility for, amongst other things, the monitoring of the financial integrity of the financial statements of TSB and the involvement of the Auditors in that process as well as reviewing the Company's internal control and risk management systems. It focuses in particular on compliance with accounting policies and ensuring that an effective system of internal financial control is maintained. The ultimate responsibility for reviewing and approving the annual report and accounts and the half-yearly reports remains with the Board.

The terms of reference of the Audit Committee cover such issues as membership and the frequency of meetings, as mentioned above, together with requirements of any quorum for and the right to attend meetings. The duties of the Audit Committee covered in the terms of reference are: financial statements and reporting, narrative reporting, internal control and risk management systems, reporting on the adequacy and security of TSB's whistleblowing arrangements and procedures for detecting fraud, TSB

Bank's internal audit function, and TSB's relationship with its external auditors. The terms of reference also set out the authority of the committee to carry out its duties.

Nomination Committee

In accordance with the requirements of the UK Corporate Governance Code, the Nomination Committee is made up of at least three members who are all independent Non-Executive Directors. The Nomination Committee is chaired by Will Samuel, the Chairman of the Company and its other members are Philip Augar, Sandra Dawson and Stuart Sinclair. The Nomination Committee meets at least once a year.

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

Remuneration Committee

In accordance with the requirements of the UK Corporate Governance Code, the Remuneration Committee is made up of at least three members who are all independent Non-Executive Directors. The Remuneration Committee is chaired by Sandra Dawson, an independent Non-Executive Director. Its other members are Philip Augar and Polly Williams who are both independent Non-Executive Directors. The Remuneration Committee meets at least four times a year. Appointments to the Remuneration Committee will normally be for a period of three years, which may be extended for a further two three-year periods.

The responsibilities of the Remuneration Committee are to determine and approve the framework of the remuneration policy of the Company and to manage, consider and approve the remuneration arrangements of the Chairman, the Chief Executive, the Company Secretary, each direct report to the Chief Executive, other senior executives and employees who are designated as Remuneration Code staff under the PRA Remuneration Code, or any other employee determined by the Remuneration Committee from time to time in accordance with the requirements of the Company's regulators ("**Designated Group**").

This includes formulating and monitoring the overall remuneration policy for the Company, including setting over-arching objectives, principles and parameters of remuneration across the Company, reviewing and approving the over-arching design of pension and other benefits, the design and approach to measuring performance for any performance related pay schemes and performance appraisal and talent management structures at the Company. The Remuneration Committee will seek input from the Chief Risk Officer in considering these issues, to ensure that rewards reflect the Company's risk appetite and profile.

For the Designated Group, the Remuneration Committee's responsibilities extend to determining and approving contracts of employment, including all aspects of remuneration, the terms and other commitments to be made on retirement, resignation or dismissal and any payments or awards to be made upon recruitment.

The Remuneration Committee will also review the Company's remuneration structures for compliance with regulatory requirements and corporate governance guidelines and monitor the reporting and disclosure of such arrangements. In carrying out its duties, the Remuneration Committee has the authority to obtain support and advice both internally from resources within the Company and from external advisers.

Risk Committee

The Risk Committee is made up of at least three members who are all independent Non-Executive Directors. The Risk Committee is chaired by Alexandra Kinney Pritchard, an independent Non-Executive Director and its other members are Stuart Sinclair, Philip Augar and Polly Williams. The Risk Committee will normally meet at least four times per year. The Risk Committee oversees the development, implementation and maintenance of TSB's risk management framework, ensuring that its strategy, principles, policies and resources are aligned to TSB's risk appetite, as well as to regulatory and industry

best practices. The Risk Committee also monitors and reviews the formal arrangements established by the TSB Board in respect of internal controls and risk management framework and reviews the effectiveness of TSB's systems for risk management and compliance with financial services legislation and other regulations.

Share dealing

The Company has adopted, with effect from Admission, a code of securities dealings in relation to the Ordinary Shares which is based on, and is at least as rigorous as, the model code published in the Listing Rules. The code adopted will apply to the Directors and other relevant employees of the Company.

Relationship Agreement with the Parent

The Company entered into the Relationship Agreement with the Parent on 9 June 2014. The Relationship Agreement has been entered into to ensure that the Company is capable at all times of carrying on its business independently of the Parent and its associates. See Part XXII: *"Additional Information – Material Contracts – Relationship Agreement"* for a more detailed description of the Relationship Agreement.

Conflicts of interest

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

Norval Bryson is deputy chairman and a non-executive director of Scottish Widows Group Limited, the holding company of various life, pensions and insurance companies which are potential competitors of TSB in the life market. Norval Bryson is a non-executive director of Lloyds Bank General Insurance Limited, a subsidiary of Scottish Widows Group Limited, which underwrites the home insurance product distributed by TSB under the General Insurance Distribution Agreement. For further information in relation to the General Insurance Distribution Agreement see Part XXII: "*Additional Information – Material Contracts – General Insurance Distribution Agreement*".

PART XII
SELECTED FINANCIAL AND OTHER INFORMATION

Selected financial and other information relating to the TSB Bank Group set out below has been extracted, without material adjustment, from Part XVI: "Historical Financial Information". Investors should read the whole of this Prospectus before making an investment decision and not rely solely on the summarised information in this Part XII.

1 Income Statement Data

The following tables set out TSB Bank Group's audited Income Statement data for the three years ended 31 December 2013, 2012 and 2011, presented on a management basis, which the TSB Board believes better reflects the underlying performance of the business by highlighting certain transactions and underlying trends (the "**Management Basis**"), as explained further in Note 4 to the Historical Financial Information included in Part XVI of this Prospectus (the "**HFI**"). Certain differences exist between the Management Basis and the income statement in the HFI. These differences resulted in changes to certain line items for the year ended 31 December 2013, as set out in the reconciliation presented at the end of this Section 1. There were no changes to the line items in the years ended 31 December 2012 or 2011.

	Management Basis		
	TSB Franchise	**Mortgage Enhancement**	**Total**
		(£m)	
Year ended 31 December 2013			
Interest and similar income	917	128	1,045
Interest and similar expense	(314)	(96)	(410)
Net interest income	**603**	**32**	**635**
Fee and commission income	220	—	220
Fee and commission expense	(62)	—	(62)
Net fee and commission income	**158**	**—**	**158**
Other operating income	5	—	5
Total other income (net of fee and commission expense)	**163**	**—**	**163**
Total income	**766**	**32**	**798**
Operating expenses	(575)	(1)	(576)
Impairment loss on loans and advances to customers	(109)	—	(109)
Underlying profit before taxation	**82**	**31**	**113**
Fair value movements on instruments held at fair value	(46)	—	(46)
Profit before taxation	**36**	**31**	**67**
Taxation			105
Profit for the year			**172**

	Management Basis		
	TSB Franchise	Mortgage Enhancement	Total
		(£m)	
Year ended 31 December 2012			
Interest and similar income	944	113	1,057
Interest and similar expense	(411)	(88)	(499)
Net interest income	**533**	**25**	**558**
Fee and commission income	231	—	231
Fee and commission expense	(57)	—	(57)
Net fee and commission income	**174**	**—**	**174**
Other operating income	5	—	5
Total other income (net of fee and commission expense)	**179**	**—**	**179**
Total income	**712**	**25**	**737**
Operating expenses	(579)	(1)	(580)
Impairment loss on loans and advances to customers	(118)	—	(118)
Underlying profit before taxation / Profit before taxation	**15**	**24**	**39**
Taxation			(11)
Profit for the year			**28**

	Management Basis		
	TSB Franchise	Mortgage Enhancement	Total
		(£m)	
Year ended 31 December 2011			
Interest and similar income	987	95	1,082
Interest and similar expense	(353)	(70)	(423)
Net interest income	**634**	**25**	**659**
Fee and commission income	244	—	244
Fee and commission expense	(57)	—	(57)
Net fee and commission income	**187**	**—**	**187**
Other operating income	10	—	10
Total other income (net of fee and commission expense)	**197**	**—**	**197**
Total income	**831**	**25**	**856**
Operating expenses	(590)	(1)	(591)
Impairment loss on loans and advances to cusotmers	(183)	—	(183)
Underlying profit before taxation / Profit before taxation	**58**	**24**	**82**
Taxation			(25)
Profit for the year			**57**

The table below sets out a reconciliation of the HFI Income Statement to the Management Basis for the year ended 31 December 2013. As noted at the outset of this section, there are no differences between the HFI and the Management Basis for the years ended 31 December 2012 or 2011.

	HFI Income Statement	Presentation differences[1]	Management Basis
		(£m)	
Year ended 31 December 2013			
Interest and similar income	1,035	10	1,045
Interest and similar expense	(410)	—	(410)
Net interest income	**625**	**10**	**635**
Fee and commission income	220	—	220
Fee and commission expense	(62)	—	(62)
Net fee and commission income	**158**	**—**	**158**
Other operating income/(expense)	(31)	36	5
Total other income	**127**	**36**	**163**
Total income	**752**	**46**	**798**
Operating expenses	(576)	—	(576)
Impairment loss on loans and advances to customers	(109)	—	(109)
Underlying profit before taxation	**67**	**46**	**113**
Fair value movements on instruments held at fair value	—	(46)	(46)
Profit before taxation	**67**	**—**	**67**
Taxation	105	—	105
Profit for the year	**172**	**—**	**172**

Note:

(1) Under the Management Basis, £10 million of interest received on interest rate derivatives that are not designated in hedging relationships is included in interest and similar income, rather than other operating income. In addition, fair value losses of £46 million on interest rate derivatives that are not in hedging relationships are presented separately below underlying profit before tax.

2 Balance Sheet Data

The following table sets out the TSB Bank Group's audited Balance Sheet data as at 31 December 2013, 2012 and 2011 and has been extracted from the HFI. There is no Management Basis of presentation applicable to the Balance Sheet.

	As at 31 December		
	2013	2012	2011
		(£m)	
Assets			
Cash and balances at central banks	200	205	196
Items in the course of collection from banks	116	156	194
Loans and advances to banks	4,125	—	—
Loans and advances to customers	23,485	24,348	23,723
Derivative financial instruments	99	—	—
Property, plant and equipment	123	90	80
Deferred tax assets	135	19	10
Retirement benefit assets	—	—	22
Other assets	50	50	45
Total assets	**28,333**	**24,868**	**24,270**
Liabilities			
Customer deposits	23,105	22,909	21,803
Items in course of transmission to banks	64	62	57
Derivative financial instruments	86	—	—
Other liabilities	86	63	54
Retirement benefit obligations	33	37	—
Current tax liabilities	5	25	25
Other provisions	12	15	7
Total liabilities	**23,391**	**23,111**	**21,946**
Net investment from Lloyds Banking Group	4,942	1,757	2,324
Net investment from Lloyds Banking Group and liabilities	**28,333**	**24,868**	**24,270**

3 Cash Flow Statement

The following table sets out the TSB Bank Group's consolidated cash flows for the years ended 31 December 2013, 2012 and 2011.

	Year ended 31 December		
	2013	2012	2011
		(£m)	
Profit before taxation	**67**	**39**	**82**
Adjustments for:			
Change in operating assets	(3,429)	(565)	76
Change in operating liabilities	317	1,119	56
Non-cash and other items	99	(30)	(56)
Tax (paid)/received	(30)	1	(11)
Net cash (used in)/provided by operating activities	**(2,976)**	**564**	**147**
Cash flows from investing activities			
Purchase of property, plant and equipment	(48)	(23)	(18)
Net cash (used in) investing activities	**(48)**	**(23)**	**(18)**
Cash flows from financing activities			
Transactions with Lloyds Banking Group	3,017	(532)	(125)
Net cash provided by/(used in) financing activities	**3,017**	**(532)**	**(125)**
Change in cash and cash equivalents	(7)	9	4
Cash and cash equivalents at beginning of year	181	172	168
Cash and cash equivalents at end of year	**174**	**181**	**172**

4 Interim Financial Information

*Selected financial and other information relating to the TSB Bank Group for the three months ended 31 March 2014 set out below has been extracted, without material adjustment, from Part XVII: "Condensed Combined Interim Financial Information (Unaudited)" (the "***Interim Financials***"). Investors should read the whole of this Prospectus before making an investment decision and not rely solely on the summarised information in this Part XII.*

The following table sets out the TSB Bank Group's income statement data for the three months ended 31 March 2014, presented on a Management Basis, as explained further in Note 4 to the Interim Financials. A reconciliation of certain differences between the Interim Financials Income Statement and the Management Basis is also presented below.

	For the three months ended 31 March 2014		
	TSB Franchise	Mortgage Enhancement	Total
		(£m)	
Interest and similar income	231	32	263
Interest and similar expense	(52)	(16)	(68)
Net interest income	**179**	**16**	**195**
Fee and commission income	52	—	52
Fee and commission expense	(15)	—	(15)
Net fee and commission income	**37**	**—**	**37**
Other operating income	—	—	—
Total other income (net of fee and commission expense)	**37**	**—**	**37**
Total income	**216**	**16**	**232**
Operating expenses	(153)	—	(153)
Impairment loss on loans and advances to customers	(27)	—	(27)
Underlying profit before taxation	**36**	**16**	**52**
Fair value movements on instruments held at fair value	(8)	—	(8)
Gain on settlement of defined benefit pension scheme	32	—	32
Profit before taxation	60	16	76
Taxation			(16)
Profit for the period			**60**

	For the three months ended 31 March 2014			
	Interim Financials Income Statement	Presentation differences		Management Basis
		Financial Instruments[1]	Pension Costs[2]	
		(£m)		
Interest and similar income	254	9	—	263
Interest and similar expense	(68)	—	—	(68)
Net interest income	**186**	**9**	**—**	**195**
Fee and commission income	52	—	—	52
Fee and commission expense	(15)	—	—	(15)
Net fee and commission income	**37**	**—**	**—**	**37**
Other operating income/(expense)	1	(1)	—	—
Total other income	**38**	**(1)**	**—**	**37**
Total Income	**224**	**8**	**—**	**232**
Operating expenses	(121)	—	(32)	(153)
Impairment loss on loans and advances to customers	(27)	—	—	(27)
Underlying profit before taxation	**76**	**8**	**(32)**	**52**
Fair value movements on instruments held at fair value	—	(8)	—	(8)
Gain on settlement of defined benefit pension scheme	—	—	32	32
Profit before taxation	**76**	**—**	**—**	**76**
Taxation	(16)	—	—	(16)
Profit for the period	**60**	**—**	**—**	**60**

Notes:

(1) Under the Management Basis, £9 million of interest received on interest rate derivatives that are not designated in hedging relationships is included in interest and similar income, rather than other operating income. In addition, fair value losses of £8 million on interest rate derivatives that are not in hedging relationships are presented separately below underlying profit.

(2) A £32 million gain in respect of settlement of the defined pension liability is included within other operating expenses in the Interim Financials, but on a Management Basis it is shown separately below underlying profit due to its non-recurring nature.

The following table sets out the TSB Bank Group's Balance Sheet data as at 31 March 2014. There is no Management Basis of presentation applicable to the Balance Sheet.

	As at 31 March 2014
	(£m)
Assets	
Cash and balances at central banks	159
Items in course of collection from banks	203
Loan and advances to banks	2,766
Loans and advances to customers	23,039
Derivative financial instruments	84
Property, plant and equipment	120
Deferred tax assets	122
Other assets	68
Total assets	**26,561**

	As at 31 March 2014
	(£m)
Liabilities	
Deposits from banks	1,535
Customer deposits	23,260
Items in course of transmission to banks	140
Derivative financial instruments	67
Other liabilities	116
Current tax liabilities	7
Other provisions	12
Total liabilities	**25,137**
Net investment from Lloyds Banking Group	1,424
Net investment from Lloyds Banking Group and liabilities	**26,561**

5 Key Financial Ratios for the Three Months Ended 31 March 2014 and for the Years Ended 31 December 2013, 2012 and 2011

Management uses a variety of key indicators to aid in assessing the TSB Bank Group's financial performance. The TSB Board believes that each of these measures provides useful information with respect to the performance of its business and operations. However, these measures may be defined or calculated differently by other companies and as a result, the key financial ratios of the TSB Bank Group may not be comparable to similar measures calculated by its peers.

The tables below present key financial ratios for the TSB Bank Group as well as TSB Franchise as at and for the three months ended 31 March 2014 and as at and for each of the years ended 31 December 2013, 2012 and 2011. Unless otherwise stated, the information set out below is taken from the HFI or Interim Financials on a Management Basis.

	Management Basis			
	Three months ended 31 March	Year ended 31 December		
	2014	2013	2012	2011
		(%)		
TSB Bank Group				
Loan to deposit ratio[(1)]	99	102	106	109
Banking net interest margin[(2)]	3.38[(3)]	2.63	2.31	2.75
Cost income ratio[(4)]	66.0	72.2	78.7	69.0
Asset quality ratio[(5)]	0.48	0.45	0.48	0.76

Notes:

(1) Loan to deposit ratio is defined as the ratio of loans and advances to customers net of allowance for impairment losses divided by customer deposits.

(2) Banking net interest margin is defined as total net interest income on a Management Basis divided by average gross customer assets. Averages have been calculated on a daily average basis.

(3) The TSB Bank Group banking net interest margin in the Interim Financials on a Management Basis was 3.38 per cent. The TSB Bank Group banking net interest margin based on the statutory results of TSB Bank plc was 3.62 per cent., as well as the TSB Franchise average gross customer assets of £20,045 million and Mortgage Enhancement average gross customer assets of £3,326 million for the month of March 2014. This reflects the TSB Franchise net interest income for the three months ended 31 March 2014 as well as net interest income for the Mortgage Enhancement from 28 February 2014 onwards. Please see Part XIII: "*Operating and Financial Review – Reconciliation of Interim Financials to Statutory Results of TSB Bank plc*" for further details.

(4) Cost income ratio is defined as operating expenses divided by total income on a Management Basis.

(5) Asset quality ratio is the impairment charge for the year in respect of loans and advances to customers expressed as a percentage of average gross loans and advances to customers.

	Management Basis			
	Three months ended 31 March	Year ended 31 December		
	2014	2013	2012	2011
		(%)		
TSB Franchise				
Loan to deposit ratio[1]	85	87	92	97
Banking net interest margin[2]	3.62[3]	2.89	2.51	2.95
Cost income ratio[4]	70.8	75.1	81.3	71.0
Asset quality ratio[5]	0.54	0.53	0.55	0.85

Notes:

(1) Loan to deposit ratio is defined as the ratio of loans and advances to customers net of allowance for impairment losses divided by customer deposits.

(2) Banking net interest margin is defined as total net interest income on a Management Basis divided by average gross customer assets. Averages have been calculated on a daily average basis.

(3) There is no difference in the TSB Franchise banking net interest margin in the Interim Financials and that of the statutory results of TSB Bank plc. Please see Part XIII: "*Operating and Financial Review – Reconciliation of Interim Financials to Statutory Results of TSB Bank plc*" for further details.

(4) Cost income ratio is defined as operating expenses divided by total income on a Management Basis.

(5) Asset quality ratio is the impairment charge for the year in respect of loans and advances to customers expressed as a percentage of average gross loans and advances to customers.

6 Key Financial Capital and Liquidity Ratios for the Three Months Ended 31 March 2014, Including Pro Forma Information

The tables below present key financial ratios for the TSB Bank Group as well as TSB Franchise as at and for the three months ended 31 March 2014, based on the unaudited pro forma income statement and balance sheet as at 31 March 2014 as set out in *Part XVIII: "Unaudited Pro forma Financial Information"*.

	Three months ended 31 March 2014	
	Unadjusted	Pro forma
TSB Bank Group		
Balance Sheet		
Loans and advances to customers (£m)	23,039	23,039
Customer deposits (£m)	(23,260)	(23,260)
Income Statement		
Total income (£m)	224	231
Operating expenses (£m)	(121)	(150)
Impairment loss on loans and advances to customers (£m)	(27)	(27)
Profit before taxation (£m)	**76**	**54**
Ratios		
Common Equity Tier 1/Tier 1 Capital Ratio[1]	17.3%	21.6%
Total Capital Ratio[1]	17.3%	27.1%
Leverage Ratio[2]	4.7%	5.6%
Liquidity Coverage Ratio[3]	—	146%

Notes:

(1) The TSB Bank Group's Common Equity Tier 1 Capital Ratio and Total Capital Ratio are calculated based on TSB's interpretation of the final CRD IV text and PRA Policy Statement, PS 7/13, which outlines the approach to implementing CRD IV in the UK. The final impact of CRD IV is dependent on technical standards to be finalised by the European Banking Authority and on the final UK implementation of those rules. Over time, TSB intends to seek approval for substantially all TSB Franchise customer asset portfolios to be treated on an IRB basis, which is expected by the end of 2015. For illustrative purposes, adjusting for the effect of this treatment results in increased excess expected losses and RWAs (by over £1.6 billion) and in a reduction in the Common Equity Tier 1 Ratio and Total Capital Ratio to approximately 17 per cent. and approximately 21 per cent., respectively. For further details on risk weighted assets, please refer to Part XIII: "*Operating and Financial Review – Capital Resources and Capital Ratios*".

(2) TSB Bank Group's Leverage Ratio is calculated by the ratio of Tier 1 capital to the total of assets, off balance sheet exposures and excess expected loss, as defined by the text of CRD IV.

(3) TSB Bank Group's Liquidity Coverage Ratio is calculated as the stock of high quality liquid assets as a percentage of net outflows over a 30-day period. This ratio is not presented for the periods covered by the HFI as significant further capitalisation of the TSB Bank Group was undertaken after 31 March 2014.

PART XIII
OPERATING AND FINANCIAL REVIEW

The following discussion summarises the significant factors and events affecting the results of operations and the financial condition of the TSB Bank Group for the years ended 31 December 2013, 2012 and 2011, and for the three months ended 31 March 2014 and should be read in conjunction with the combined financial information of the TSB Bank Group as set out in Part XVI: "Historical Financial Information" and the other financial information contained elsewhere in this Prospectus, including under Part III: "Presentation of Information", Part XII: "Selected Financial and Other Information", and Part XVII: "Condensed Combined Interim Financial Information (Unaudited)", and Part XVIII "Unaudited Pro forma Financial Information".

The following discussion of the TSB Bank Group's results of operations and financial condition contains forward-looking statements that reflect the current views of TSB Bank's management. The TSB Bank Group's actual results could differ materially from those anticipated in any forward-looking statements as a result of the factors discussed below and elsewhere in this Prospectus, particularly under Part II: "Risk Factors". Investors should carefully consider the following information, together with the other information contained in this Prospectus, before investing in the Ordinary Shares.

1 Introduction and Overview

Introduction

This section provides a description of TSB's historical financial information as at and for the three years ended 31 December 2013, 2012 and 2011, as set out in the HFI, and as at and for the three months ended 31 March 2014, as set out in the Interim Financials, including the financial condition and key factors affecting performance of the TSB Bank business over these periods.

TSB reports its results in two segments: TSB Franchise, which comprises the retail banking business carried out in the UK under the TSB brand, and the Mortgage Enhancement, which comprises a separate portfolio of mortgage assets, now in run-off with no new lending. The Additional Mortgages that comprise the Mortgage Enhancement have been equitably assigned to TSB, but are not TSB-branded and are managed by the Bank of Scotland. For further detail on the composition of the Mortgage Enhancement, please see Part X: *"Information on the TSB Group – Mortgage Enhancement Structure and related funding arrangements"*. References in this section to the TSB Franchise are to the TSB branded business and exclude the Mortgage Enhancement.

As TSB Bank existed within Lloyds Banking Group throughout the period covered by the HFI and the Interim Financials, the HFI and the Interim Financials are prepared on a "combined" basis. As a result, certain specific items as described under *"Comparability of historical financial information and future results"* below are not wholly representative of TSB on a fully standalone basis. Of these, certain items are now reflected in TSB Bank's results for the first quarter of 2014, as described under *"Events reflected in the results to 31 March 2014"* below, together with significant items that occurred after 31 March 2014 and prior to Admission, as set out in "*Changes occurring between 31 March 2014 and Admission*" below. For further explanation of these items, please also see Part XVIII: "*Unaudited Pro forma Financial Information*".

Overview

TSB is a multi-channel retail banking business with 631 branches in England, Wales and Scotland. It is the seventh largest retail banking group in the UK by branch network with approximately 6 per cent. of the retail bank branches in the UK as at 31 August 2013. It has a digital distribution platform and four telephony contact centres able to support 11 million calls per year. As at 31 March 2014, it served approximately 4.5 million retail customers and 113,000 small business customers.

TSB provides a full range of retail banking products to meet the needs of its customers. These products include PCAs, savings, mortgages, unsecured lending and a range of similar products aimed at meeting the needs of its small business customers. As at 31 December 2013, TSB had a 4.2 per cent. market share of PCAs, an estimated 1.7 per cent. share of savings balances and a 1.4 per cent. share of mortgage lending (excluding the Additional Mortgages). TSB had market shares of approximately 1.4 per cent. and 1.5 per cent. in unsecured personal loans and credit cards, respectively.

TSB has a simple balance sheet, with 75 per cent. of gross lending at 31 December 2013 relating to the TSB Franchise mortgage book (£17,729 million, excluding the Additional Mortgages), and which is fully funded from savings deposits of £16,603 million and PCAs of £6,502 million. The TSB Franchise mortgage book is composed predominantly of residential lending to the prime end of the market, including certain lower risk buy-to-let assets. Of these mortgage balances, 66 per cent. are lower-yielding SVR balances, which are capped at 200 bps above the Base Rate. Other lending of £2,467 million comprises a portfolio of unsecured personal loans, credit cards, commercial loans to small businesses and PCA overdrafts. 67 per cent. of TSB Bank's savings balances are held on instant access savings accounts, 18 per cent. are held in variable rate ISAs and 9 per cent. in fixed rate ISAs and 6 per cent. fixed term deposits. TSB Bank's principal source of revenue is customer net interest income, or income from lending activities less the cost of funding. Another important source of TSB Bank's revenue is fee and commission income.

The evolution of the TSB business, including its separation from the Lloyds Banking Group business, has taken place over a number of stages as described in Part IX: "*Introduction to TSB*". This process resulted in the current TSB business which comprises (i) TSB Franchise and (ii) further financial enhancements that have been transferred to the divested business, principally through the Mortgage Enhancement, to address the recommendations from the OFT, which has been designed with the aim of enhancing TSB's profitability by approximately £220 million in aggregate in the four-year period to the end of 2017.

The key eligibility criteria used to select the Additional Mortgages were as follows:

- assets had to have sufficient margin to meet the profit enhancement criteria;
- assets had to meet TSB's risk appetite;
- accounts that had been in arrears for an amount equal to one monthly repayment on the relevant mortgage within the 12-month period prior to the date of the equitable assignment were excluded; and
- mortgages with an Indexed LTV greater than 80 per cent. were excluded.

On 4 March 2014, the Additional Mortgages were subject to an equitable assignment between Bank of Scotland and TSB Bank that was transacted at fair value (with an effective date of 28 February 2014).

2 Basis of Preparation

TSB has not comprised a separate legal entity or group of entities for the years ended 31 December 2013, 2012 and 2011 or for all of the three-month period ended 31 March 2014. The HFI is, therefore, prepared on a basis that combines the results, assets and liabilities of the TSB Bank Group in accordance with IFRS and certain accounting conventions commonly used for the preparation of carve out historical financial information. Note 2 to the HFI sets out the basis of preparation in full.

The key stages in the evolution of the TSB business, including its separation from Lloyds Banking Group, have impacted the historical financial performance of the business. As TSB Bank was highly integrated within the existing Lloyds Banking Group business and did not operate as a standalone entity for the substantial majority of the periods covered by the HFI, there are a number of items in the HFI that are not reflective of TSB's anticipated performance as a completely stand-alone business. These items are described further under "*Comparability of historical financial information and future results*" below.

The HFI includes the historical financial performance of the Mortgage Enhancement and represents the actual financial performance of the specific Additional Mortgages over the relevant period. It does not represent the track record of a discrete business. During the period under review, the Additional Mortgages were managed and serviced by Lloyds Banking Group, separately from the TSB Bank business (beneficial title to the Additional Mortgages not being transferred to TSB Bank until 28 February 2014).

The unaudited interim financial information for the three months ended 31 March 2014 set out in the Interim Financials has been prepared on the same basis as the HFI and as set out in Note 1 to the Interim Financials. Going forward, TSB's results will be prepared on the basis set out in note 10 to the Interim Financials and as described in "*Reconciliation of Interim Financials to the Statutory Results of TSB Bank plc*" below.

The HFI and Interim Financials in Part XVI: "*Historical Financial Information*" and Part XVII: "*Condensed Combined Interim Financial Information (Unaudited)*", respectively, present the results

of TSB Bank using IFRS disclosure formats in the primary statements. However, the presentation of results to the Executive Directors and Senior Management through the Management Basis is intended to highlight certain one-off transactions or underlying trends. In accordance with IFRS 8 "Operating Segments", the Management Basis of presenting the results is used to disclose the performance of individual operating segments and this analysis is provided in Note 4 to each of the HFI and the Interim Financials. This Part XIII: "*Operating and Financial Review*" reflects the Management Basis as the TSB Board believes that it better reflects the underlying performance of the business by highlighting certain transactions and underlying trends.

Line by line reconciliations of the Management Basis against the HFI and the Interim Financials are provided in Part XII: "*Selected Financial and Other Information*" for the year ended 31 December 2013 and the three months ended 31 March 2014. There were no differences between the Management Basis and the HFI in the years ended 31 December 2012 and 2011.

In addition, the unaudited pro forma financial information presented in this Operating and Financial Review and in Part XVIII has been prepared for illustrative purposes only. The unaudited pro forma net assets statement as at 31 March 2014 of the TSB Group has been prepared to illustrate the effect of certain capital, liquidity and funding actions undertaken between 31 March 2014 and Admission as if each of the foregoing had taken place on 31 March 2014. The unaudited pro forma income statement for the three months ended 31 March 2014 of the TSB Group has been prepared to illustrate the effect of those actions as if each had taken place on 1 January 2014, the start of the financial period. By its very nature, the unaudited pro forma financial information addresses a hypothetical situation and, therefore, does not represent the TSB Group's actual financial position or results.

3 Key factors impacting business performance

TSB's results of operations are directly and indirectly affected by a number of external and internal factors. The external factors include general UK macro-economic conditions and trends, including prevailing interest rates, levels of unemployment, house prices and changes to the legal and regulatory environment for retail banking in the UK. All of these factors affect TSB and the retail banking industry as a whole. The persistently low interest rates throughout the period under review have, however, disproportionately affected the evolution of TSB Bank's Balance Sheet and the income generated by the business compared to the UK retail banking sector generally.

The internal factors include TSB Bank's banking net interest margin and profitability, which have been influenced by Lloyds Banking Group's ability and, post separation, its own ability to manage the pricing of its customer balances, its credit and interest rate risk and control its costs of operations. TSB Bank's results have also been impacted by the perimeter selected for the TSB business and actions taken in the course of managing these assets and liabilities, both in the context of its position within the Lloyds Banking Group business and during the separation of TSB Bank from the Lloyds Banking Group retained business.

Balance Sheet

During the period under review, the TSB Franchise Balance Sheet has been impacted by the deleveraging in the retail banking industry and declining demand and tightened criteria for customer lending. TSB Bank's low levels of gross mortgage lending have also been driven by the absence of a mortgage intermediary channel for much of the period under review, as well as by the UK's flat housing market. The absence of an established mortgage intermediary channel resulted in just 2 per cent. of TSB Bank's new mortgage lending in 2013 being originated via intermediaries, whereas intermediaries account for over half of originated new business in the UK mortgage market generally. TSB Bank's comparatively low levels of origination were partially offset by the effect of fewer customers refinancing their lending at the end of their original product term. More customers chose to remain on SVR mortgages in the low interest rate environment and, consequently, SVR mortgages have increased as a proportion of overall mortgage lending.

The combination of a tightened credit risk appetite and customer deleveraging has reduced both supply and demand for unsecured credit, contributing to declining levels of unsecured personal lending balances over the period under review.

In contrast to the decline in customer assets, customer deposit balances have increased over the period. Low interest rates have encouraged the growth and persistency of non-interest and low interest bearing balances, predominantly PCAs, and savings balances on reversionary rates, as

customers remain fairly insensitive to the interest rate differential available between savings products. These factors, combined with the decrease in customer lending balances, have resulted in the TSB Franchise increasing its excess liquidity throughout the period under review.

On 1 November 2013, arrangements were put in place between Lloyds Banking Group and TSB Bank to establish stand-alone funding, liquidity and interest rate risk management arrangements for TSB Bank within Lloyds Banking Group. As a result, a separate liquid assets balance of £4.1 billion, held with Lloyds Banking Group, has been recognised on TSB Bank's Balance Sheet as at 31 December 2013. Subsequent changes to TSB's capital, liquidity and funding structure occurred in April and May 2014 to complete its capitalisation and finalise the liquidity and funding arrangements for TSB on a standalone basis. These arrangements are reflected in the unaudited pro forma financial information contained in Part XVIII: "*Unaudited Pro forma Financial Information*".

Income Statement

Typically, in periods of low interest rates, liability margins are low and asset margins are high. Prior to June 2010 (after which date mortgages with capped SVR were no longer written), a large proportion of the mortgages originated were mortgages with an SVR capped at 200 bps above the Base Rate. This capped rate has been materially below the average reversionary rate in the market. As a result, customers have been reluctant to refinance onto higher rate new mortgage products given the sustained low Base Rate environment. This has resulted in TSB Bank being unable to fully access the potentially higher margins that are available from new business with uncapped reversionary rates. In addition, this lower level of refinancing and the closure of the intermediary mortgage channel have resulted in an increase in capped SVR balances as a proportion of the total mortgage book. Furthermore, higher margin unsecured lending declined following reduced customer demand and tightened credit criteria. As a result, TSB Bank's interest income has been constrained during the period under review.

TSB Bank's customer deposit balances are low-cost, stable sources of funding given the high proportion of personal current accounts and instant access variable rate savings products. In the recent period of low interest rates, the difference between rates paid on customer deposits and those on wholesale funding has narrowed, but as interest rates increase it is expected that wholesale funding costs will increase relative to deposit funding.

Rate insensitive balances, of which PCAs are a material component, are invested by TSB primarily in a rolling series of five year rate swaps. The period of persistently low interest rates has seen a flattening of the forward swap curve that has reduced both the overall level and the income benefit of hedging the rate insensitive balances.

Funds transfer pricing ("**FTP**") is a central process managed by Lloyds Banking Group for allocating the net costs of Lloyds Banking Group's overall funding, capital, liquidity, and interest rate risk to its banking businesses and has historically formed a significant part of TSB Bank's total interest and similar expense. Since specific standalone arrangements were put in place for the TSB Franchise from 1 November 2013 and the Mortgage Enhancement from 4 March 2014, TSB Bank's interest and similar expense has significantly reduced.

TSB Bank's impairment has improved both as a result of the low interest rate environment and tightened lending criteria. TSB's financial performance has also been supported by recent favourable movements in house prices and a decrease in unemployment.

Mortgage Enhancement

The macro-economic factors affecting the performance of the Mortgage Enhancement are broadly similar to those described above affecting the TSB Franchise mortgages. However, the Additional Mortgages were subject to a set of narrowly defined criteria which resulted in key differences between the composition of the Mortgage Enhancement and the TSB Franchise portfolio. For example, no mortgages that had been in arrears for an amount equal to one monthly repayment on the relevant mortgage within the 12-month period prior to the date of equitable assignment were included in the Mortgage Enhancement. As a result, the impairment against the Mortgage Enhancement portfolio is lower than would be expected for a portfolio that did not exclude such mortgages. In addition, the gross yield on the Additional Mortgages is greater than that of the TSB Franchise portfolio.

For further detail on the composition of the Mortgage Enhancement, see Part X: *"Information on the TSB Group – Mortgage Enhancement Structure and related funding arrangements"*.

4 Financial Position – TSB Franchise

4.1 Assets

The following table sets out certain balance sheet information of the TSB Franchise, as at 31 December 2013, 2012 and 2011. Balance Sheet information as at 31 March 2014 is included in *"Financial position and results of operations for the three months ended 31 March 2014"* below.

	As at 31 December		
	2013	2012	2011
		(£m)	
Cash and balances at central banks	200	205	196
Items in the course of collection from banks	116	156	194
Derivative financial instruments	99	—	—
Loans and advances to banks	4,125	—	—
Loans and advances to customers	20,099	21,168	21,069
Tangible fixed assets	123	90	80
Deferred tax assets	135	19	10
Retirement benefit assets	—	—	22
Other assets	50	50	45
Total assets	**24,947**	**21,688**	**21,616**

Total assets as at 31 December 2013 were £24,947 million, a 15 per cent. increase from £21,688 million as at 31 December 2012. The increase was primarily due to the following changes to the Balance Sheet occurring as part of the separation from Lloyds Banking Group:

- The recognition of a deposit of £4.1 billion held with Lloyds Banking Group and classified under "Loans and advances to banks". This balance, comprising cash on deposit with Lloyds Banking Group, principally represents the excess of customer deposits over loans and advances to customers of £3.0 billion. The equivalent items in the Balance Sheets at 31 December 2011 and 2012 were accounted for within "Net investment from Lloyds Banking Group". The change in classification resulted from the formalisation of these arrangements with Lloyds Banking Group as part of the separation process.
- A gross derivative asset of £99 million and a derivative liability of £86 million reflecting the fair value of a portfolio of hedges put in place on 1 November 2013 were recognised on the Balance Sheet at 31 December 2013 (see below).

These increases were partially offset by a decrease in loans and advances to customers from £21,168 million as at 31 December 2012 to £20,099 million as at 31 December 2013. The decrease was primarily driven by the full-year impact of the closure of TSB Bank's mortgage intermediary channel and the change in mortgage "porting" arrangements (i.e. customers transferring their existing mortgage products to a new loan on a different property) with Lloyds Banking Group. Prior to July 2013, C&G branch customers who chose to port their mortgages but whose mortgages were intended to be retained by Lloyds Banking Group had their ported mortgage allocated to the TSB Franchise. After the separation of the TSB Franchise mortgage book from Lloyds Banking Group in July 2013, further C&G ported mortgages remained with Lloyds Banking Group.

Total assets of £21,688 million as at 31 December 2012 were broadly flat compared to £21,616 million as at 31 December 2011.

Loans and advances to customers

The following table sets out a breakdown of the TSB Franchise loans and advances to customers as at 31 December 2013, 2012 and 2011.

	As at 31 December		
	2013	2012	2011
		(£m)	
Mortgages	17,729	18,666	18,435
Personal Unsecured	2,143	2,232	2,395
Small Business Banking	324	375	380
Loans and advances to customers before allowance for impairment losses	**20,196**	**21,273**	**21,210**
Allowance for impairment losses	(97)	(105)	(141)
Loans and advances to customers	**20,099**	**21,168**	**21,069**

Mortgages

The following table sets out the composition of the TSB Franchise mortgages as at 31 December 2013, 2012 and 2011.

	As at 31 December		
	2013	2012	2011
		(£m)	
Mortgages			
Opening balance	**18,666**	**18,435**	**18,660**
Direct	10,196	9,309	8,873
Intermediary	8,470	9,126	9,787
Gross new lending	**1,393**	**2,250**	**2,558**
Direct	1,363	1,973	1,825
Intermediary	30	277	733
Principal repayments	**(2,332)**	**(1,965)**	**(2,204)**
Direct	(1,275)	(1,041)	(1,003)
Intermediary	(1,057)	(924)	(1,201)
Other	2	(54)	(579)
Closing balance	**17,729**	**18,666**	**18,435**
Direct	10,286	10,196	9,309
Intermediary	7,443	8,470	9,126

Mortgages are the TSB Franchise's largest asset portfolio and have a significant impact on its overall financial performance. There are a number of key factors influencing the overall size and shape of this portfolio that are likely to have varying impacts on the future growth and composition of the book and, consequently, on TSB's performance. These include lending criteria, demand for mortgage financing, levels of unemployment and the state of the UK housing market. The mortgage book decreased by 5 per cent. from £18,666 million as at 31 December 2012 to £17,729 million as at 31 December 2013. This decrease was primarily driven by the closure of the Lloyds TSB Scotland intermediary channel and a decrease in ported mortgages resulting from changes in porting arrangements with Lloyds Banking Group.

TSB Bank's mortgage book remained broadly flat from £18,435 million as at 31 December 2011 to £18,666 million as at 31 December 2012.

Gross new lending:

The TSB Franchise mortgage book was originated through two key channels: the direct sales channel which includes branches and telephony and the intermediary channel. The C&G intermediary channel was closed in March 2011 and the Lloyds TSB Scotland intermediary channel was closed in January 2013. This constrained TSB Bank's ability to increase gross new lending.

The following table sets out the sources of the TSB Franchise gross new mortgage lending as at 31 December 2013, 2012 and 2011.

	As at 31 December		
	2013	2012	2011
		(£m)	
Direct – branches and telephony	963	1,079	1,121
Direct – retained customer porting	400	894	704
	1,363	1,973	1,825
Intermediary	23	249	575
Intermediary – retained customer porting	7	28	158
Gross new lending	1,393	2,250	2,558

Gross new lending fell 38 per cent. from £2,250 million as at 31 December 2012 to £1,393 million as at 31 December 2013 and by 12 per cent. from £2,558 million as at 31 December 2011 to £2,250 million as at 31 December 2012. The decrease was driven by the following factors:

- Closures of the C&G intermediary mortgage channel in March 2011 and the Lloyds TSB Scotland intermediary channel in January 2013.
- A decrease in retained customer mortgage porting throughout the period under review.

The factors discussed above were partially offset by the effect of fewer customers refinancing their lending at the end of their original product term resulting in more customers moving on to reversionary rate SVR mortgages. The average SVR in 2013 offered by TSB Bank was 2.5 per cent., compared to the average market SVR of 4.4 per cent. (including the Base Rate). As a result, the proportion of total mortgage balances subject to SVR has increased from 59 per cent. in 2011 to 65 per cent. in 2012 and 66 per cent. in 2013. TSB Bank has not written capped SVR mortgages since June 2010.

Principal repayments:

Principal repayments increased in 2013, primarily due to increased market activity which has encouraged customers to refinance their mortgages. In 2012, repayments were lower, in part due to the overall reduction in re-mortgaging activity.

Other:

Other includes £576 million and £58 million in 2011 and 2012, respectively, which relate to the transfer of certain mortgages from TSB Bank to Lloyds Banking Group that were then subject to securitisation by Lloyds Banking Group and, therefore, no longer met the perimeter requirements. From the date of transfer, those mortgages were no longer considered part of TSB Bank.

As a result of the factors described above, TSB Bank's overall market share of gross lending in the UK decreased from 1.7 per cent. in 2011 to 0.8 per cent. in 2013.

Personal unsecured

The following table sets out a breakdown of the TSB Franchise personal unsecured lending as at 31 December 2013, 2012 and 2011.

	As at 31 December		
	2013	2012	2011
		(£m)	
Personal Unsecured			
Personal loans	1,313	1,389	1,523
Credit cards	548	557	603
Overdrafts	282	286	269
Personal unsecured	2,143	2,232	2,395

TSB Bank's personal unsecured book comprises personal loans, credit cards and overdrafts originated directly by TSB Bank, of which personal loans are the largest component, amounting to £1,313 million or 61 per cent. of the total as at 31 December 2013 (2012: £1,389 million, 62 per cent. 2011: £1,523 million, 64 per cent.).

Personal unsecured lending decreased by 4 per cent. from £2,232 million as at 31 December 2012 to £2,143 million as at 31 December 2013 and by 7 per cent. from £2,395 million as at 31 December 2011 to £2,232 million as at 31 December 2012. The decreases were primarily attributable to reductions in personal loans and in credit card lending. The key drivers of these reductions were tightened credit risk management, reduced consumer demand caused by general economic uncertainty and suppressed consumer confidence.

Personal loans:

The following table sets out the components of the TSB Franchise net new lending as at 31 December 2013, 2012 and 2011.

	As at 31 December		
	2013	2012	2011
		(£m)	
Gross new lending	719	684	690
Principal repayments	(730)	(735)	(785)
Charge-offs	(65)	(83)	(106)
Net reduction	(76)	(134)	(201)

TSB Bank's personal loan book declined over the period as customers continued to reduce their personal indebtedness and TSB Bank tightened its credit risk appetite.

In 2013, gross new lending increased by 5 per cent. driven by lower customer interest rates and consumer confidence returning as economic conditions began to improve. This has been offset by increased principal repayments due to market competition and improving economic conditions that have enabled customers to repay their balances.

Credit cards and overdrafts:

The credit card book decreased by 9 per cent. in the period from 31 December 2011 to 31 December 2013, reflecting similar factors to those affecting personal loans, including market competition that drove increased customer attrition and changes to forbearance policy.

The monthly trend in overdrafts has been broadly flat over the period. However, the year end balance is affected by customer behaviour and the day of the week on which the month end occurs. This effect was pronounced in 2012, which explains the slight increase as compared to 2011.

Small business banking

The following table sets out a breakdown of the TSB Franchise small business banking assets as at 31 December 2013, 2012 and 2011.

	As at 31 December		
	2013	2012	2011
		(£m)	
Small Business Banking			
Term lending	272	312	314
Overdrafts	46	56	59
Credit cards	6	7	7
Small business banking total	324	375	380

TSB Bank's small business banking assets decreased from £375 million as at 31 December 2012 to £324 million as at 31 December 2013 and from £380 million as at 31 December 2011 to £375 million as at 31 December 2012. These decreases were primarily due to a decrease in new term lending caused by ongoing customer deleveraging and some customer base attrition.

4.2 Liabilities

The following table sets out certain balance sheet information of the TSB Franchise as at 31 December 2013, 2012 and 2011. Balance Sheet information as at 31 March 2014 is included in *"Financial position and results of operations for the three months ended 31 March 2014"* below.

	As at 31 December		
	2013	2012	2011
		(£m)	
Customer deposits	23,105	22,909	21,803
Items in course of transmission to banks	64	62	57
Derivative financial instruments	86	—	—
Other liabilities	86	63	54
Retirement benefit obligations	33	37	—
Current tax liabilities	5	25	25
Other provisions	12	15	7
Total liabilities	23,391	23,111	21,946

Total liabilities as at 31 December 2013 were £23,391 million, a 1 per cent. increase compared to £23,111 million as at 31 December 2012, with growth in personal and business current accounts largely offset by a decline in savings accounts. Total liabilities as at 31 December 2012 were £23,111 million, a 5 per cent. increase over £21,946 million as at 31 December 2011, representing customer deposit inflows to both PCA and savings accounts, in line with UK market trends during 2012.

Customer deposits

The following table sets out a breakdown of the TSB Franchise customer deposits as at 31 December 2013, 2012 and 2011.

	As at 31 December		
	2013	2012	2011
		(£m)	
Personal			
Non-interest bearing current accounts	3,715	3,611	3,686
Interest bearing current accounts	2,100	1,646	1,327
Total personal current accounts	5,815	5,257	5,013
Access savings accounts	11,022	11,702	11,022
ISA accounts	4,344	4,143	3,701
Fixed savings accounts	1,048	972	1,318
Other	61	71	50
Total personal savings accounts	16,475	16,888	16,091
Total personal customer deposits	22,290	22,145	21,104
Small business banking			
Non-interest bearing current accounts	658	586	529
Interest bearing current accounts	29	24	20
Savings accounts	128	154	150
Total small business banking deposits	815	764	699
Total customer deposits	23,105	22,909	21,803

Customer deposits comprise PCAs, savings and deposits account balances held by TSB Bank on behalf of personal and Small Business Banking customers.

Customer deposits increased marginally from £22,909 million as at 31 December 2012 to £23,105 million as at 31 December 2013 and 5 per cent. from £21,803 million as at 31 December 2011 to £22,909 million as at 31 December 2012. These balances have broadly grown in line with the overall market and are an important source of stable low cost funding for TSB Bank. The higher deposits in PCAs have more than offset the reduction in savings balances.

Personal current accounts

The following table sets out certain key metrics for the TSB Franchise PCAs as at 31 December 2013, 2012 and 2011.

	As at 31 December		
	2013	2012	2011
	(£m, except where indicated)		
Non-interest bearing current accounts	3,715	3,611	3,686
Interest bearing current accounts	2,100	1,646	1,327
Total	5,815	5,257	5,013
Number of accounts ('000)	3,066	3,027	2,934

The low interest rate environment during the period under review has led to growth in PCA balances as customers have remained insensitive to the relatively small differences between the interest rates offered on savings products and those offered on PCAs. This has been compounded by some PCA accounts offering relatively high rates of interest compared to savings accounts, up to a certain limit. TSB Bank enhanced current accounts in this period offered interest rates up to 4 per cent. on applicable balances and, as a result, the balances comprising interest bearing current accounts have increased 28 per cent. from 31 December 2012 to 31 December 2013. In late 2012, instant access savings rates were reduced across the banking industry as banks' demand for deposits decreased. As a result, interest bearing PCAs became comparatively more attractive without rates changing on these accounts.

Savings

The following table sets out the TSB Franchise personal savings accounts as at 31 December 2013, 2012 and 2011.

	As at 31 December		
	2013	2012	2011
		(£m)	
Variable rate	13,992	14,678	13,951
Fixed	2,483	2,210	2,140
Total	16,475	16,888	16,091

Personal savings balances decreased by 2 per cent. from £16,888 million as at 31 December 2012 to £16,475 million as at 31 December 2013. Personal savings balances increased by 5 per cent. from £16,091 million as at 31 December 2011 to £16,888 million as at 31 December 2012.

The reduction in savings balances in 2013 was driven predominantly by rate cuts on instant access savings accounts which were made ahead of most of the market. Savings rates pricing in 2013 was adjusted consistent with Lloyds Banking Group's pricing to manage overall liquidity and interest margins.

TSB Bank maintained ISA market share at 2 per cent. over the period driven by maintaining competitive rates for both fixed and variable rate products to retain large customer deposits. Growth in fixed rate deposits occurred in 2013 as C&G customers (not in the original business perimeter) re-deposited maturing balances back into TSB Bank fixed rate products.

Overall, TSB Bank's market share has reduced marginally to 1.7 per cent. from 1.8 per cent. in 2012 with the largest decline being on instant access savings accounts.

Small business banking

Small business banking current account balances have increased during the period under review, reflecting a wider market trend for customers to hold higher balances as the economy has improved. Savings account balances have reduced which reflects the lower incentive for customers to migrate funds from the current accounts to instant access savings accounts due to comparatively lower interest rates.

Excess liquidity – TSB Franchise

	As at 31 December		
	2013	2012	2011
		(£m)	
Customer deposits	23,105	22,909	21,803
Less:			
Loans and advances to customers	20,099	21,168	21,069
Excess liquidity	**3,006**	**1,741**	**734**

During the period under review, the TSB Franchise had an excess of customer deposits over customer loans and advances, resulting in excess liquidity before taking into account the impact of the Mortgage Enhancement. The volume of excess liquidity increased over the period from £734 million as at 31 December 2011 to £1,741 million as at 31 December 2012 to £3,006 million as at December 2013. The growth in customer deposits has been driven by Lloyds Banking Group liquidity requirements as well as market and pricing dynamics. The reduction in loans and advances to customers is primarily due to the closure of the intermediary mortgage channel, decreased mortgage porting, muted customer demand and tightened credit criteria.

5 Financial Position – Mortgage Enhancement

Loans and advances to customers

The following table sets out certain key Balance Sheet information of the Mortgage Enhancement as at 31 December 2013, 2012 and 2011.

	As at 31 December		
	2013	2012	2011
		(£m)	
Mortgages			
Opening balance	3,181	2,655	2,282
Gross new lending	334	624	451
Principal repayments	(128)	(98)	(78)
Loans and advances to customers	3,387	3,181	2,655

The historical track record of the Mortgage Enhancement does not represent or reflect overall portfolio management decisions made with respect to the mortgage originating Lloyds Banking Group business. Instead, the book is reflective of the aggregation of the Additional Mortgages' historical financial performance. The gross new lending represents the origination of the selected mortgages that occurred during the relevant period.

There are no full redemptions in the period under review because the Additional Mortgages would not have been available for selection at 28 February 2014. The increase in principal repayments over the period is due to a greater proportion of the loans being in place for the full year.

6 Results of Operations for the Years Ended 31 December 2013, 2012 and 2011 – TSB Franchise

The following table sets out certain income statement items of the TSB Franchise for the years ended 31 December 2013, 2012 and 2011. Income Statement information for the three months ended 31 March 2014 is included in "*Financial position and results of operations for the three months ended 31 March 2014*" below. The income statement data in this table and throughout this section is extracted from the HFI for each year, prepared on a Management Basis, as explained in "*Basis of preparation*" above. A line by line reconciliation of differences between the Management Basis and the HFI for the year ended 31 December 2013 is provided in Part XII: "*Selected Financial and Other Information*". There were no differences between the Management Basis and HFI in the years ended 31 December 2012 and 2011.

	Management Basis		
	Year ended 31 December		
	2013	2012	2011
		(£m)	
Interest and similar income	917	944	987
Interest and similar expense	(314)	(411)	(353)
Net interest income	603	533	634
Other income (net of fee and commission expense)(1)	163	179	197
Total income	766	712	831
Operating expenses	(575)	(579)	(590)
Impairment loss on loans and advances to customers	(109)	(118)	(183)
Underlying profit before taxation	**82**	**15**	**58**
Other gains and losses (fair value movements on instruments held at fair value)	(46)	—	—
Profit before taxation	**36**	**15**	**58**

Note:
(1) Other income comprises net fee and commission income and other operating income.

Profit before taxation increased 140 per cent. from £15 million in 2012 to £36 million in 2013 (£82 million on an underlying basis) primarily due to an increase in net interest income as well as decreases in operating expenses and impairment.

6.1 Net interest income

The following table sets out the breakdown of the TSB Franchise net interest income and key margins for the years ended 31 December 2013, 2012 and 2011. This data is prepared in accordance with the Management Basis of presentation.

	Management Basis		
	Year ended 31 December		
	2013	2012	2011
	(£m, except where indicated)		
Interest and similar income			
Mortgages	525	555	580
Fixed	143	167	201
Tracker[1]	55	95	110
SVR	301	291	269
HVR	26	2	—
Personal unsecured	358	367	385
Small business banking	20	22	22
Other interest	14	—	—
Total interest and similar income	917	944	987
Interest and similar expense			
Customer deposits	(271)	(299)	(233)
Personal current accounts	(27)	(22)	(21)
Savings	(243)	(276)	(211)
Small Business Banking	(1)	(1)	(1)
Funds transfer pricing charges	(43)	(112)	(120)
Net interest rate swap flows	35	9	(29)
LBG liquidity and capital costs	(78)	(121)	(91)
Total interest and similar expense	(314)	(411)	(353)
Net interest income	603	533	634
TSB Franchise banking net interest margin	2.89%	2.51%	2.95%
Average gross customer assets	20,869	21,260	21,522

Note:

(1) Includes EIR (2011: £2.7 million; 2012: £7.4 million; 2013: £6.6 million) and ERC (2011: £5.6 million; 2012: £4.1 million; 2013: £3.3 million).

Net interest income for 2013 was £603 million, a 13 per cent. increase compared to £533 million in 2012. This reflected reduced rates on customer deposit balances, as well as a 62 per cent. decline in the FTP charge by Lloyds Banking Group, due to both an increasing net surplus liquidity position and TSB Bank's standalone funding from 1 November 2013. These were partially offset by a decrease in interest income from mortgage lending. Net interest income for 2012 was £533 million a 16 per cent. decrease from £634 million in 2011, driven by a decrease in interest income and an increase in interest expenses, particularly on customer deposits.

The components of TSB Bank's net interest income are described in more detail below.

Interest and similar income

Interest and similar income declined by 3 per cent. from 2012 to 2013, primarily due to reduced mortgage income as principal mortgage balances declined. In addition, the increased proportion of capped SVR mortgages led to a decrease in the total gross yield of all TSB Franchise mortgages from 3.1 per cent. in 2011 to 3.0 per cent. in 2012 and 2.9 per cent. in 2013. As a greater proportion of mortgages has become subject to the lower reversionary SVR, the overall gross yield on the book has been diluted with limited opportunity to increase yields until these mortgages are refinanced or mortgages originated at higher rates form a greater proportion of the overall book. The SVR cap of 200 bps above the Base Rate negatively impacts TSB Franchise's banking net interest margin by reference to gross standard variable rates across the market, which average 393 bps above the Base Rate. The SVR portfolio is,

however, well seasoned and has low average indexed LTV Ratios, low arrears rates and low repossession rates, which partly compensate for the low margin it yields. New mortgages written by TSB Bank since June 2010 revert to HVR, which does not contain a contractual ceiling relative to the Base Rate. The HVR was 3.99 per cent. as at 31 March 2014. As TSB Bank's SVR varies with the Base Rate, management expects the SVR to become less attractive for customers as base rates rise and that customers will look to refinance their SVR products onto a new product that fixes their payments, or benefits from a short-term discount offered on variable rates. These products will not have a capped SVR.

Similarly, the continued deleveraging across credit cards and personal loans reduced interest income on TSB Bank's unsecured assets. The blended customer interest rate for personal loans has increased from 12.0 per cent. in 2011 to 12.6 per cent. in 2012 and 13.1 per cent. in 2013. This was the result of an increase in new lending rates in 2011 and 2012 reflecting the impact of continuing financial uncertainty on risk appetite. The shorter maturity profile of these assets relative to mortgages resulted in the overall book yield improving relatively quickly in response to this re-pricing.

Other interest of £14 million in 2013 comprises £4 million of interest from deposits with banks, representing the deposits held with Lloyds Banking Group and £10 million of interest on interest rate derivatives, which are not in designated hedging relationships.

Interest and similar expense

Interest and similar expense decreased by 24 per cent. from £411 million in 2012 to £314 million in 2013. This was driven by a reduction in the blended average rate on deposits, which decreased from 1.4 per cent. in 2012 to 1.2 per cent. in 2013, principally due to the re-pricing of access savings products and a significant reduction in FTP charges.

Interest and similar expense increased by 16 per cent. from £353 million in 2011 to £411 million in 2012, primarily due to an increase in interest paid on customer deposits (blended average rate increased from 1.1 per cent. in 2011 to 1.4 per cent. in 2012), as competition in the market demanded higher rates to maintain customer balances, combined with an increase in deposit balances.

Rate cuts in 2013 reduced the blended gross customer rate paid from 1.6 per cent. in 2012 to 1.4 per cent. in 2013. This compares to an increase in the blended gross customer rate from 1.4 per cent. in 2011 to 1.6 per cent. in 2012, when intense competition for deposits increased pricing. Interest expense includes an effective interest rate ("**EIR**") adjustment, which spreads the cost of the initial incentive period of a savings product over the behavioural life of the deposit balance. In 2012, the behavioural life assumptions within the savings EIR calculation were updated and the reduced behavioural lives resulted in a one-off incremental charge of £25 million. This one-off adjustment, combined with the ongoing impact of the shorter behavioural lives, contributed to a £36 million year-on-year variance compared to 2011.

The TSB Franchise and the Mortgage Enhancement were included in Lloyds Banking Group's FTP mechanism until 1 November 2013 and 1 March 2014, respectively. The following table sets out the FTP charges to the TSB Franchise business during the years ended 31 December 2013, 2012 and 2011.

	As at 31 December		
	2013	**2012**	**2011**
		(£m)	
FTP charges – TSB Franchise			
Interest income/(costs)	35	9	(29)
Liquidity and capital costs	(78)	(121)	(91)
	(43)	**(112)**	**(120)**

During the period under review, the TSB Franchise loan to deposit ratio was consistently less than 100 per cent., due to excess customer deposits. This excess liquidity increased from £734 million in 2011 to £3,006 million in 2013, and contributed to Lloyds Banking Group's overall liquidity and funding position. Although TSB's underlying liquidity charges reduced, the allocated costs reflect Lloyds Banking Group's overall funding position and market conditions across the period.

Interest transfer prices are driven by the mix of variable and fixed rate products in each portfolio and the level of LIBOR and five-year swap rates. The reduction from £29 million of costs to £35 million of income in the TSB Franchise is primarily driven by the reduction in the loan to deposit ratio, partially offset by a decline in rolling average five-year swap rates from 3.8 per cent. at 31 December 2011 to 2.1 per cent. at 31 December 2013.

The TSB Franchise did not incur FTP costs after 1 November 2013 when it established its own standalone funding, liquidity and interest rate risk management arrangements.

Banking net interest margin

As a result of the foregoing movements in the components of TSB Franchise's net interest income, the TSB Franchise banking NIM for 2013 was 2.89 per cent., a 38 basis point increase compared to 2.51 per cent. in 2012. NIM declined from 2.95 per cent. in 2011 to 2.51 per cent. in 2012.

6.2 Other income

The following table sets out the breakdown of the TSB Franchise other income for the years ended 31 December 2013, 2012 and 2011. This data is prepared in accordance with the Management Basis.

	Year ended 31 December		
	2013	2012	2011
		(£m)	
Current accounts and other fees (net)	68	76	73
Credit and debit card fees (net)	57	56	57
Investment and protection income	11	34	54
Household insurance commission income	27	13	13
Total other income (net of fee and commission expense)	**163**	**179**	**197**

Other income (net of fee and commission income) decreased by 9 per cent. from £197 million in 2011 to £179 million in 2012 and a further 9 per cent. in 2013 to £163 million. The decrease is primarily driven by the decline in investment and protection income. The decline in investment income was driven by the decision to remove the in-branch qualified financial advisers in 2012 ahead of the FCA's retail distribution review regulations. These advisers generated fee and commission income on the sale of Scottish Widows investment and protection products. In addition, Bancassurance staff, who were authorised to sell protection products to customers, were removed from branches from June 2013, following the end of discussions with the Co-operative Group, as there was no Bancassurance capability built for TSB from July 2013. Bancassurance arrangements through a new third party arrangement will commence from the second half of 2014, yielding a lower level of income but with no extra costs and reduced risk.

Current accounts and other fees increased in 2012 driven by increased income on AVAs. Conversely, since these were no longer offered in branch from January 2013, AVA income has been decreasing. The rise in Household insurance income in 2013 was due to new terms of trade with Lloyds Banking Group (the provider of general insurance to TSB).

6.3 Operating expenses

The following table sets out the breakdown of the TSB Franchise operating expenses for the years ended 31 December 2013, 2012 and 2011.

	Year ended 31 December		
	2013	2012	2011
		(£m)	
Staff costs	192	190	201
Premises and equipment	62	61	59
Recharges in respect of management fees	265	273	283
Other expenses	41	42	33
Depreciation of tangible fixed assets	15	13	14
Total operating expenses	575	579	590

Operating expenses for 2013 reduced 1 per cent. to £575 million from £579 million in 2012 and 2 per cent. from £590 million in 2011 to £579 million in 2012. During the period, TSB Bank incurred costs that were directly attributable to its business operations and activities and also received recharges for certain IT services and business services provided by Lloyds Banking Group. These recharges were provided through a cost driver allocation process, during which time the separation activities to establish TSB on an independent basis were being built.

The directly attributable costs relate principally to the branch and office property costs, the customer service operations (including telephony), and the branch network costs. These costs have remained relatively stable throughout the period under review. Direct salary costs decreased by £14 million in 2013 compared to 2012, primarily due to the Bancassurance sales force being removed from the network. This represented a 3 per cent. reduction in FTE but a 9 per cent. reduction in costs. The impact of this cost reduction compared to 2012 was masked due to a one-off past service net credit of £8 million in 2012 in respect of allocated pension costs.

The overall decrease in operating costs across the period was primarily due to a decrease in allocated recharges from Lloyds Banking Group, arising from a substantial cost reduction and efficiency improvement programme undertaken at Lloyds Banking Group.

The increase in premises and equipment and depreciation was driven by investment in property improvements and re-branding during 2013 across the C&G branches, as these were fitted out in order to provide customers with a consistent offering across all TSB Bank branches.

6.4 Other Gains and Losses

When TSB Bank established its standalone interest rate risk management arrangements in November 2013, a portfolio of derivatives to hedge interest rate risk was put in place with an initial fair value "Day 1" cost of £54 million. This Day 1 cost will unwind over a period matching the effective maturity of the underlying derivatives, with £7 million of unwind being recognised in the period to 31 December 2013. The derivatives portfolio was revalued to market value at 31 December 2013, leading to a mark-to-market loss of £39 million being recognised in the 2013 Income Statement. The derivatives did not enter designated hedging relationships for accounting purposes until 1 January 2014 and, as a result, there is no offsetting gain from revaluation of the hedged items. Due to its non-recurring nature, the Management Basis presents the impact of this item outside of underlying profit before tax because the TSB Board believes that presentation gives a more accurate picture of the business performance. For further detail, please see "*Basis of Preparation*" above and the reconciliation between the HFI and Management Basis contained in Part XII: "*Selected Financial and Other Information*".

7 Results of Operations for the Years Ended 31 December 2013, 2012 and 2011 – Mortgage Enhancement

The following table sets out certain key income statement line items and key margins for the Mortgage Enhancement for the years ended 31 December 2013, 2012 and 2011:

	Year ended 31 December		
	2013	2012	2011
	(£m, except where indicated)		
Interest and similar income	128	113	95
Interest and similar expense	(96)	(88)	(70)
Net interest income	32	25	25
Operating expenses	(1)	(1)	(1)
Impairment loss on loans and advances to customers	—	—	—
Profit before taxation	**31**	**24**	**24**
Gross customer asset margin	3.89%	3.82%	3.82%
Average gross customer assets	3,292	2,940	2,484

7.1 Net interest income

Net interest income increased to £32 million in 2013 from £25 million in 2012 after remaining flat from 2011 to 2012.

The increase in interest income across the periods was primarily driven by the 28 per cent. increase in the Additional Mortgages portfolio from 2012 to 2013. The average gross customer asset margin increased slightly year-on-year to 3.89 per cent. in 2013, from 3.82 per cent. in 2012 and 3.82 per cent. in 2011. In addition, the composition of the Mortgage Enhancement in terms of rate type changed as Mortgage Enhancement Variable Rate mortgages increased from 48 per cent. in 2011 to 53 per cent. in 2013.

The Mortgage Enhancement portfolio differs from the mortgage portfolio of the TSB Franchise business, as it does not contain SVR mortgages that have contractually capped variable rates. As a result, the yield on this portfolio has been consistently greater than the TSB Franchise portfolio.

Interest expense on the Mortgage Enhancement portfolio has moved in line with the TSB Franchise portfolio as the FTP charges reflect Lloyds Banking Group's cost of funding and the lengthening of the behavioural maturity of the mortgage assets. However, the charge was lower in relative terms because the Mortgage Enhancement consists of a higher proportion of variable rate products which attract lower interest transfer price charges compared to fixed rate products.

	As at 31 December		
	2013	2012	2011
		(£m)	
FTP charges – Mortgage Enhancement			
Interest costs	(29)	(32)	(39)
Liquidity and capital costs	(67)	(56)	(31)
	(96)	**(88)**	**(70)**

Banking net interest margin on the Mortgage Enhancement portfolio for the year ended 31 December 2013 was 0.97 per cent., a 15 bps increase compared to 0.82 per cent. in the year ended 31 December 2012. The increase in 2013 was primarily driven by the reduced rate at which FTP charges were allocated by Lloyds Banking Group to the portfolio. In 2012, there was a 19 bps decrease in banking net interest margin from 1.01 per cent. to 0.82 per cent. due to Lloyds Banking Group's higher cost of funds in 2012. The relative incremental contribution of the Mortgage Enhancement will increase in 2014 as it will no longer pay Lloyds Banking Group's FTP charges but will predominantly be funded from surplus deposits in the TSB Franchise business.

7.2 Operating expenses

Operating costs for the Mortgage Enhancement have been allocated on a combined basis. These charges reflect the costs associated with servicing and management of these assets by the Bank of Scotland mortgage business. These costs have been consistent at £1 million for the years ended 31 December 2013, 2012 and 2011.

Since the equitable assignment in March 2014, TSB Bank has been charged a fee by Bank of Scotland for the servicing, administration and reporting of the portfolio, which is charged at 12 bps on the outstanding balance of the mortgage assets. These charges are included as negative income in other income.

8 Credit Risk

8.1 Impairment

The following table provides the breakdown of TSB Bank's impairment losses for the three months ended 31 March 2014 and the years ended 31 December 2013, 2012 and 2011.

	Three months ended 31 March	Year ended 31 December		
	2014	2013	2012	2011
	(£m, except where indicated)			
Impairment losses on loans and receivables				
Mortgages	—	(5)	(5)	(2)
Personal unsecured	(25)	(98)	(107)	(173)
Small business banking	(2)	(6)	(6)	(8)
Total impairment losses on loans and receivables	**(27)**	**(109)**	**(118)**	**(183)**
Mortgage Enhancement	—	—	—	—
Total impairment charged to the income statement	**(27)**	**(109)**	**(118)**	**(183)**
Asset quality ratios				
TSB Franchise Mortgages	—	0.02%	0.03%	0.01%
Personal unsecured	—	4.47%	4.56%	6.79%
Small business banking	—	1.72%	1.49%	2.00%
Overall TSB Franchise(1)	**0.54%**	**0.53%**	**0.55%**	**0.85%**
Mortgage Enhancement	—	0.00%	0.00%	0.00%
Overall TSB Bank Group	**0.48%**	**0.45%**	**0.48%**	**0.76%**

Note:

(1) The asset quality ratios have been calculated using the impairment charge of the respective periods and the average customer assets calculated on a monthly average basis, with the exception of PCAs, which have been calculated on a daily average basis.

The total impairment charge has fallen 8 per cent. from £118 million in 2012 to £109 million in 2013 and by 36 per cent. from £183 million in 2011 to £118 million in 2012. This decline has been driven primarily by an improvement in the quality of the personal unsecured asset portfolio. This improvement was the result of a tightening of credit risk measures implemented from 2008 that have since been maintained. Over the period, the sustained low interest rates, improving macro-economic conditions and customer deleveraging, also contributed to the reduction in impairment charges.

Overall, the asset quality ratios ("**AQRs**") improved from 31 December 2011 with the underlying impairment charge decreasing over the period. At 31 December 2013, the overall TSB Franchise AQR was 0.53 per cent., compared to 0.55 per cent. in 2012 and 0.85 per cent. in 2011, driven by the high quality of assets in the TSB Franchise mortgage portfolio.

As at 31 March 2014, the TSB Franchise AQR was 0.54 per cent. and TSB Bank Group AQR was 0.48 per cent. The TSB Bank Group AQR is expected to rise to approximately 0.50 per cent. by 31 December 2014, moving towards a range of 0.55 per cent. to 0.60 per cent. for the period thereafter until 31 December 2018.

The tables below set out TSB Bank's impairment provisioning on loans and advances to customers for the three months ended 31 March 2014 and the years ended 31 December 2013, 2012 and 2011.

	Loans and advances to customers	Impaired loans	Impaired loans as a % of closing advances[1]	Impairment provisions	Impairment provisions as a % of impaired loans[1]
	(£m)		*(%)*	*(£m)*	*(%)*
At 31 March 2014					
Mortgages					
TSB Franchise	17,415	133	0.8	22	16.9
Mortgage Enhancement	3,290	—	—	1	—
Total	20,705	133	0.6	23	17.3
Personal Unsecured	2,116	82	3.9	67	80.8
Small business banking	313	15	4.7	5	37.0
Total gross lending	23,134	230	1.0	95	41.3
Impairment provisions	(95)				
Total	23,039				

	Loans and advances to customers	Impaired loans	Impaired loans as a % of closing advances[1]	Impairment provisions	Impairment provisions as a % of impaired loans[1]
	(£m)		*(%)*	*(£m)*	*(%)*
At 31 December 2013					
Mortgages					
TSB Franchise	17,729	139	0.8	24	17.3
Mortgage Enhancement	3,387	—	—	1	—
Total	21,116	139	0.7	25	17.6
Personal Unsecured	2,143	88	4.1	68	77.5
Small business banking	324	15	4.6	5	34.2
Total gross lending	23,583	242	1.0	98	40.3
Impairment provisions	(98)				
Total	23,485				

	Loans and advances to customers	Impaired loans	Impaired loans as a % of closing advances	Impairment provisions	Impairment provisions as a % of impaired loans
	(£m)		*(%)*	*(£m)*	*(%)*
At 31 December 2012					
Mortgages					
TSB Franchise	18,666	155	0.8	22	14.2
Mortgage Enhancement	3,181	—	—	1	—
Total	21,847	155	0.7	23	14.7
Personal Unsecured	2,232	99	4.5	81	80.9
Small business banking	375	15	4.1	2	14.4
Total gross lending	24,454	269	1.1	106	39.1
Impairment provisions	(106)				
Total	24,348				

	Loans and advances to customers	Impaired loans	Impaired loans as a % of closing advances[1]	Impairment provisions	Impairment provisions as a % of impaired loans[1]
	(£m)		(%)	(£m)	(%)
At 31 December 2011					
Mortgages					
TSB Franchise	18,435	203	1.1	22	11.2
Mortgage Enhancement	2,655	2	0.1	1	33.8
Total	21,090	205	1.0	23	11.5
Personal Unsecured	2,395	137	5.7	116	84.1
Small business banking	380	16	4.2	3	19.4
Total gross lending	23,865	358	1.5	142	39.6
Impairment provisions	(142)				
Total	23,723				

Note:

(1) Percentages have been calculated from the source data and as such the percentages presented in the tables above may be different from those calculated using the data in the tables above, which is presented to the nearest million.

Total impaired loans declined 10 per cent. from £269 million in 2012 to £242 million in 2013 and 25 per cent. from £358 million in 2011 to £269 million in 2012. The consistent decline reflected the high quality of the lending portfolio and its low levels of loss emergence.

The impairment provision fell 8 per cent. from £106 million in 2012 to £98 million in 2013 and by 25 per cent. from £142 million in 2011 to £106 million in 2012, driven by the personal unsecured portfolio. Management has made an assessment of the TSB Franchise mortgages and strengthened the provision coverage to a level it believes is appropriate. The coverage ratio (impairment provision as a percentage of impaired loans) has been strengthened from 11.2 per cent. in 2011 to 17.3 per cent. in 2013.

Total impaired loans for personal unsecured balances one or more payments in arrears have decreased steadily from 31 December 2011 to £82 million comprising £26 million from cards, £37 million from loans and £19 million from overdrafts at 31 March 2014. Rates of arrears emergence for new unsecured lending have remained low and stable through to 31 March 2014.

8.2 Forbearance

TSB Bank operates a number of schemes to assist borrowers who are experiencing financial difficulties.

TSB Bank classifies the treatments offered to retail customers who have experienced financial difficulty into the following categories: reduced contractual monthly payments, reduced payment arrangements and term extensions and repairs. Further details are included in Note 22(1)(e) to the HFI.

TSB Bank has applied revised forbearance definitions based upon principles developed through the British Bankers' Association. As this definition was adopted after the date of separation, TSB Bank does not have access to all of the historical positions required to calculate forbearance as at 31 December 2011 and 2012 on a consistent basis with 31 December 2013. The portfolio trends on impaired loans and monthly tracking of forbearance, however, indicate a continuing improvement in the level of forbearance.

Forbearance – mortgages

The following tables set out TSB Bank's forborne mortgages as at 31 March 2014 and 31 December 2013.

	Total loans and advances that are forborne	Total current and recent forborne loans and advances which are impaired	Impairment provisions as a % of loans and advances which are currently or recently forborne[1]
	At 31 March 2014		
	(£m)		(%)
TSB Franchise			
Reduced contractual monthly payment	19	3	3.8
Reduced payment arrangements	39	4	1.8
Term extensions and repairs	135	9	1.5
TSB Franchise – total	193	16	1.8

	Total loans and advances that are forborne	Total current and recent forborne loans and advances which are impaired	Impairment provisions as a % of loans and advances which are currently or recently forborne[1]
	At 31 December 2013		
	(£m)		(%)
TSB Franchise			
Reduced contractual monthly payment	34	5	2.7
Reduced payment arrangements	36	3	2.1
Term extensions and repairs	142	10	1.8
TSB Franchise – total	212	18	2.0

Note:

(1) Percentages have been calculated from the source data and as such the percentages presented in the tables above may be different from those calculated using the data in the tables above, which are presented to the nearest million.

At 31 December 2013, mortgages currently or recently subject to forbearance amounted to 1 per cent. of total mortgages.

Forbearance – unsecured

The following tables set out TSB Bank's forborne unsecured lending as at 31 March 2014 and 31 December 2013.

	Total loans and advances that are forborne	Total current and recent forborne loans and advances which are impaired	Impairment provisions as a % of loans and advances which are currently or recently forborne
	At 31 March 2014		
	(£m)		(%)
Reduced contractual monthly payment	19	19	34.3
Reduced payment arrangements	13	13	53.6
Repair and term extensions	12	5	11.8
Total	44	37	33.9

	Total loans and advances that are forborne	Total current and recent forborne loans and advances which are impaired	Impairment provisions as a % of loans and advances which are currently or recently forborne
	At 31 December 2013		
	(£m)		(%)
Reduced contractual monthly payment	19	19	38.1
Reduced payment arrangements	14	13	54.3
Repair and term extensions	15	6	12.7
Total	48	38	34.8

At 31 December 2013, unsecured loans and advances currently or recently subject to forbearance were 2 per cent. of total personal unsecured loans and advances. Total commercial loans forborne at 31 December 2013 were 5 per cent. of total commercial loans and advances.

8.3 Mortgage portfolio composition

Mortgages – composition by product type

	TSB Franchise				Mortgage Enhancement				Total			
	At 31 March	At 31 December			At 31 March	At 31 December			At 31 March	At 31 December		
	2014	2013	2012	2011	2014	2013	2012	2011	2014	2013	2012	2011
						(%)						
Mainstream	86.6	86.7	86.6	85.9	85.2	85.3	85.4	86.6	86.3	86.4	86.4	86.0
Buy-to-let	13.4	13.3	13.4	14.1	14.8	14.7	14.6	13.4	13.7	13.6	13.6	14.0
Total	100	100	100	100	100	100	100	100	100	100	100	100

The composition of the mortgage portfolio has remained broadly stable over the historical period with a slight decrease in the proportion of buy-to-let mortgages, which reflects TSB Bank's risk appetite.

Mortgages – composition by repayment type

	TSB Franchise				Mortgage Enhancement				Total			
	At 31 March	At 31 December			At 31 March	At 31 December			At 31 March	At 31 December		
	2014	2013	2012	2011	2014	2013	2012	2011	2014	2013	2012	2011
						(%)						
Interest-only	45.3	45.8	47.9	50.5	45.8	45.9	48.3	51.5	45.4	45.8	47.9	50.7
Repayment	54.7	54.2	52.1	49.5	54.2	54.1	51.7	48.5	54.6	54.2	52.1	49.3
Total	100	100	100	100	100	100	100	100	100	100	100	100

Between 31 December 2011 and 31 December 2013, the percentage of interest-only mortgages as a proportion of total mortgages decreased from 51 per cent. in 2011 to 46 per cent. in 2013. This reflects an overall market trend away from interest-only lending.

Mortgages – composition by rate type

	TSB Franchise				Mortgage Enhancement				Total			
	As at 31 March	As at 31 December			As at 31 March	As at 31 December			As at 31 March	As at 31 December		
	2014	2013	2012	2011	2014	2013	2012	2011	2014	2013	2012	2011
						(%)						
SVR	65.0	65.8	65.2	59.2	—	—	—	—	54.6	55.3	55.7	51.8
HVR[1]	6.8	5.3	1.6	—	56.3	52.9	46.6	47.8	14.7	12.9	8.1	6.0
Fixed	16.5	16.4	17.2	19.1	4.7	0.1	12.1	20.0	14.6	13.7	16.5	19.2
Tracker	11.7	12.5	16.0	21.7	39.0	47.0	41.3	32.2	16.1	18.1	19.7	23.0
Total	100	100	100	100	100	100	100	100	100	100	100	100

[1] In relation to the Mortgage Enhancement, the Mortgage Enhancement Variable Rate.

The overall composition of the mortgage portfolio has changed in the historical period. SVR mortgages have increased as a proportion of the TSB Franchise book from 59 per cent. in 2011 to 65 per cent. in 2012 and 66 per cent. in 2013. The prevailing low interest rates resulted in borrowers maintaining their mortgages beyond the initial incentive periods. Tracker mortgages reduced as a proportion of the total book from 23 per cent. in 2011 to 20 per cent. in 2012 and 18 per cent. in 2013. The reduction is caused by reduced customer demand for these products and the effect of tracker mortgages moving to reversionary rates at the end of their natural term.

Mortgages – composition by region

	At 31 March 2014		
	TSB Franchise	Mortgage Enhancement	Total
	(%)		
London and South East of England	35.3	43.8	36.7
Scotland	24.1	—	20.2
Other	40.6	56.2	43.1
Total	100	100	100

TSB Bank has a diversified portfolio of secured exposures across the UK with the split between London and the South East of England, Scotland and other regions remaining relatively static in the historical period. For the three months ended 31 March 2014, approximately 35 per cent. of the TSB Franchise mortgages were attributable to London and the South East of England.

Actual and average Indexed LTVs across the mortgage portfolios

At 31 March 2014	Mainstream	Buy-to-let	TSB Franchise	Mortgage Enhancement
		(%)		
Less than 70%	63.8	72.7	65.0	81.7
70% to 80%	17.9	16.1	17.6	18.0
80% to 90%	10.6	5.8	9.9	0.3
90% to 100%	4.5	3.4	4.4	—
Greater than 100%	3.2	2.1	3.1	—
Total	**100**	**100**	**100**	**100**
Average loan-to-value				
Stock of residential mortgages	45.5	51.9	46.3	44.8
New residential lending[1]	52.8	58.8	53.2	—
Impaired mortgages	56.5	65.8	56.8	—

Note:

(1) The distribution of LTVs for new business over this period was 50.2 per cent. at less than 70 per cent. LTV, 28.8 per cent. at 70 to 80 per cent. LTV, 20.7 per cent. at 80 to 90 per cent. LTV and 0.4 per cent. at 90 to 100 per cent. LTV.

At 31 December 2013	Mainstream	Buy-to-let	TSB Franchise	Mortgage Enhancement
		(%)		
Less than 70%	64.8	72.4	65.9	73.7
70% to 80%	17.7	16.5	17.5	26.3
80% to 90%	10.4	5.3	9.7	—
90% to 100%	4.2	4.1	4.2	—
Greater than 100%	2.9	1.7	2.7	—
Total	100	99.9	100	100
Average loan-to-value				
Stock of residential mortgages	45.4	52.4	46.3	46.6
New residential lending[1]	55.2	57.0	55.3	54.3
Impaired mortgages	56.0	70.5	56.6	—

Note:

(1) The distribution of LTVs for new business over this period was 45.9 per cent. at less than 70 per cent. LTV, 29.1 per cent. at 70 to 80 per cent. LTV, 24.4 per cent. at 80 to 90 per cent. LTV, 0.5 per cent. at 90 to 100 per cent. LTV and 0.1 per cent. at greater than 100 per cent LTV.

At 31 December 2012	Mainstream	Buy-to-let	TSB Franchise	Mortgage Enhancement
			(%)	
Less than 70%	54.1	60.2	54.9	51.0
70% to 80%	19.2	23.3	19.7	31.5
80% to 90%	13.9	8.0	13.2	17.1
90% to 100%	7.1	4.9	6.8	0.4
Greater than 100%	5.7	3.6	5.4	0.0
Total	100	100	100	100
Average loan-to-value				
Stock of residential mortgages	48.9	56.2	49.8	52.5
New residential lending[1]	57.1	57.6	57.1	56.3
Impaired mortgages	58.8	76.4	59.4	—

Note:

(1) The distribution of LTVs for new business over this period was 46.6 per cent. at less than 70 per cent. LTV, 29.0 per cent. at 70 to 80 per cent. LTV, 23.4 per cent. at 80 to 90 per cent. LTV, 0.8 per cent. at 90 to 100 per cent. LTV and 0.2 per cent. at greater than 100 per cent. LTV.

At 31 December 2011	Mainstream	Buy-to-let	TSB Franchise	Mortgage Enhancement
			(%)	
Less than 70%	54.5	58.2	55.0	49.0
70% to 80%	19.3	26.6	20.4	30.3
80% to 90%	12.9	6.8	12.0	19.5
90% to 100%	7.8	5.3	7.4	1.2
Greater than 100%	5.5	3.1	5.2	—
Total	100	100	100	100
Average loan-to-value				
Stock of residential mortgages	48.1	56.9	49.2	53.2
New residential lending[1]	58.0	57.6	58.0	56.8
Impaired mortgages	59.4	68.6	59.6	61.3

Note:

(1) The distribution of LTVs for new business over this period was 47.1 per cent. at less than 70 per cent. LTV, 26.4 per cent. at 70 to 80 per cent. LTV, 21.5 per cent. at 80 to 90 per cent. LTV, 4.8 per cent. at 90 to 100 per cent. LTV and 0.3 per cent. at greater than 100 per cent. LTV.

The average Indexed LTV of the TSB Franchise mortgage portfolio as at 31 December 2013 decreased to 46 per cent. from 50 per cent. at 31 December 2012 reflecting increases in UK house prices in 2013. The improved housing market has also reduced the proportion of secured accounts in negative equity from 5.4 per cent. to 2.7 per cent.

Mortgages – greater than three months in arrears (excluding repossessions)

	Number of Cases				Total mortgage accounts			
	31 March	31 December			31 March	31 December		
	2014	2013	2012	2011	2014	2013	2012	2011
		(#)				(%)		
TSB Franchise								
Mainstream	2,276	2,301	2,460	2,935	1.5	1.5	1.5	1.8
Buy-to-let	91	94	90	91	0.4	0.4	0.4	0.4
Total	2,367	2,395	2,550	3,026	1.3	1.3	1.4	1.6

	Value of debt				Total mortgage balances			
	31 March	31 December			31 March	31 December		
	2014	2013	2012	2011	2014	2013	2012	2011
		(£m)				(%)		
TSB Franchise								
Mainstream	218	221	238	288	1.5	1.4	1.5	1.8
Buy-to-let	11	12	10	11	0.5	0.5	0.4	0.4
Total	229	233	248	299	1.3	1.3	1.3	1.6

The percentage of customers greater than three months in arrears has reduced to 1.3 per cent. in 2013 from 1.6 per cent. in 2011, with a total value in 2013 at £233 million. This improvement was driven by tighter credit risk policies for new business and the sustained low interest rate environment which has improved affordability. Furthermore, this level is lower than the Council of Mortgage Lenders ("**CML**") industry level of 1.7 per cent. as at 31 December 2013. The general downward trend is aligned with impaired asset trends and the recovery of the broader economy.

8.4 Small Business Banking Portfolio Composition

	At 31 March 2014
	(%)
Real estate	29.4
Agriculture	16.6
Hotels and restaurants	12.4
Retail trade	9.3
Health and social work	5.4
Construction	4.5
Motor trade	3.2
Manufacturing	2.6
Recreational areas	1.8
Wholesale trade	1.4
Other	13.4
Total	100

The Small Business Banking portfolio is a small part of TSB Bank's exposures, with customer advances of £313 million representing only 1.4 per cent. of total loans and advances to customers. The portfolio is a mixture of secured and unsecured lending to small businesses. The Small Business Banking portfolio has broad representation across industry sectors with Real Estate contributing 29.4 per cent. of the book at 31 March 2014. The composition of the book has remained broadly consistent in the historical period. However, some movement in the sector distribution is possible going forward as some customers may decide to return to Lloyds Banking Group.

9 Comparability of Historical Financial Information and Future Results

Prior to separation, TSB Bank's business was managed as part of Lloyds Banking Group and many of its operations and central functions were highly integrated within the Lloyds Banking Group business. There are, therefore, a number of items contained within the historical financial track record for the three years to 31 December 2013 that are either not reflected in the three months ended 31 March 2014, as described in *"Financial position and results of operation for the three months ended 31 March 2014"* below, or are subject to further change thereafter as described below in Sections 9.2 and 9.3. The effects of these items are described below and certain of these are described in the Unaudited Pro Forma Financial Information. As a result, it is important to consider the effect of these adjustments and the impact these have on the position and performance of TSB Bank in the three month-period to 31 March 2014, as well as how they could impact TSB's future results.

The following timeline sets out a table of key events impacting the comparability of TSB Bank's financial information, as well as those described in the Unaudited Pro Forma Financial Information.

Date	Event
1 November 2013	Standalone funding and liquidity arrangements with Lloyds Banking Group established for TSB Franchise
1 November 2013	Standalone hedging derivative arrangements with Lloyds Banking Group established
1 January 2014	Standalone operating expense arrangements established (including shadow TSA)
1 January 2014	Hedging derivatives – hedge accounting established
28 February 2014	Effective date of the equitable assignment of the Additional Mortgages
4 March 2014	Initial unsecured funding facility with Lloyds Bank established for Mortgage Enhancement
4 March 2014	TSB Bank and Bank of Scotland executed the Mortgage Sale Agreement (equitable assignment of the Additional Mortgages)
All further items are described in full in Part XVIII: "Unaudited Pro forma Financial Information"	
31 March 2014	Employees transfer to TSB Bank under the Transfer of Undertakings (Protection of Employment) Regulations 2006. Defined benefit pension scheme liability de-recognised and cessation of defined benefit pension scheme charges
1 May 2014	Tier 2 capital settled by Lloyds Bank
1 May 2014	Exit from Lloyds Banking Group's defined liquidity group and liquid assets transferred to the Bank of England held in cash
19 May 2014	Tier 1 Capital injection from Lloyds Bank
20 May 2014	£10 million drawn down from Lloyds Bank under the RMBS Funding Facility
2 June 2014	Further £240 million drawn down from Lloyds Bank under the RMBS Funding Facility and unsecured funding facility repaid

9.1 Events reflected in the results to 31 March 2014

The following items are reflected in TSB's results for the three months ended 31 March 2014 as set out in *"Financial position and results of operations for the three months ended 31 March 2014"* below.

Standalone funding and liquidity arrangements – TSB Franchise and Mortgage Enhancement

Since 1 November 2013, the TSB Franchise has not been part of Lloyds Banking Group's FTP process and, instead, specific arrangements were put into place between Lloyds Banking Group and TSB Bank to establish standalone funding, liquidity and interest rate risk management arrangements. Since TSB Bank has excess liquidity, held with Lloyds Banking Group, TSB Bank has since received interest income from Lloyds Banking Group for its excess liquidity. The balances bear interest at three-month LIBOR.

Between 4 March 2014 and 2 June 2014, the Mortgage Enhancement was funded by a combination of TSB's excess retail deposits and an unsecured funding facility from Lloyds Bank. However, prior to 4 March 2014, the costs of funding the Mortgage Enhancement were provided through FTP charges.

Standalone hedging derivative arrangements established

Until 31 October 2013, TSB Bank's interest rate risk was managed on its behalf through Lloyds Banking Group's hedging activities. As a result, no derivatives are reflected on TSB Bank's balance sheets for the years ended 31 December 2011 and 2012. Lloyds Banking Group's net flows in respect of this hedging activity for these periods were also charged through the FTP process.

On 1 November 2013, TSB Bank established a portfolio of hedges to manage interest rate risk in its banking activities on an independent basis. Consequently, TSB Bank's balance sheet as at 31 December 2013 includes the fair value of those interest rate derivatives and TSB Bank's Income Statement includes the fair value gains and losses on financial instruments held at fair value. From 1 January 2014, TSB Bank has taken advantage of hedge accounting requirements in the EU-endorsed version of IAS 39 "Financial Instruments: Recognition and Measurement" and, as such, mitigates the effect of the fair value movements on the derivatives held.

Standalone operating expense arrangements established (including TSA charges)

Operating costs in the three years to 31 December 2013 include direct costs as well as recharges from Lloyds Banking Group. Since 1 January 2014, Lloyds Banking Group has charged operating costs to TSB Bank using the service charges schedule agreed under the TSA for those services included in the TSA, or has passed through costs directly incurred on TSB Bank's behalf that have not yet been transitioned to TSB Bank, e.g. costs for those employees that subsequently transferred under the Transfer of Undertakings (Protection of Employment) Regulations 2006. TSB Bank has therefore no longer received a recharge for its share of Lloyds Banking Group allocated operating costs. The costs for the period also reflect the actual costs for new staff, as well as those that transferred to TSB Bank on 31 March 2014 under the Transfer of Undertakings (Protection of Employment) Regulations 2006, as well as the effect of TSB establishing some of its own contractual arrangements with a number of third parties.

TSB Bank's recharged operating costs for the three-year track record reflect the significant economies of scale in place within Lloyds Banking Group, particularly with respect to the corporate central functions. Consequently, as a result of separation, TSB Bank's operating costs on a standalone basis are significantly greater in the three months to 31 March 2014 than in the historical period and continue to increase (see Section 9.3 below).

Since the date of the equitable assignment of the Mortgage Enhancement to TSB Bank, the Bank of Scotland has charged a fee for its servicing, administration and reporting of the portfolio. The fee, accounted for as part of other operating income, is charged at a level of 12 bps of the outstanding principal balances on the mortgages. This replaces the operating costs allocated in the three-year track record.

9.2 Changes occurring between 31 March 2014 and Admission

Changes impacting the comparability of the Interim Financials and TSB's results going forward that have taken place in the TSB Bank Group since 31 March 2014 include injections of Tier 1 and Tier 2 capital, transfer of liquid assets to the Bank of England from Lloyds Banking Group and a drawdown on the RMBS Funding Facility. The effect of these items, had they been in place for the three month period ended 31 March 2014, and the effect of any post-balance sheet changes arising are presented in Part XVIII: "*Unaudited Pro forma Financial Information*".

9.3 Changes to operating costs after 31 March 2014

Operating costs were £153 million on a Management Basis in the three months to 31 March 2014 (excluding the impact of a one-off £32 million gain arising on de-recognition of the defined benefit pension scheme liability). This result, on an annualised basis, is calculated as £612 million. However, as TSB further establishes itself as a standalone bank, additional costs will be incurred through 2014 that are not fully reflected in the first three months. These include ongoing increases in resource capacity across certain central function roles (e.g. legal and risk), as well as the build of the mortgage intermediary channel capability due to go live in the first quarter of 2015.

Furthermore, investment spend, regulatory (e.g. FSCS levy) and other costs will be incurred at a higher level through the remainder of 2014 than in the first quarter, and therefore costs will not only be materially higher compared to those reported in the historical track record but will also continue to grow throughout 2014. However, operating costs are not expected to be more than a further £110 million for the full year over the £612 million annualised costs for the first quarter in 2014 on a Management Basis.

In 2015, excluding inflationary impacts, the effect of these cost increases on an annual basis are not expected to exceed a further incremental £20 million on the 2014 total operating

costs. Thereafter, direct operating costs are then anticipated to grow less than 3 per cent. per annum, on average, over the remaining period (excluding the LTSA uplift and the additional costs as TSB establishes its own capabilities in replacement of certain services previously provided under the TSA). The LTSA uplift is expected to result in approximately £104 million of additional operating costs from 2017 (subject to business volumes, customer activity and inflation).

9.4 Current trading

Trading performance since 31 March 2014 has progressed largely in line with the trends seen in the three months ended 31 March 2014. The Classic Plus PCA product continues to attract new customers to TSB above trend levels with corresponding increases in the level of customer interest payments.

10 Financial Position and Results of Operations for the Three Months Ended 31 March 2014

This section provides a description of TSB Bank Group's historical financial information as at and for the three months ended 31 March 2014 and outlines the impact of the key events and changes that have taken place in the period. For a reconciliation of the differences between the Interim Financials and the statutory results (of TSB Bank plc), see Section 11 below.

10.1 Financial position as at 31 March 2014

The TSB Bank Group Balance Sheet as at 31 March 2014 shows broadly similar trends to those seen as at 31 December 2013 with respect to loans and advances to customers and customer deposits. The following table sets out the TSB Bank Group's balance sheet data as at 31 March 2014 and 31 December 2013.

	As at 31 March 2014	As at 31 December 2013
		(£m)
Assets		
Cash and balances at central banks	159	200
Items in course of collection from banks	203	116
Loans and advances to banks	2,766	4,125
Loans and advances to customers	23,039	23,485
Other non-interest bearing assets	394	407
Total assets	26,561	28,333
Liabilities		
Deposits from banks	1,535	—
Customer deposits	23,260	23,105
Other liabilities	342	286
Total liabilities	25,137	23,391
Net investment from Lloyds Banking Group	1,424	4,942
Net investment from Lloyds Banking Group and liabilities	26,561	28,333

The transfer of the Mortgage Enhancement was formally agreed on 4 March 2014 with an effective date of 28 February 2014 and at that date constituted £3,359 million of mortgage assets. For this, £1,534 million was funded from the Lloyds Bank unsecured funding facility classified within deposits from banks, and the remainder was drawn from cash held with Lloyds Banking Group classified within loans and advances to banks.

Loans and advances to customers

The following table sets out TSB Bank Group's loans and advances to customers as at 31 March 2014.

	As at 31 March 2014	As at 31 December 2013
		(£m)
Mortgages – TSB Franchise	17,415	17,729
Mortgages – Mortgage enhancement	3,290	3,387
Total mortgages	**20,705**	**21,116**
Personal Unsecured	2,116	2,143
Small Business Banking	313	324
Loans and advances to customers before allowance for impairment losses	**23,134**	**23,583**
Allowance for impairment losses	(95)	(98)
Loans and advances to customers	**23,039**	**23,485**

Mortgages in the TSB Franchise decreased from £17,729 million as at 31 December 2013 to £17,415 million as at 31 March 2014. This reflects a continuation of trends seen in 2013 resulting in a declining book driven by the absence of available new lending through intermediaries. Contrary to historical seasonal trends, gross new lending through the direct channel has marginally increased in the three months to 31 March 2014 reflecting the wider rise in market activity. The composition of the portfolio has remained largely stable with SVR balances comprising 66 per cent. of the portfolio but with HVR balances increasing from 5 per cent. to 7 per cent. Tracker balances reduced slightly to 12 per cent. while fixed balances remained stable at 16 per cent.

The Mortgage Enhancement portfolio decreased from £3,387 million as at 31 December 2013 to £3,290 million as at 31 March 2014 as the portfolio formally transferred at 28 February 2014 and is now in run-off with no new lending. Customers that refinance a property (i.e. switching products) without taking further lending remain in the portfolio. To the extent customers currently on Mortgage Enhancement Variable Rates refinance onto new product lending rates, there is likely to be a decline in the average gross margin of the mortgages over time. The portfolio consists of 56 per cent. Mortgage Enhancement Variable Rate and 39 per cent. tracker mortgages and, although there were no fixed mortgages at the transfer date, 5 per cent. of the portfolio is on fixed rates as at 31 March 2014 as the associated customers switched products in March 2014.

Personal unsecured lending decreased marginally from £2,143 million as at 31 December 2013 to £2,116 million as at 31 March 2014, comprising £1,314 million in personal loans, £531 million in credit cards and £271 million in overdrafts. The marginal decline overall reflects seasonal trends, resulting in customers paying down their overdraft and credit cards following the Christmas period.

Small business banking assets decreased from £324 million as at 31 December 2013 to £313 million as at 31 March 2014 comprising £260 million term lending and £53 million in credit cards and overdrafts.

Customer deposits

The following table sets out TSB Bank's customer deposits as at 31 March 2014 and as at 31 December 2013.

	As at 31 March 2014	As at 31 December 2013
		(£m)
Non-interest bearing current accounts	4,411	4,373
Interest bearing current accounts	2,377	2,129
Savings accounts	16,472	16,603
Total customer deposits	23,260	23,105

Customer deposits increased from £23,105 million as at 31 December 2013 to £23,260 million as at 31 March 2014. The overall trend of deposit growth seen in 2013 continued into early 2014, with growth in PCAs and a marginal decline in savings accounts.

Interest bearing PCAs increased 12 per cent. from £2,129 million as at 31 December 2013 to £2,377 million as at 31 March 2014 due to the success of the interest bearing Enhance current account and attractive interest rates offered. As some customers upgraded to the interest bearing Enhance current account, there were marginal declines in other PCA accounts. Savings account balances decreased from £16,603 million as at 31 December 2013 to £16,472 million as at 31 March 2014 mainly driven by interest rate reductions implemented in 2013, partly offset by ISA balances increasing prior to the tax year end. Fixed deposits increased during the period following the trend in the last six months of 2013, arising from legacy C&G branches being capable of offering TSB products.

Business banking deposits declined from £815 million at 31 December 2013 to £787 million (£667 million business current accounts, £120 million savings accounts) at 31 March 2014 primarily due to TSB Bank not offering fixed term deposits from January 2014 with all outstanding deposits of this nature being returned to customers. Business current accounts declined marginally due to a seasonal peak in December.

10.2 Results of operations for the three months ended 31 March 2014

The following table sets out certain income statement items of the TSB Franchise for the three months ended 31 March 2014. The income statement data in this table and throughout this Section 10.2 is extracted from Note 4 to the Interim Financials, prepared in line with the Management Basis of presentation, as explained in "*Basis of Preparation*" above. Note 4 provides a line by line reconciliation of certain differences between the Management Basis and the Interim Financials.

	Management Basis
	Three months ended 31 March 2014
	(£m)
Net interest income[1]	195
Other income (net of fee and commission expense)[1][2]	37
Total income	232
Operating expenses	(153)
Impairment loss on loans and advances to customers	(27)
Underlying profit before taxation[3]	52
Fair value movements on instruments held at fair value[2]	(8)
Gain on settlement of defined benefit pension scheme	32
Profit before taxation	76

Notes:

(1) Net interest income includes £9 million of interest income received on interest rate derivatives that are not in designated hedging relationships, which is recorded in other income within the statement of comprehensive income.

(2) Other income within the statement of comprehensive income includes fair value gains of £8 million relating to interest rate derivatives that are not in designated hedging relationships. For the purposes of the Management Basis, this gain is recorded below the underlying result.

(3) Underlying profit before taxation is presented on a Management Basis, which excludes fair value movements on instruments held at fair value and gain on settlement of the defined benefit pension scheme liability.

Net interest income

The following table sets out a breakdown of the TSB Bank Group's net interest income for the three months ended 31 March 2014. This data is prepared in accordance with the Management Basis of presentation, as explained in the introduction to "*Results of Operations for the Years Ended 31 December 2013, 2012 and 2011 – TSB Franchise*" above.

	Management Basis
	Three months ended 31 March 2014
	(£m, except where indicated)
Interest and similar income	
Loans and advances to customers – TSB Franchise	217
Loans and advances to customers – Mortgage Enhancement	32
Other	14
Total interest and similar income	263
Interest and similar expense	
Customer deposits	(52)
Deposits from banks	(1)
Funding costs and funds transfer pricing charge – Mortgage Enhancement	(15)
Total interest and similar expense	(68)
Net interest income	195
TSB Bank Group banking net interest margin	3.38%
TSB Franchise banking net interest margin	3.62%
TSB Bank Group average gross customer assets	23,370
TSB Franchise average gross customer assets	20,045

Net interest income for the three months ended 31 March 2014 on a Management Basis of presentation was £195 million.

Interest and similar income for the three months ended 31 March 2014 was £263 million. Mortgage yields have remained stable from 2013 with a fall in fixed rate mortgage yield offset by an increasing proportion of reversionary mortgages on the uncapped HVR rate. Unsecured lending yields on a broadly flat book size have remained static during the quarter. Other income includes interest on treasury deposits and interest on derivatives arising from TSB Bank's standalone treasury arrangements, which have been in place since 1 November 2013.

Total interest and similar expense for the three months ended 31 March 2014 was £68 million. The average yield on customer deposits has fallen from 2013. The reduction is primarily attributable to the re-pricing of the savings book in mid-2013 offset by the increasing volumes of the interest-bearing Enhance current account. In addition, from 1 November 2013, the TSB Franchise was no longer included in Lloyds Banking Group's FTP process and, from 1 March 2014, the Mortgage Enhancement was no longer included. Consequently, the FTP charge in the period represents only the allocated funding cost for the Mortgage Enhancement for two months. No FTP charge was recognised for the TSB Franchise in the three months ended 31 March 2014.

Banking net interest margin

TSB Bank Group's banking net interest margin for the three months ended 31 March 2014 was 3.38 per cent., reflecting the reduction in average savings yield plus the impact of TSB Franchise exiting the FTP process in November 2013. No related Lloyds Banking Group liquidity charges were borne throughout the first quarter of 2014, except in January and February 2014 in respect of the Mortgage Enhancement.

TSB Franchise banking net interest margin was 3.62 per cent. for the three months ended 31 March 2014, reflecting the mix of products and significantly reduced funding costs as a result of the liquidity in the TSB Franchise. Franchise banking net interest margin is expected to widen modestly in the medium term, driven primarily by an expected increase in interest rates.

Other income

Other income (net of fee and commission income) for the three months ended 31 March 2014 on a Management Basis was £37 million, reflecting the trends seen in 2013, with reduced investment and protection income, partially offset by an increase in household insurance commission income following new terms in place with Lloyds Banking Group. AVA income continued to reduce as a result of these products no longer being sold in branch since January 2013.

Operating expenses

The following table sets out the operating expenses of the TSB Franchise for the three months ended 31 March 2014.

	Management Basis
	Three months ended 31 March 2014
	(£m)
Staff costs	81
Premises and equipment	18
Group recharges based on Transitional Service Agreement Schedule	26
Other expenses	24
Depreciation of tangible fixed assets	4
Operating expenses	153
Gain on settlement of defined benefit pension scheme	(32)
Total operating expenses	121

TSB Bank's standalone cost base has evolved significantly from late 2013 through the first quarter of 2014. Since 1 January 2014, Lloyds Bank has recharged costs to TSB Bank using the service charges schedule agreed under the TSA as if the TSA had been in place from the start of the year. TSB will continue to be dependent upon Lloyds Bank for the provision of IT services and business services under the TSA.

Direct staff costs in the three months ended 31 March 2014 include the cost of staff in TSB Bank's corporate central functions. In the years ended 31 December 2013, 2012 and 2011, the Lloyds Banking Group recharge included, in part, the cost of these central functions as an allocation of Lloyds Banking Group's overall costs. Staff numbers have continued to increase in the three months ended 31 March 2014 as TSB Bank has continued to expand resource capacity in preparation for becoming a fully standalone and listed organisation. Other expenses relate primarily to marketing and regulatory expenses. In addition, TSB has undertaken an advertising campaign and will continue to undertake strategic advertising activities over the course of the year. For further details on the estimated quantum of this investment spend and other future costs, please see "*Changes to operating costs after 31 March 2014*" above.

Other gains and losses – hedging derivative costs

As previously described, TSB established a portfolio of derivatives to hedge interest rate risk on 1 November 2013 and, from 1 January 2014, was able to adopt hedge accounting for the majority of this portfolio. The net position of the remaining "Day 1" cost and mark-to-market loss of £39 million will continue to unwind over a period matching the effective maturity of the related derivatives. A net £8 million of fair value unwind was recognised in the period to 31 March 2014.

TSB Bank's hedging portfolio also includes derivatives designed to hedge basis risk related to the Mortgage Enhancement portfolio. These derivatives are currently not in designated hedging relationships for accounting purposes. Fair value movements on these derivatives resulted in a loss of £1 million in the three months ended 31 March 2014. Until a solution is put in place, these derivatives will be a source of future income statement volatility.

A small balance of hedge ineffectiveness (£1 million income) was also recognised during this period.

11 Reconciliation of Interim Financials to Statutory Results of TSB Bank plc

The HFI and Interim Financials have been prepared in accordance with IFRS and on a combined basis as described in Notes 1 and 2 to the HFI and the Interim Financials, respectively. The differences between the income statement reported in the Interim Financials and the statutory results of TSB Bank for the three months ended 31 March 2014, which are also prepared under IFRS, are set out below.

Net interest income

The Additional Mortgages were legally transferred to TSB Bank with an effective date of 28 February 2014 and the statutory results of TSB Bank plc reflect interest and similar income and expense from 1 March 2014 onwards. The Interim Financials, however, include interest and similar income for three months as well as FTP charges for January and February 2014. The net difference of £6 million reflects the net interest income on the Additional Mortgages for January and February 2014.

Other income

Other income of £1 million was recognised from the repurchase of debt securities issued by TSB Bank plc. This gain is not recorded in the Interim Financials because the debt securities are not within the divesting perimeter of TSB.

Gain on settlement of defined benefit pension scheme

Prior to the de-recognition of the defined benefit pension scheme liability on 31 March 2014, the Interim Financials, prepared on a combined basis, recorded a liability for the past and present pension costs of all eligible TSB employees. The statutory results of TSB Bank plc recognised an allocation of the current and past service costs for legacy Lloyds TSB Scotland plc employees and current service costs of employees who were assigned to support the operation of TSB Bank at the point of the Part VII transfers in 2013. At the point of de-recognition, the defined benefit pension liability in the statutory results of TSB Bank plc was £64 million and the liability in the Interim Financials was £32 million. Accordingly, the settlement gain in the statutory results of TSB Bank plc is £32 million higher than in the Interim Financials.

TSB Group's results for the six months to 30 June 2014 and all periods thereafter will be presented under IFRS for the statutory TSB Group, incorporating the statutory results of TSB Bank plc. The following table sets out a reconciliation of the Interim Financials to the statutory results of TSB Bank plc, both presented on a Management Basis as set out in Section 2 of Part XIII: "*Operating and Financial Review*". A detailed description of these differences are also included in Note 10 to the Interim Financials.

	Interim Financials	Differences	Statutory results of TSB Bank plc
	(£m, except where indicated)		
Three months ended 31 March 2014			
Net interest income	195	(6)	189
Other income (net of fee and commission expense)	37	1	38
Total income	232	(5)	227
Expenses	(153)	—	(153)
Impairment loss on loans and advances to customers	(27)	—	(27)
Underlying profit before taxation	52	(5)	47
Fair value movements on instruments held at fair value	(8)	—	(8)
Gain on settlement of defined benefit pension scheme	32	32	64
Profit before taxation	76	27	103
Taxation	(16)	(5)	(21)
Profit after taxation	60	22	82
TSB Bank Group banking net interest margin	3.38%		3.62%
TSB Franchise banking net interest margin	3.62%		3.62%

12 Liquidity and Funding

Until 1 November 2013, and for the years ended 31 December 2012 and 2011, Lloyds Banking Group managed liquidity risk on behalf of the TSB Bank Group and the TSB Bank Group was dependent on Lloyds Banking Group to meet its funding and liquidity requirements. As a result, no liquidity portfolio was reflected on the TSB Bank Group's Balance Sheet in 2012 and 2011. However, since arrangements were put in place from 1 November 2013, the funding balance caused by excess deposits is shown on the balance sheet at 31 December 2013. This funding was held with Lloyds Banking Group as TSB Bank participated in Lloyds Banking Group's defined liquidity group. From 1 May 2014, TSB established its own reserve account with the Bank of England and the liquidity buffer of £1.9 billion was placed on deposit with the Bank of England.

The tables below analyse the financial instrument liabilities of the TSB Bank Group, on an undiscounted future cash flow basis according to contractual maturity, into relevant maturity groupings based on the remaining period at the balance sheet date. Balances with no fixed maturity are included in the "up to 1 month" category. In practice, customer deposits will be repaid later than the earliest date on which repayment could be required. Likewise, in practice, customer assets may be repaid ahead of their contractual maturity. As such, TSB uses past performance of each asset and liability class to forecast the likely cash flow requirements of the TSB Group.

The following table sets out the maturity of TSB's liabilities as at 31 December 2013. Certain balances included in the table below on the basis of their residual maturity are repayable on demand upon payment of a penalty.

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
			(£m)			
At 31 December 2013						
Customer deposits[1]	20,706	753	613	1,119	—	23,191
Items in the course of transmission to banks	64	—	—	—	—	64
Gross settled derivatives – inflows	5	12	41	218	7	283
Gross settled derivatives – outflows	(4)	(9)	(40)	(134)	(6)	(193)
Total	20,771	756	614	1,203	1	23,345
At 31 December 2012						
Customer deposits[1]	20,703	163	971	1,189	—	23,026
Items in the course of transmission to banks	62	—	—	—	—	62
Total	20,765	163	971	1,189	—	23,088
At 31 December 2011						
Customer deposits[1]	19,706	264	997	982	—	21,949
Items in the course of transmission to banks	57	—	—	—	—	57
Total	**19,763**	**264**	**997**	**982**	—	**22,006**

Note:

(1) Customer deposits represent PCAs and savings accounts.

The majority of TSB's funding for its customer assets is generated through customer liabilities in the form of PCA and savings deposits. The TSB Board views the generation and maintenance of its retail deposit funding base as a key part of its strategy. As at 31 March 2014, TSB had £23,260 million of customer deposits and 72 per cent. of PCA customers had a tenure of six years or more.

Between 4 March 2014 and 2 June 2014, the Mortgage Enhancement was funded by a combination of TSB's excess retail deposits and an unsecured funding facility from Lloyds Bank charged at three-month LIBOR. This unsecured funding facility was repaid on 2 June 2014, in part with funds drawn down under the RMBS Funding Facility, which has a commitment fee charged at 30 bps on the undrawn balance and 3 month LIBOR plus 60 bps on the drawn balance as well as certain increased margins payable in certain circumstances which may be outside TSB's control. Following Admission, TSB intends to issue supplementary public RMBSs to add diversification to the funding base.

TSB estimated its initial wholesale funding requirement during 2013, to ensure that it could both meet liquidity requirements and fund the Mortgage Enhancement during the early part of 2014. This was estimated at £1.5 billion, which was achieved via an unsecured funding facility with Lloyds Bank, as described above.

The Balance Sheet at 31 March 2014 was somewhat stronger than the TSB Board anticipated and the £1.5 billion unsecured funding facility results in a liquidity level of £2.8 billion, significantly in excess of TSB's current risk appetite. This excess liquidity has no material impact on the income statement as the cost of the unsecured funding (£2 million) is broadly equivalent to the return on the surplus liquidity.

On 20 May 2014, the RMBS Funding Facility became active when £10 million of this facility was drawn down from Lloyds Bank. On 2 June 2014, a further £240 million was drawn down from Lloyds Bank and the unsecured funding facility was fully repaid.

The Parent and Lloyds Bank will provide an ongoing guarantee in relation to any participation by TSB in the Bank of England's liquidity facilities. The release of such guarantee is at the discretion of the Bank of England.

13 Capital Resources and Capital Ratios

This Section 13 sets out the TSB Bank Group's unaudited pro forma capital resources as at 31 March 2014 incorporating the effect of the capital injections that occurred after 31 March 2014. For further information, see Part XVIII: *"Unaudited Pro forma Financial Information"*.

Total capital resources and capital ratios	**Unaudited pro forma as at 31 March 2014** *(£m, except where indicated)*
Common Equity Tier 1	
Statutory equity and reserves	
Share capital	75
Reserves	1,220
Total	**1,295**
Share capital issuance (pro forma)	200
Shareholders' Equity	**1,495**
Less: Deductions	
Excess expected loss	(14)
Common Equity Tier 1 Capital	**1,481**
Total Tier 1 Capital	**1,481**
Tier 2	
Tier 2 securities issuance (pro forma)	383
Excess default provisions	1
Total Tier 2 Capital	**384**
Total Capital Resources	**1,865**
Risk Weighted Assets	**6,865**
Common Equity Tier 1 Capital Ratio(1)	**21.6%**
Tier 1 Capital Ratio(1)	**21.6%**
Total Capital Ratio	**27.1%**

Note:

(1) Over time, TSB intends to seek approval for substantially all TSB Franchise customer asset portfolios to be treated on an IRB basis, which is expected by the end of 2015. For illustrative purposes, adjusting for the effect of this treatment results in increased excess expected losses and RWAs (by over £1.6 billion). The Common Equity Tier 1 ratio and Total Capital ratio reduce to approximately 17 per cent. and approximately 21 per cent., respectively.

The pro forma adjustments relate to the following capital increases that occurred after 31 March 2014. On 1 May 2014, an increase in capital was given effect by the settlement of Tier 2 Securities by Lloyds Bank for net proceeds of £383 million which, unless previously redeemed or purchased and

cancelled, will be redeemed on the interest payment date falling on or nearest to 6 May 2026. Furthermore, the Company issued ordinary shares for a cash consideration of £200 million on 19 May 2014.

Shareholders' Equity represents the statutory equity and reserves of TSB Bank plc at 31 March 2014, excluding profits for the three months ended 31 March 2014, that are deemed unverified for regulatory capital purposes.

	Unaudited pro forma as at 31 March 2014
Reconciliation of Net Assets per Interim Financials to the pro forma Shareholders' Equity included in Capital Resources as at 31 March 2014	*(£m)*
Net Assets per Interim Financials	**1,424**
Tier 1 Capital issuance (pro-forma)	200
Net Assets per pro forma	**1,624**
Differences	(47)
Statutory Shareholders' Equity	**1,577**
Deduct: Unverified statutory profits for three months ended 31 March 2014	(82)
Shareholders' Equity included in Capital Resources	**1,495**

There are certain differences between the pro forma net assets under the HFI basis and under the Statutory basis. These differences are outlined in Note 11 to the Interim Financials.

	Pro forma as at 31 March 2014
Risk-Weighted Assets	*(£m)*
Risk-Weighted Assets	
TSB Franchise mortgages	1,800
TSB Personal unsecured	1,703
Mortgage Enhancement	1,206
Total Banking Book Risk-Weighted Assets	**4,709**
Other Credit Risk	602
Operational Risk	1,488
Market and Counterparty Risk	66
Total Risk-Weighted Assets	**6,865**

RWAs are calculated on the basis that is expected to be adopted at Admission, which is assumed to be standardised ratings for all TSB Franchise and Mortgage Enhancement assets, with the exception of the Franchise mortgages, which are calculated using an IRB basis.

Over time, TSB intends to seek approval for substantially all TSB Franchise customer asset portfolios to be treated on an IRB basis, which is expected by the end of 2015. For illustrative purposes, adjusting for the effect of this, results in increased excess expected losses and RWAs (by over £1.6 billion). The Common Equity Tier 1 ratio and the Total Capital ratio reduce to approximately 17 per cent. and 21 per cent., respectively.

14 Interest Rate Risk

TSB's interest rate risk arises from its customer balances (loans and deposits), management of its liquidity portfolio and investment of free reserves and interest rate insensitive deposit balances.

TSB's banking liabilities are primarily customer deposits that are either interest rate insensitive, for example interest bearing or non-interest bearing PCAs, or interest rate sensitive but bear rates which may be varied, or managed, at TSB's discretion and generally reflect changes in the Base Rate. There is also a small volume of customer deposits whose rate is contractually fixed for their term to maturity.

TSB's banking assets are mainly sensitive to interest rate movements. There is a large volume of managed rate assets, such as variable rate mortgages, which may be considered as a natural offset to the interest rate risk arising from the managed rate liabilities. There is, however, a significant proportion of TSB's lending assets, for example many personal loans and mortgages, that bear interest rates which are contractually fixed for periods of up to five years or longer.

During 2011 and 2012 and until 31 October 2013, management of interest rate risk was undertaken by Lloyds Banking Group on behalf of the TSB Group. TSB's PCAs are non-dated liabilities with typically low funding costs, which are predominantly rate insensitive. These non-dated liabilities can contractually be withdrawn without notice but behaviourally act like longer term liabilities and are judged to have a behavioural life in excess of five years. A swap position is created to stabilise and enhance returns on these balances. The benefit of this structural hedging flows through FTP in the historical period until 31 October 2013. Due to interest rates being at historically low levels during the period, the level of five year swap rates (average maturity of 2.5 years), and therefore the income benefit from this hedging, has been depressed. The total rate insensitive balances as at 31 March 2014 were approximately £6.9 billion. A 50 bps increase in the rolling average five-year swap rates equates to £35 million incremental income per annum.

On 1 November 2013, TSB's Treasury function took on responsibility for managing the TSB Bank Group's interest rate risk and entered into a series of interest rate swaps with Lloyds Banking Group designed to reflect the continuity of an ongoing asset liability management strategy for TSB, including its structural interest rate risk hedging. TSB holds derivatives solely for risk management purposes to manage and hedge its interest rate risk arising from normal banking business.

The fair values and notional amounts of those derivatives are set out in the following table:

	As at 31 December 2013		
	Contract/ notional amount	Fair value assets	Fair value liabilities
		(£m)	
Total derivative assets/(liabilities) held for trading	13,491	99	86

Interest rate risk exposure is managed within a TSB Board-approved framework and risk appetite. Risk exposure is monitored monthly, using market value sensitivity and net interest income sensitivity. This methodology considers all re-pricing mismatches in the current balance sheet and calculates the change in market value and net interest income that would result from a set of defined interest rate shocks. Where re-pricing maturity is based on assumptions about customer behaviour, these assumptions are also reviewed monthly. A monitoring framework is in place to ensure that risks stemming from residual and temporary positions or from changes in assumptions about customer behaviour remain within TSB's risk appetite.

The following table shows the TSB Bank Group's sensitivities at 31 December 2013 to an immediate up and down basis points change to all interest rates.

	As at 31 December 2013	
	Up 0.25%	Down 0.25%
	(£m)	
Market value sensitivity	2.4	(2.4)

The market value is calculated on the basis of the balance sheet with re-pricing dates adjusted according to behavioural assumptions. The above sensitivities show how this projected market value would change in response to an immediate parallel shift to all relevant interest rates – market and administered. This is a risk based disclosure and the amounts shown would be amortised in the Income Statement (within 'Net interest income') over the duration of the portfolio. The measure, however, is simplified in that it assumes a parallel shift in all interest rates at the same time and by the same amount. Stress testing and scenario analysis serve to demonstrate the impact of market shocks and a slowdown in economic activity. The results provide senior management with an assessment of the financial effects that such events would have on the profitability of the TSB Bank Group.

15 Critical Accounting Estimates and Judgements

The preparation of the combined HFI 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 inherent uncertainty in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates.

The significant judgements made by management in applying accounting policies and the key sources of estimation uncertainty in these financial statements, which together are deemed critical to the results and financial position, are set out in Part XVI: "*Historical Financial Information – Critical accounting estimates and judgements*".

PART XIV
RISK MANAGEMENT

1 TSB's approach to risk

Effective risk management is a key component of TSB's strategy to deliver local banking for Britain. TSB maintains a simple business model which embodies a risk culture grounded in a prudent appetite for risk.

TSB's risk management framework ensures a robust and consistent approach to risk management is applied across all business areas and all risk types in order to maintain TSB's risk profile in line with risk appetite. It articulates individual and collective accountabilities for risk management, risk oversight and risk assurance and supports the discharge of responsibilities to customers, shareholders and regulators. This framework enables TSB to comply with regulatory requirements and aims to protect TSB from financial and reputational damage by demonstrating to customers, shareholders and regulators that TSB has an effective risk and control environment in place.

TSB's risk framework is underpinned by three key principles:

- Simplicity: TSB applies a consistent risk management approach across its business, with simple reporting requirements and with uniform data used to provide a holistic view of risk throughout TSB's operations.
- Transparency: TSB promotes a transparent risk management function, allowing for clear comparability between risk exposures and risk categories across TSB's operations.
- Accountability: TSB ensures clear ownership of each risk category within the bank and empowers senior employees to manage risk exposures in line with expected values and behaviours.

TSB organises its risk management activities across three "lines of defence" that aim to ensure that there are effective, independent checks over key risk decisions and that risk management responsibilities and accountabilities are clearly defined:

- Business line: Each business line has primary responsibility for risk decisions and measuring, monitoring and controlling risks within its area of accountability. Business lines identify, assess, manage and mitigate the risks relevant to their lines and establish controls to ensure compliance with TSB's policies and the risk appetite parameters set out and approved by the Board. Business lines perform the day-to-day control activities, the testing and monitoring of the effectiveness of such controls and their compliance with TSB-wide risk controls and standards. Finally, business lines report on their risk management activities to the relevant TSB governance committees and fora.
- Risk function: TSB's risk function designs policies, strategies, standards, methodologies and frameworks for risk assessment and management to formulate risk policies for the business lines and provides independent oversight and challenge to the effectiveness of business line risk management. TSB's risk function also formulates and recommends TSB's risk management appetite to the TSB Board and provides enterprise-wide risk reporting to the TSB Board and senior executives. Finally, TSB's risk function oversees external reporting and disclosures by TSB relating to risk.
- Audit: TSB's internal audit function provides a third level of independent objective assurance. In addition to providing assurance on the risk management activities of both the business lines and the risk function, audit reports to the TSB Board and senior executives as to the effectiveness of TSB's risk management activities. Audit also identifies areas where risk management activities could be improved, allocating ownership for such initiatives and tracking their development and implementation. The audit function has a primary reporting line to the chair of the Board Audit Committee with a secondary reporting line to the chief executive.

TSB's risk appetite articulates the amount of risk that the TSB Board is prepared to take on in pursuit of TSB's business objectives, including in stressed situations. Risk appetite is set at a level that safeguards the interests of customers and other key stakeholders and key metrics are measured and reported to senior executive committees and the TSB Board. TSB's risk appetite is embedded in TSB's policies and procedures and is defined in a number of qualitative and quantitative metrics which are regularly reviewed by the TSB Board.

2 Principal risks

TSB believes the following areas of risk and risk management to be most significant to its overall risk management activities.

2.1 Credit risk

2.1.1 ***Definition***

TSB defines credit risk as the risk that parties with whom TSB has contracted fail to meet their obligations, both on or off the balance sheet.

2.1.2 ***Principal risks***

Credit risk arises principally from TSB's lending activities through adverse changes in the credit quality of TSB's customers and macro-economic disruptions to the credit markets. TSB also faces credit risk in relation to the geographical concentration of its credit portfolio in the UK generally, and Scotland and the South East of England, in particular. Additional credit risks also arise in relation to the processes by which TSB assesses customer credit quality, which requires difficult, subjective and complex judgements, including forecasts of how changing macro-economic conditions might impair the ability of customers to repay their loans.

Adverse changes in the credit quality or behaviour of TSB's borrowers or other counterparties would be expected to reduce the value of TSB's assets and increase TSB's write-downs and allowances for impairment losses. The overall credit quality profile of TSB's borrowers and other counterparties can be affected by a range of macro-economic and other factors, including increased unemployment, reduced asset values, lower consumer spending, increased customer indebtedness, increased insolvency levels, reduced business profits, increased interest rates and/or higher default rates. TSB's portfolios may be impacted by some or all of these factors and, notwithstanding continued improvement in consumer and business confidence, the possibility of further economic downside risk and, consequently, heightened credit risk remains. See Part II: "*Risk Factors – TSB is subject to risks concerning customer and counterparty credit quality*" and "*Concentration of credit risk could increase TSB's potential for significant losses*".

2.1.3 ***Mitigating actions***

Credit risk appetite is set at the Board level and is described and reported through a suite of metrics devised from a combination of accounting and credit portfolio performance measures. TSB manages its exposure to credit risk in a number of ways, including:

- Developing credit policy to incorporate prudent lending criteria aligned with Board-approved risk appetite to effectively manage credit risk;
- Deploying clearly defined levels of authority to ensure that TSB lends appropriately and responsibly with a separation of origination and sanctioning activities; and
- Deploying robust credit processes and controls, including well-established committees, to ensure distressed and impaired loans are identified, considered and controlled within independent credit risk oversight.

2.2 Conduct risk

2.2.1 ***Definition***

Conduct risk is defined as the risk of regulatory censure and/or a reduction in earnings or value, through financial or reputational loss, from inappropriate or poor customer treatment.

2.2.2 ***Principal risks***

While TSB benefits from an indemnity from Lloyds Bank against historical conduct risk losses, TSB has identified a number of drivers of potential conduct risk in the financial products and services that it currently provides to customers, which it continually monitors and manages. These include:

- Selling products to customers that do not meet their needs;

- Failing to deal with customers' complaints effectively;
- Not meeting customer expectations; and
- Exhibiting behaviours that do not meet market or regulatory standards.

Given the high level of scrutiny regarding financial institutions' treatment of customers and business conduct from regulatory bodies, politicians and the media, there is a risk that certain aspects of TSB's current or historic business may be determined by the FCA, other regulatory bodies or the courts as not being conducted in accordance with applicable laws or regulations or standards of fair and reasonable treatment. TSB may also be liable for damages to third parties harmed by the conduct of its business. See Part II: "*Risk Factors – TSB is subject to substantial and changing conduct regulations*".

2.2.3 ***Mitigating actions***

TSB takes a range of mitigating actions with respect to conduct risk. These actions have been developed using TSB's "Conduct Strategy" as a foundation, and include:

- A customer-focused conduct strategy, which ensures that customers are at the heart of everything TSB does;
- TSB's product approval, review process and outcome testing are supported by conduct management information; and
- TSB has developed clear customer accountabilities for colleagues, including rewards with customer-centric metrics.

These actions are supported by policies and standards in key areas, including product governance, customer treatment, sales, responsible lending, customers in financial difficulties, claims and complaints handling. TSB develops colleagues' awareness of these and other expected standards of conduct through these and other policies and standards and codes of responsibility.

2.3 Market risk

2.3.1 ***Definition***

Market risk is defined as the risk that changes in market prices or rates, including changes in and increased volatility of interest rates, inflation rates, credit spreads, foreign exchange rates, equity, commodity prices and prices for bonds and other instruments lead to a reduction or increase in TSB's earnings and/or value.

2.3.2 ***Principal risks***

The main market risk faced by TSB arises from interest rate levels, the related volatility and basis risk. In TSB's retail banking business, interest rate risk arises from the different re-pricing characteristics of the assets and liabilities. Interest rates affect the cost and sources of funding available to TSB, product margins and, in turn, its net interest margin and revenue. Interest rates also affect TSB's net interest income, impairment levels and customer affordability. In some circumstances, TSB has balance sheet hedges in place that are sensitive to an interest rate that is different to the item that it is hedging. This results in residual basis risk. The level of sterling interest rate swap rates also affect the return TSB is able to achieve on certain of its investments. See Part II: "*Risk Factors – TSB faces risks associated with interest rate levels and volatility*" and "*TSB is subject to risks associated with its hedging and treasury operations, including potential negative fair value adjustments*".

2.3.3 ***Mitigating actions***

TSB seeks to contain market risk through a Board-approved appetite and policy framework. It uses a range of industry-standard metrics to monitor TSB's market risk profile against its stated risk appetite in light of prevailing market conditions. TSB is exposed to fair value interest rate risk on its fixed rate customer loans, its fixed rate customer deposits and the majority of its subordinated debt, and to cash flow interest rate risk on its variable rate loans and deposits together with its floating rate subordinated debt.

TSB manages exposure to interest rate levels and volatility through portfolio hedging, including use of derivatives transactions. These derivatives must be marked to market, even where they have been transacted to hedge interest rate risk on the TSB balance sheet. TSB can mitigate this accounting profit and loss volatility by hedge accounting. All of the hedge accounting relationships are fair value hedges where interest rate swaps are used to hedge the interest rate risk from assets and liabilities. TSB holds undated liabilities, principally current account balances and shareholder funds. TSB's experience is that these liabilities are stable in nature and have a profile that is similar to a five-year fixed rate deposit. Accordingly, TSB locks in a five-year return on these liabilities through acquiring assets of a similar duration in a conservative way. See Part XIII: "*Operating and Financial Review – Interest Rate Risk*".

2.4 Operational risk

2.4.1 ***Definition***

TSB defines operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

2.4.2 ***Principal risks***

TSB faces a range of operational risks in relation to its processes, systems and controls, including services provided by Lloyds Bank. TSB's operational risk framework has identified the following principal operational risks within TSB:

- Supplier management: the risk of failure of TSB's key outsource supplier, Lloyds Bank, to deliver the services required for TSB to operate effectively. This includes the provision of IT systems and services and associated resilience, particularly that these systems may not operate as expected, may not fulfil their intended purpose or may be damaged or interrupted by unanticipated increases in usage, human error, unauthorised access, natural hazards or disasters or similarly disruptive events;
- Information security: the risk of information leakage or loss or theft of bank or customer data; and
- External fraud: the risk of loss to TSB and/or its customers resulting from external criminal conduct targeting TSB's systems or processes.

See Part II: "*Risk Factors – TSB is exposed to operational risks related to systems and processes"* and *"TSB's reliance on services arrangements with Lloyds Bank exposes TSB to a range of potential operational and regulatory risks*".

2.4.3 ***Mitigating actions***

TSB employs a robust operational risk management framework that includes both manual and automated controls. These controls fall into three general categories:

- Preventative controls, meant to minimise the risk of errors in TSB's activities. Preventative controls include encryption of externally transferred information or dual authorisation of payments to minimise payment errors and fraudulent payments. In this area, TSB benefits from the significant investment that Lloyds Banking Group has made in this IT security infrastructure to ensure its resilience and to enhance its functionality.
- Detective controls, which identify errors or control failures that have already occurred. Detective controls include a register of high risk data transfers and a regular exception report showing employees with access to certain systems. These are intended to prevent the misuse of customer information and to facilitate the re-checking of payment reports against original instructions to detect non-compliance with customer instructions or processing errors.
- Mitigative controls, which are designed to limit the extent and impact of operational risk events that have already occurred. Mitigative controls include TSB's

property insurance policies, intended to guard against direct financial loss from damage to TSB's property, and business continuity planning to limit the length of any disruption to TSB's business.

The TSA and LTSA, which govern the provision of certain IT and other operational services by Lloyds Bank to TSB, also contain provisions that seek to mitigate any operational risks arising from the provision of such services. These include:

- Governance: governance fora and processes and reporting obligations have been put in place to enable TSB to understand and monitor the provision of the services under the TSA and LTSA;
- Service standards: the provision of services is governed by a service level regime, which specifies service standards that Lloyds Bank must meet and for fee rebates to be payable if service levels are not met;
- Information and security: Lloyds Bank is required to maintain technical and organisational controls to guard against unauthorised access to data and to comply with the agreed information sharing protocol and Lloyds Bank's information security policy;
- Disaster recovery: Lloyds Bank is required to maintain a business continuity and disaster recovery plan and to implement the plan if the need arises; and
- Regulatory events: provisions are in place to address any regulatory changes that affect the services under the TSA and LTSA and TSB has the ability to terminate services if required by a regulatory authority.

For a summary of the material provisions of the TSA and LTSA, see Part XXII: "*Additional Information – Material contracts – Transitional Services Agreement*" and Part XXII: "*Additional Information – Material contracts – Long Term Services Agreement*".

2.5 People risk

2.5.1 ***Definition***

People risk is defined as the risk that TSB fails to lead, manage and enable colleagues to deliver to customers, shareholders and regulators, leading to reductions in earnings and/or value.

2.5.2 ***Principal risks***

TSB's management of material people risks is critical to its capability to deliver against its strategic objectives. The following factors materially affect TSB's management of people risks:

- TSB's ongoing pace of change;
- The developing and increasingly rigorous and intrusive regulatory environment that may challenge TSB's people strategy, remuneration practices and retention;
- Negative political and media attention on banking sector culture, sales practices and ethical conduct, which may impact colleague engagement, investor sentiment and TSB's cost base; and
- Negative industrial relations, potentially resulting in high levels of employee absenteeism and/or turnover, low productivity and employee reluctance to take part in or believe in change.

See Part II: "*Risk Factors – TSB could fail to attract or retain Senior Management or other key employees*".

2.5.3 ***Mitigating actions***

TSB takes many mitigating actions with respect to people risk, including:

- Strengthening the risk and customer focused culture amongst colleagues by developing and delivering a number of initiatives that reinforce risk-based behaviours to generate the best possible long term outcomes for customers and colleagues;

- Continuing to ensure strong management of the impact of organisational change and consolidation on colleagues;
- Embedding the TSB's code of responsibility across the bank;
- Reviewing and developing remuneration policies continually to ensure they promote colleagues' behaviours that meet customer needs and regulatory expectations; and
- A comprehensive employee relations strategy, centred on constructive union relations and a high level of colleague engagement.

2.6 Liquidity and funding risk

2.6.1 ***Definition***

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

2.6.2 ***Principal risks***

TBS's current funding is primarily obtained through PCA and retail savings deposits. TSB faces the risk that its funding needs may increase and that its funding structure may not continue to be efficient, giving rise, in both cases, to a requirement to raise wholesale funding. See Part II: "*Risk Factors – The TSB Franchise business is subject to risks relating to the cost and availability of liquidity and funding*".

2.6.4 ***Mitigating actions***

TSB undertakes certain activities to monitor and mitigate risks associated with funding and liquidity, including:

- Maintaining a prudent liquid asset buffer of high quality unemcumbered assets in line with regulatory requirements;
- A strong liquidity position, demonstrated by the ability to meet prudent liquidity risk appetite metrics throughout TSB's planning horizon; and
- Stress tests of TSB's liquidity position, which are conducted against a range of scenarios, with TSB able to meet all UK liquidity regulatory requirements.

See Part XIII: "*Operating and Financial Review – Liquidity and Funding*".

2.7 Legal and regulatory risk

2.7.1 ***Definition***

TSB defines legal and regulatory risk as the risk that TSB is exposed to fines, censure or legal or regulatory enforcement action due to failures to comply with applicable laws, regulations, FCA rules of conduct or legal obligations.

2.7.2 ***Principal risks***

TSB is exposed to various forms of legal and regulatory risk in its operations, including:

- certain aspects of TSB's business may be determined by the relevant authorities, the FOS or the courts not to have been conducted in accordance with applicable local or, potentially, overseas laws or regulations or, in the case of the FOS, with what is fair and reasonable in the Ombudsman's opinion;
- the possibility of mis-selling of financial products or the mishandling of complaints related to the sale of such products by or attributed to an employee of TSB, resulting in disciplinary action or requirements to amend sales processes, withdraw products or provide restitution to affected customers, all of which may require additional provisions;

- the high level of scrutiny of the treatment of customers by financial institutions from regulatory bodies, the press and politicians; the FCA in particular continues to drive its focus on retail conduct risk issues as well as conduct of business activities through its supervision activity;
- contractual obligations may either not be enforceable as intended or may be enforced against TSB in an adverse way;
- the intellectual property of TSB (including trade marks) may not be adequately protected or enforceable, and the conduct of the TSB business may infringe the intellectual property of third parties;
- TSB may be liable for damages to third parties harmed by the conduct of its business;
- the risk of regulatory proceedings and private litigation, arising out of regulatory investigations, enforcement actions or otherwise (brought by individuals or groups of plaintiffs) in the UK and other jurisdictions;
- the increased "market-related" activities in the financial services market, including by the CMA and the FCA and possibly in future the Payments Systems Regulator; and
- non-compliance with regulatory and statutory reporting requirements.

See also Part II: *"Risk Factors – TSB faces risks associated with its operations' compliance with a wide range of laws and regulations"*.

2.7.3 ***Mitigating actions***

Each TSB business line is responsible for identifying, assessing monitoring, reporting and managing their legal and regulatory risks effectively and in a timely manner. This includes the implementation of an effective governance and oversight framework and involving other parts of TSB, in particular the legal and risk functions, to ensure the legal and regulatory risks that may have a wider impact for TSB are understood and appropriately addressed. Senior Management is charged with overseeing business unit assessment, management and reporting of legal and regulatory risks and ensuring that individuals within their units are sufficiently familiar with, understand and adhere to the laws, regulations and codes of practice governing the activities they conduct and promptly report any breaches of such laws, regulations and codes of practice of which they become aware.

2.8 Financial Crime Risk

2.8.1 ***Definition***

TSB defines financial crime risk as the risk that, whether through a failure of internal controls or otherwise, TSB is found or alleged to be in violation of applicable anti-money laundering and anti-bribery laws or regulations, which include, but are not limited to the Proceeds of Crime Act 2002, the Anti-terrorism, Crime and Security Act 2001, the Money Laundering Regulations 2007, the Counter Terrorism Act 2008, the Serious Organised Crime and Police Act 2005 and the System and Control Rules of the FCA Handbook and the UK Bribery Act 2010.

2.8.2 ***Principal risks***

TSB faces potential financial crime risks in each area of its operations.

2.8.3 ***Mitigating actions***

TSB takes a number of mitigating actions, including in relation to any rectification programmes, with respect to financial crime risk, including:

- New and ongoing customer due diligence: TSB has processes in place designed to ensure that: (i) customer identities are appropriately identified and verified, both when accounts are initially opened and on an ongoing basis thereafter; (ii) any beneficial owners of accounts are identified; (iii) an account's purpose and the

intended nature of the business relationship are established; and (iv) customers designated as "Politically Exposed Persons" or as otherwise having high risk relationships are flagged for further investigation and review against risk appetite;

- Education and awareness: TSB employees undergo training designed with the aim of ensuring they understand the threats TSB faces from a financial crime perspective, the controls TSB has in place to manage these risks, employees' legal and regulatory obligations and the manner in which employees can report suspicious activity;
- Transaction monitoring: TSB has systems in place to monitor unusual customer activity designed to ensure such activities are reported to the appropriate authorities;
- Appointment of reporting officer: TSB has appointed a local money laundering reporting officer for each business unit, charged with establishing and embedding a culture attuned to money laundering risks and monitoring employee compliance with the relevant policies and procedures; and
- Business lines report on key risk indicators to confirm that procedures and controls are in place to identify, manage and mitigate bribery risks.

2.9 Capital Risk

2.9.1 ***Definition***

TSB defines capital risk as the risk that TSB has a sub-optimal amount or quality of capital or that capital is inefficiently deployed.

2.9.2 ***Principal Risks***

TSB faces a number of inherent risks in respect of capital risk including:

- Changes in the regulatory framework for capital, for example the introduction of CRD IV additional requirements;
- Changes in public policy, which result in specific amendments to the bank's capital requirements; and
- The impact of the macroeconomic environment on the bank's credit risk profile as discussed in section 2.1 above.

2.9.3 ***Mitigating Actions***

TSB takes a number of mitigating actions with respect to capital risk, including:

- TSB undertakes a number of stress tests as part of the business planning cycle with the aim of ensuring the bank is able to operate within its risk appetite, including in stressed situations, throughout the period of the plan;
- TSB's capital planning takes into account known CRD IV requirements; and
- TSB operates a rigorous investment planning and approval process with the objective of ensuring that the investments the bank makes are aligned with the delivery of the Board's strategy and risk appetite.

2.10 Model Risk

2.10.1 ***Definition***

TSB defines model risk as the risk that arises from using models that produce inadequate or significantly incorrect outputs or from the misuse of model outputs.

2.10.2 ***Principal Risks***

TSB faces a risk of making poor business decisions resulting from the failure to identify risk or the misreporting of risk which may result in financial or reputational losses.

2.10.3 ***Mitigating Actions***

TSB takes a number of mitigating actions with respect to model risk, including:

- TSB has a robust model governance framework which covers the required standards for the development, review, approval, implementation, monitoring and use of its risk models in line with regulatory requirements and industry best practice; and

- TSB undertakes regular monitoring of the performance of its risk models and undertakes fuller validations on an annual basis. The results of this monitoring and validation is reported the Model Governance Designated Committee. The Model Governance Designated Committee also approves all the bank's material risk models.

3 Risk governance structure

TSB's risk committees and fora monitor and challenge risk exposures in the context of TSB's approved risk appetite and take appropriate actions to ensure the acceptability of TSB's overall risk profile.

3.1 The TSB Board

The TSB Board ensures that the bank manages risk effectively by approving TSB's risk appetite and risk management framework and monitoring TSB's aggregate risk exposures. The TSB Board also ensures that the executive management of the bank has established and maintains appropriate systems to plan and control operations and risks and complies with relevant legislation and regulations. The TSB Board further ensures that the executive management provides regular and sufficient information to the TSB Board and the TSB Bank Board to enable them to discharge their monitoring duties in relation to risk management. The TSB Board committees noted below meet with agendas covering both TSB Banking Group plc and TSB Bank plc matters, although they may on occasion discuss items relevant to only one of the entities.

3.2 Board Committees

- Board Audit Committee

  The Board Audit Committee oversees the financial statements and reporting, including narrative reporting, of the Company and TSB Bank, the internal controls and risk management systems, whistleblowing and fraud, TSB Bank's internal audit function and the Company and TSB Bank's relationship with their external auditors.

- Board Risk Committee

  The Board Risk Committee considers and recommends the risk appetite of TSB Banking Group and TSB Bank and the risk management framework of TSB Banking Group and TSB Bank including consideration of risk exposures and risk/reward returns. The Board Risk Committee takes a forward-looking perspective, anticipating changes in business conditions.

- Board Remuneration Committee

  The Board Remuneration Committee sets the principles and parameters of remuneration policy for TSB Banking Group and TSB Bank and oversees the remuneration policy and outcomes for specified employees.

- Board Nomination Committee

  The Board Nomination Committee assists the Chairman in keeping the composition of the Board under review and leads the appointment process for nominations to the Board of TSB Banking Group and TSB Bank.

3.3 TSB Bank Board Sub-Committees

- Bank Executive Committee

  Chaired by TSB's Chief Executive Officer, the Bank Executive Committee is TSB's principal executive committee. The Bank Executive Committee provides support to the CEO in performing his duties through collective support, monitoring and decision making on issues that affect TSB. In fulfilling this role, consideration is given to the interests of all stakeholders, including shareholders, customers and employees. The Committee develops and implements TSB's strategy, business objectives and operations.

3.4 Bank Executive Committee Sub-Committees

- Risk Committee

  Chaired by TSB's Chief Risk Officer as a subcommittee of TSB's Executive Committee, the Risk Committee reviews and recommends TSB's overall risk appetite, including the allocation of risk appetite within TSB, as well as overseeing TSB's governance, risk and control frameworks. The Risk Committee also regularly reviews aggregate risk exposures, concentrations or risk and risk versus reward returns.

- Model Governance Designated Committee

  Chaired by TSB's Chief Risk Officer as a subcommittee of TSB's Executive Committee, the Model Governance Designated Committee approves, monitors and reviews TSB's material risk models.

- Product Pricing Committee

  Chaired by the Products Director, the Product Pricing Committee reports to the Bank Executive Committee and reviews and approves pricing strategy and decisions relating to TSB's products. The Committee aligns with senior management oversight to identify, measure, monitor, report and control relevant categories of risk, including conduct risk, associated with products pricing strategy and tactical changes.

- Asset and Liability Committee

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

- The Spend Wise Committee

  Chaired by TSB's Chief Operating Officer as a subcommittee of the Bank Executive Committee, the Spend Wise Committee is responsible for all expenditure within TSB, both Operational and Investment. The Spend Wise Committee will review the total cost case budgets and forecasts to ensure that they are in line with TSB's strategy. The Committee will also consider and scrutinise any requests for expenditure that are outside of the forecast and/or budget before they are spent to ensure these requests represent value for money.

- The Disclosure Committee

  Chaired by TSB's Chief Financial Officer as a subcommittee of the Bank Executive Committee and overseen by the Board Audit Committee, the Disclosure Committee is responsible for identifying inside information and to make decisions on how and when TSB should disclose that information in accordance with its disclosure policy. This includes reviewing and recommending to the Board or Board Audit Committee items for Board or Board Audit Committee approval, including, but not limited to, the annual report and financial statements, preliminary announcement of annual results, half-year report and interim management statements and/or quarterly reports.

3.5 Other Risk Committees and Fora

- Business Risk Forum

  Chaired by the Business Risk Director, the Business Risk Forum oversees the design and operational effectiveness of TSB's risk policies and procedures and monitors and challenges TSB's risk management framework, aggregate risk profile and alignment with risk appetite. The Business Risk Forum is also responsible for the escalation of material risk issues to the Chief Risk Officer and/or Risk Committee or Board Audit Committee and Board Risk Committee, as it deems appropriate.

- Product Governance Committee

  Chaired by the Products Director, the Product Governance Committee reports to the Risk Committee and provides strategic and senior management oversight over the Product Governance Policy to identify, measure, monitor and control risks associated with product and sales process activities.

- Complaints Committee

  Chaired by the Chief Operating Officer, the Complaints Committee reports to the Risk Committee and is responsible for monitoring and challenging TSB's complaints-handling framework, including complaint resolution and prevention, root cause analysis, reporting, managing TSB's relationship with Regulators and Ombudsmen and ensuring effective communication of complaints-related issues.

- Balance Sheet Management Committee

  Chaired by TSB's Treasurer, the Balance Sheet Management Committee reports to the Asset and Liability Committee and is responsible for supporting the Asset and Liability Committee in the operational management of all treasury risk on TSB's balance sheet.

- Portfolio Quality Review Committee

  Chaired by the Director of Portfolio Management as a subcommittee of the Risk Committee, the Portfolio Quality Review Committee is the primary committees for the detailed review, challenge and direction-setting of the mortgage, unsecured and business banking portfolios.

PART XV
CAPITALISATION AND INDEBTEDNESS STATEMENT

1 Capitalisation and Indebtedness of TSB Bank Group

TSB Bank Group's published financial information as at 31 March 2014 is presented on a combined basis as it has not constituted a separate legal group for the three-month period then ended. As a result, it is not possible to provide a meaningful analysis of share capital or reserves for TSB Bank Group.

The following table sets out the TSB Bank Group's indebtedness extracted without material adjustment from the unaudited interim financial information for the three-month period ended 31 March 2014 set out in Part XVII: "*Condensed Combined Interim Financial Information (Unaudited)*".

	31 March 2014
	(£ millions)
Consolidated indebtedness	
Deposits from banks[(1), (2)]	1,535
Total indebtedness	1,535

Notes:
(1) Deposits from banks are unsecured, unguaranteed and current.
(2) Customer deposits are not classified as indebtedness, as the taking of customer deposits is part of the core business of the Group.

TSB Bank Group had no indirect or contingent indebtedness at 31 March 2014. None of TSB Bank Group's indebtedness is guaranteed by any other party.

2 Capitalisation and Indebtedness of the Company

The Company was incorporated on 31 January 2014 with subscriber share capital of £50,000, being 50,000 ordinary shares of £1. On 4 April 2014, the shares were split, with 100 Ordinary Shares of one pence being created for each ordinary share of £1. On 25 April 2014, it acquired the entire share capital of TSB Bank from Lloyds Bank for consideration of a further 50,000,000 Ordinary Shares of one pence. On 19 May 2014, share capital was further increased by the issue of 445 million Ordinary Shares of one pence to Lloyds Bank for cash consideration of £200 million.

As at 31 March 2014, the Company had no indebtedness.

Section A: Accountants' Report on the Historical Financial Information

The Directors
TSB Banking Group plc
20 Gresham Street
London EC2V 7JE

Citigroup Global Markets Limited
Citigroup Centre
Canada Square
London E14 5LB

J.P. Morgan Securities plc
25 Bank Street
London E14 5JP

9 June 2014

Dear Sirs

TSB Bank plc

We report on the financial information set out in Section B of Part XVI below (the "**IFRS Financial Information Table**") of TSB Bank plc and its subsidiaries (the "**TSB Bank Group**"). The IFRS Financial Information Table has been prepared for inclusion in the prospectus dated 9 June 2014 (the "**Prospectus**") of TSB Banking Group plc (the "**Company**") on the basis of the accounting policies set out in note 2. This report is required by item 20.1 of Annex I to the PD Regulation and is given for the purpose of complying with that item and for no other purpose.

Responsibilities

The Directors of the Company are responsible for preparing the IFRS Financial Information Table in accordance with International Financial Reporting Standards as adopted by the European Union.

It is our responsibility to form an opinion as to whether the IFRS Financial Information Table gives a true and fair view, for the purposes of the Prospectus and to report our opinion to you.

Save for any responsibility which we may have to those persons to whom this report is expressly addressed and for any responsibility arising under item 5.5.3R(2)(f) of the Prospectus Rules to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with item 23.1 of Annex I to the PD Regulation, consenting to its inclusion in the Prospectus.

Basis of opinion

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. It also included an assessment of significant estimates and judgments made by those responsible for the preparation of the financial information and whether the accounting policies are appropriate to the TSB Bank Group's circumstances, consistently applied and adequately disclosed.

PricewaterhouseCoopers LLP is a limited liability partnership registered in England with registered number OC303525. The registered office of PricewaterhouseCoopers LLP is 1 Embankment Place, London WC2N 6RH. PricewaterhouseCoopers LLP is authorised and regulated by the Financial Conduct Authority for designated investment business.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement whether caused by fraud or other irregularity or error.

Our work has not been carried out in accordance with auditing standards generally accepted in the United States of America or auditing standards of the Public Company Accounting Oversight Board (United States) and accordingly should not be relied upon as if it had been carried out in accordance with those standards.

Opinion

In our opinion, the Financial Information Table gives, for the purposes of the Prospectus dated 9 June 2014, a true and fair view of the state of affairs of the TSB Bank Group as at the dates stated and of its profits, cash flows and changes in net investment for the periods then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Declaration

For the purposes of Prospectus Rule 5.5.3R(2)(f) we are responsible for this report as part of the Prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Prospectus in compliance with item 1.2 of Annex I to the PD Regulation.

Yours faithfully

PricewaterhouseCoopers LLP
Chartered Accountants

Section B: Historical Financial Information

TSB BANK GROUP

HISTORICAL FINANCIAL INFORMATION

FOR THE YEARS ENDED 31 DECEMBER 2013, 2012 AND 2011

Statement of Comprehensive Income for the years ended 31 December 2013, 31 December 2012 and 31 December 2011

	Notes	Year ended 31 December 2013	Year ended 31 December 2012	Year ended 31 December 2011
			(£m)	
Interest and similar income	5	1,035	1,057	1,082
Interest and similar expense	5	(410)	(499)	(423)
Net interest income	5	**625**	**558**	**659**
Fee and commission income	6	220	231	244
Fee and commission expense	6	(62)	(57)	(57)
Net fee and commission income	6	158	174	187
Other operating (expense) / income	7	(31)	5	10
Other income		**127**	**179**	**197**
Total income		**752**	**737**	**856**
Operating expenses	8	(576)	(580)	(591)
Impairment loss on loans and advances to customers	12	(109)	(118)	(183)
Profit before taxation		**67**	**39**	**82**
Taxation	9	105	(11)	(25)
Profit for the year		**172**	**28**	**57**
Other comprehensive (expense)/income				
Items that will not be reclassified subsequently to profit or loss:				
Post-retirement defined benefit scheme remeasurements before taxation	17	(5)	(82)	22
Taxation	15	1	19	(6)
Other comprehensive (expense)/income for the year, net of taxation		**(4)**	**(63)**	**16**
Total comprehensive income/(expense) for the year		**168**	**(35)**	**73**

The combined financial information may not be representative of future results, for example, future funding costs reflected in interest and similar expense, pension costs and certain operating costs, and tax charges may be significantly different from those that resulted from TSB Bank Group being wholly owned by Lloyds Banking Group.

Balance Sheet as at 31 December 2013, 31 December 2012 and 31 December 2011

	Notes	As at 31 December 2013	As at 31 December 2012	As at 31 December 2011
			(£m)	
Assets				
Cash and balances at central banks		200	205	196
Items in the course of collection from banks		116	156	194
Loans and receivables:				
Loans and advances to banks	10	4,125	—	—
Loans and advances to customers – TSB Franchise		20,099	21,168	21,069
Loans and advances to customers – Mortgage enhancement		3,386	3,180	2,654
Loans and advances to customers	11	23,485	24,348	23,723
Derivative financial instruments	13	99	—	—
Property, plant and equipment	14	123	90	80
Deferred tax assets	15	135	19	10
Retirement benefit assets	17	—	—	22
Other assets		50	50	45
Total assets		**28,333**	**24,868**	**24,270**
Liabilities				
Customer deposits	16	23,105	22,909	21,803
Items in course of transmission to banks		64	62	57
Derivative financial instruments	13	86	—	—
Other liabilities		86	63	54
Retirement benefit obligations	17	33	37	—
Current tax liabilities		5	25	25
Other provisions	18	12	15	7
Total liabilities		**23,391**	**23,111**	**21,946**
Net investment from Lloyds Banking Group		4,942	1,757	2,324
Net investment from Lloyds Banking Group and liabilities		**28,333**	**24,868**	**24,270**

Statement of Change in Net Investment from Lloyds Banking Group for the years ended 31 December 2013, 31 December 2012 and 31 December 2011

	Year ended 31 December 2013	Year ended 31 December 2012	Year ended 31 December 2011
		(£m)	
Balance at 1 January	1,757	2,324	2,376
Comprehensive income/(expense)			
Profit for the year	172	28	57
Other comprehensive (expense)/income	(4)	(63)	16
Total comprehensive income/(expense)	**168**	**(35)**	**73**
Transactions with Lloyds Banking Group:			
Net funding received from / (provided to) Lloyds Banking Group	3,017	(532)	(125)
Balance at 31 December	**4,942**	**1,757**	**2,324**

Cash flow Statement for the years ended 31 December 2013, 31 December 2012 and 31 December 2011

	Notes	Year ended 31 December 2013	Year ended 31 December 2012	Year ended 31 December 2011
			(£m)	
Profit before taxation		**67**	**39**	**82**
Adjustments for:				
Change in operating assets	24(a)	(3,429)	(565)	76
Change in operating liabilities	24(b)	317	1,119	56
Non-cash and other items	24(c)	99	(30)	(56)
Tax (paid)/received		(30)	1	(11)
Net cash (used in)/provided by operating activities		**(2,976)**	**564**	**147**
Cash flows from investing activities				
Purchase of property, plant and equipment		(48)	(23)	(18)
Net cash used in investing activities		**(48)**	**(23)**	**(18)**
Cash flows from financing activities				
Net funding received from/(provided to) Lloyds Banking Group		3,017	(532)	(125)
Net cash provided by/(used in) financing activities		**3,017**	**(532)**	**(125)**
Change in cash and cash equivalents		(7)	9	4
Cash and cash equivalents at beginning of year		181	172	168
Cash and cash equivalents at end of year	24(d)	**174**	**181**	**172**

Notes to the Historical Financial Information for the years ended 31 December 2013, 31 December 2012 and 31 December 2011

1 General information

TSB Bank plc (formerly Lloyds TSB Scotland plc) ("**TSB Bank**") was incorporated and is domiciled in Scotland, and together with its subsidiaries is referred to as "TSB Bank Group". Part IX: "*Introduction to TSB*" sets out the detailed steps that have been taken as part of the State Aid Restructuring Plan agreed with the European Commission that have been executed in advance of the Offer and are summarised for the purposes of the historical financial information below.

As a result of the agreement with the European Commission, the TSB Bank Group's branch network of 631 branches comprises the entire branch networks of the businesses branded Cheltenham & Gloucester and Lloyds TSB Scotland, together with some of the existing Lloyds TSB-branded branches in England and Wales. The transfer of the branches was executed by way of a banking business transfer scheme pursuant to Part VII of the FSMA, which resulted in certain assets and liabilities associated with 447 branches being transferred to TSB Bank plc from Lloyds Bank plc (formerly Lloyds TSB Bank plc). The last of the branch transfers took place on 15 April 2013. Product transaction took place on 13 July 2013 for Mortgages and on 13 May 2013 for other product areas.

Certain principles were agreed and applied, as at 31 December 2010, in order to identify the perimeter (the "**Perimeter**") of the divesting business. Subject to certain exceptions, the Perimeter included:

a. the banking business of retail customers associated with divesting heritage Lloyds TSB-branded branches in England, Scotland and Wales, together with the mortgages and savings accounts of customers associated with the Cheltenham & Gloucester-branded branches;

b. additional Cheltenham & Gloucester-branded mortgage assets, which were added into the perimeter in order to ensure compliance with the requirements of the State Aid Restructuring Plan; and

c. the banking business of branch-based charities, clubs and societies and business customers of divesting heritage Lloyds TSB-branded branches in England, Scotland and Wales whose annual turnover was less than £500,000 and lending threshold less than €1 million.

In addition, certain customer assets and liabilities not forming part of the divesting business were transferred out of TSB Bank plc. On 1 October 2012, the Court of Session in Scotland approved two banking business transfer schemes pursuant to which certain of these assets and liabilities were transferred from TSB Bank plc to Lloyds Bank plc and Bank of Scotland plc. The last of the customer accounts were transferred out of TSB Bank plc pursuant to such schemes on 15 March 2013. In addition, certain customer assets and liabilities forming part of the divesting business were transferred from Lloyds Bank plc to TSB Bank plc pursuant to the scheme approved by the Court of Session in Scotland on 5 March 2013. The last of the customer accounts was transferred to TSB Bank plc pursuant to such scheme on 15 July 2013.

The branches, the associated customers and related assets and liabilities being divested comprise the TSB Franchise segment set out in note 4.

On 11 September 2013, Lloyds Banking Group announced that it had agreed to provide TSB with the "economic benefit of a portfolio of residential mortgages of approximately £4 billion, together with the associated capital, designed to enhance TSB's profitability by over £200 million in aggregate in the first four years". Lloyds Banking Group has met this commitment through the Mortgage Enhancement Structure. The final Mortgage Enhancement Structure (pursuant to which a portfolio of residential mortgages of approximately £3.4 billion was transferred) has been designed with the aim of enhancing TSB's profit by approximately £220 million over the same period. Lloyds Banking Group also agreed to provide TSB with an additional £40 million of capital to enable future customer acquisition and develop its branch network.

In order to effect the transfer of the economic benefit of the Mortgage Enhancement from Lloyds Banking Group to TSB, the Mortgage Enhancement was equitably assigned by Bank of Scotland plc to TSB Bank with effect from 28 February 2014 pursuant to the Mortgage Sale Agreement at fair value and for a cash consideration of £3,359 million. Subject to certain perfection events (namely an insolvency event in relation to Bank of Scotland or specified material breach by Bank of Scotland of its obligations under the Mortgage Sale Agreement or following termination of the appointment of Bank of Scotland as servicer under the Mortgage Servicing Agreement at the option of TSB Bank), legal title in the Mortgage Enhancement has remained and will remain with Bank of Scotland and the

1 General information (continued)

Mortgage Enhancement customers remain customers of Lloyds Banking Group and will not be affected by the measures. Bank of Scotland has the right and/or the obligation to repurchase the Mortgage Enhancement from TSB Bank under the put or call option. In line with TSB's accounting policy set out in note 2c, the loans and advances to customers equitably assigned as part of the Mortgage Enhancement will be recognised by TSB.

The Mortgage Enhancement represents the segment set out in note 4. The TSB Franchise and Mortgage Enhancement segments together represent the TSB Bank Group.

The principal activity of the TSB Bank Group is the provision of retail and small business banking services through its network of 631 branches in England, Scotland and Wales.

The principal accounting polices applied in the preparation of this Historical Financial Information (the "**HFI**") are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

2 Accounting policies

(a) Basis of preparation

The TSB Bank Group's business (the combination of the TSB Franchise and the Mortgage Enhancement described above in Note 1), has not comprised a separate legal entity or a separate group of entities for the years ended 31 December 2013, 2012 and 2011 (the "**Track Record Period**"). The HFI, which has been prepared specifically for the purpose of this Prospectus, is therefore prepared on a basis that combines the results, assets and liabilities of the TSB Bank Group's business by applying the principles underlying the consolidation procedures of IFRS 10 'Consolidated Financial Statements' ("**IFRS 10**") for each of the three years ended 31 December 2013, 2012 and 2011 and as at these dates. On such basis, the HFI sets out the combined balance sheet as at 31 December 2013, 2012 and 2011 and the results of operations and cash flows for the three years then ended. Consequently, the HFI in the Prospectus is prepared on a different basis from the statutory financial statements of TSB Bank plc for the comparable three years albeit both are prepared in accordance with IFRS.

The HFI has been prepared in accordance with the requirements of the Prospectus Directive Regulation, the Listing Rules and this basis of preparation. This basis of preparation describes how the HFI has been prepared in accordance with International Financial Reporting Standards as adopted by the European Union, the Companies Act 2006 that applies to companies reporting under IFRS and IFRIC interpretations (together "**IFRS**"). References to "IFRS" hereafter should be construed as references to IFRS as adopted by the EU.

IFRS does not provide for the preparation of combined financial information, or for the specific accounting treatment set out below, and, accordingly, in preparing the HFI, certain accounting conventions commonly used for the preparation of historical financial information for inclusion in investment circulars as described in the Annexure to SIR 2000 "Standards for Investment Reporting applicable to public reporting engagements on historical financial information" issued by the UK Auditing Practices Board have been applied.

The HFI is presented in millions of pounds sterling ("**£**") except when otherwise indicated and on a historical cost basis as modified by the revaluation of financial assets and financial liabilities, including derivative instruments at fair value through profit or loss.

This HFI has been prepared on a going concern basis. Management has considered the planned separation of the business, and expects that the appropriate funding will be available for future operations after the separation occurs. Management expects that following separation from Lloyds Banking Group, the business will continue operating. The business's forecasts and projections, taking account of possible changes in trading performance, and including stress testing and scenario analysis, show that the business will be able to operate at adequate levels of both liquidity and capital for the foreseeable future.

The following summarises the accounting and other principles applied in preparing the HFI:

The key criterion for inclusion of historical financial information throughout the Track Record Period is the identification of a customer's primary account, being either a current or savings account ("**Primary Account**") that is associated with the 631 branches which are being

2 Accounting policies (continued)

(a) Basis of preparation (continued)

divested. Where a customer has a Primary Account with a divested branch, the associated in scope non-branch banking products of that customer (i.e. loans, credit cards and mortgages) are also divested. Given the nature of the perimeter, being based on a customer Primary Account relationship, the Perimeter has evolved over time. To the extent that a new customer opens a Primary Account during the Track Record Period, the customer's Primary Account and non-branch banking relationship with the Group will be included within the HFI.

The Mortgage Enhancement represents a specific portfolio of Lloyds Banking Group mortgage accounts which are not connected to the TSB Franchise customer base. The financial information presents the historical performance of this portfolio through the Track Record Period. This portfolio was acquired with no capacity for origination of new business and TSB is only entitled to receive the gross customer interest receivable and capital repayments. Therefore, no adjustments are recorded to reflect origination fees that were payable to Lloyds Banking Group.

Wholesale funding, derivative and associated balances

Up until 1 November 2013, the TSB Bank Group was historically funded and hedged on a Lloyds Banking Group group-wide basis and therefore, other than the customer deposits which are directly attributable to the TSB Bank Group, there are no direct funding instruments, balances or hedging relationships directly included within the HFI. To the extent appropriate, these transactions have been included within net investment from Lloyds Banking Group as net funding paid to/received from Lloyds Banking Group.

Lloyds Banking Group uses a Funds Transfer Pricing ("**FTP**") mechanism to allocate the costs and income of funding, liquidity, capital and interest rate risk management borne by Lloyds Banking Group to the TSB Bank Group. The FTP mechanism has been utilised to determine the TSB Bank Group's share of wholesale funding and hedging costs and income up until 1 November 2013 with the net cost recharge to the TSB Bank Group being included within "Interest and similar expense".

On 1 November 2013, the TSB Bank Group established its own treasury function, assumed direct responsibility for the management of the TSB Bank Group's funding and interest rate risk management activities and entered into a series of derivatives with Lloyds Bank designed to reflect the continuity of the TSB Bank Group's economic hedging approach. As a result, the TSB Bank Group was not subject to the FTP allocation mechanism from 1 November 2013. Note that the responsibility for managing the funding and interest rate risk management of the Mortgage Enhancement remained with Lloyds Banking Group throughout the period.

Details of all related party transactions with Lloyds Banking Group are set out in note 19.

Operating cost allocation

Costs directly associated with the Perimeter being divested, for example, the costs associated with employing the branch staff and premises costs, are separately identifiable and have been included directly within the HFI.

In addition, there are a number of other indirect central costs which have been allocated into the HFI to reflect the fact that TSB Bank operated as part of the wider Lloyds Banking Group. These costs primarily relate to IT functions, certain back office functions (such as Finance, Risk and Treasury) and marketing. These costs are allocated into the HFI in accordance with the pre-existing Lloyds Banking Group methodology for cost allocations recharged through to its businesses and legal entities. The costs are allocated using specific drivers (such as volume-based drivers) that are specific to the cost being allocated.

Allocation of conduct provisions

*Payment protection insurance ("**PPI**") mis-selling provisions*

The management and risks and rewards of all open PPI policies arising from historical sales in divesting branches remain with Lloyds Banking Group. As a consequence, no PPI commission income or mis-selling provisions have been included within the HFI.

2 Accounting policies (continued)

(a) Basis of preparation (continued)

Taxation

Tax charges / credits in the HFI have been determined based on the tax charges / credits recorded in the legal entities comprising the TSB Bank Group, together with an allocation of the tax charges recorded in Lloyds Banking Group associated with the business transferred. In relation to the recognition of the deferred tax asset arising from the transfer of assets and liabilities from Lloyds Banking Group into TSB Bank plc (see below), only the charges / credits recognised within TSB Bank plc have been included in the HFI.

The tax charges recorded in the income statement may not necessarily be representative of the charges that may arise in the future.

At 31 December 2013, the TSB Bank Group recognised deferred tax assets of £135 million (2012: £19 million, 2011: £10 million). The significant increase reflects temporary differences that arose from the application of taxation transfer pricing rules to the transfer of assets and liabilities from Lloyds Banking Group during 2013. Although these transferred assets and liabilities have been recognised in the balance sheet of the TSB Bank Group throughout the Track Record Period, this transfer between legal entities gives rise to recognition of a deferred tax asset in TSB Bank and, consequently, within TSB Bank Group. The associated charges that were recognised in the transferor Lloyds Banking Group company have not been included within the HFI.

Net investment from Lloyds Banking Group

The TSB Bank Group does not form a separate legal entity or group of entities throughout the Track Record Period and, as described above, a number of items in the income statement and on the balance sheet are presented as allocations of transactions of the wider Lloyds Banking Group. The net investment from Lloyds Banking Group represents a combination of the overall receivables and payables with Lloyds Banking Group, funding balances with Lloyds Banking Group and equity investment by Lloyds Banking Group in the TSB Bank Group, which cannot be separately identified or allocated throughout the Track Record Period.

Adoption of new and revised standards

This combined historical financial information is the first to be prepared for the TSB Bank Group. The financial information has been prepared in accordance with the accounting standards endorsed at the date of this Prospectus that are effective for financial years beginning on or after 1 January 2014. Therefore, in preparing this financial information, the TSB Bank Group has adopted the following pronouncements:

Amendments to IAS 1 'Presentation of Items of Other Comprehensive Income' (effective 1 July 2012). The amendments to IAS 1 require items of other comprehensive income to be grouped by those items that will be reclassified subsequently to profit or loss and those that will never be reclassified, together with their associated income tax. The amendments have been applied retrospectively. The effect of these changes is shown on the statement of comprehensive income.

IFRS 12 'Disclosure of interests in other entities' (effective 1 January 2013). The standard requires enhanced disclosure that enables users of the financial statements to evaluate the nature of, and the risks associated with, interests in other entities. The adoption of this standard had no impact on the HFI.

IFRS 13 'Fair Value Measurement' (effective 1 January 2013). The standard required prospective application from the beginning of the annual period to which it is first applied. IFRS 13 impacts the measurement of fair value for certain assets and liabilities as well as introducing new disclosures, as set out in note 21. In 2012 and 2011, no assets or liabilities were carried at fair value; therefore, the impact of applying IFRS 13 within this historical financial information is limited to the additional disclosure requirements.

Amendment to IFRS 7 'Financial Instruments: Disclosures' (effective 1 January 2013). The amendment requires additional disclosure regarding the offsetting of financial instruments, as set out in note 21.

2 Accounting policies (continued)

(a) Basis of preparation (continued)

IAS 19 'Employee Benefits' (effective 1 January 2013). The revision to IAS 19 changes the definition of short-term and other long-term employee benefits to clarify the distinction between the two and, in the case of defined benefit schemes, removes the accounting policy choice for recognition of actuarial gains and losses. Further detail on long-term benefits provided to employees is provided in notes 3 and 17.

Amendment to IAS 32 'Financial Instruments: Presentation' (effective 1 January 2014). The amendment provides clarifications on the application of offsetting rules. The adoption of this standard had no impact on the HFI.

Amendments to IAS 39 "*Novation of Derivatives and Continuation of Hedge Accounting*" (effective 1 January 2014) which provides an exception to the requirement for the discontinuation of hedge accounting. The adoption of this standard had no impact on the HFI.

Amendments to IAS 36 "*Recoverable Amount Disclosures for Non-Financial Assets*" (effective 1 January 2014). The overall effect of the amendments is to reduce the circumstances in which the recoverable amount of assets or cash-generating units is required to be disclosed, clarify the disclosures required and to introduce an explicit requirement to disclose the discount rate used in determining impairment (or reversals) where recoverable amount (based on fair value less costs of disposal) is determined using a present value technique. The adoption of this standard had no impact on the HFI.

Accounting standards not yet effective

The financial information has been prepared in accordance with the accounting standards effective and EU endorsed for financial years beginning on or after 1 January 2014. Details of those IFRS pronouncements which will be relevant to the TSB Bank Group but which were not effective and/or EU endorsed for financial years beginning on or after 1 January 2014 and which have not been applied in preparing this combined financial information are given in note 25.

(b) Revenue recognition

Interest income and expense

Interest income and expense are recognised in the income statement for all interest bearing financial instruments using the effective interest rate method. The effective interest rate 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 effective interest rate is the rate that discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability.

The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts paid or received by the TSB Bank 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 premia 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.

Fees and commission income and expense

Fees and commissions which are not an integral part of the effective interest rate are generally recognised when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. Where it is unlikely that loan commitments will be drawn, loan commitment fees are recognised over the life of the facility.

(c) Financial assets and liabilities

On initial recognition, financial assets that are not derivatives are classified as loans and receivables. Derivatives are classified as fair value through profit or loss (see note 2d below).

2 Accounting policies (continued)

(c) Financial assets and liabilities (continued)

Financial liabilities that are not derivatives are measured at amortised cost, except for other financial liabilities designated at fair value through profit or loss on initial recognition which are held at fair value. Purchases and sales of financial assets and liabilities are recognised on trade date, being the date that the TSB Bank Group is committed to purchase or sell an asset.

Financial assets are derecognised when the contractual right to receive cash flows from those assets has expired or when the TSB Bank Group has transferred its contractual right to receive the cash flows from the assets and either:

- substantially all of the risks and rewards of ownership have been transferred; or
- the TSB Bank Group has neither retained nor transferred substantially all of the risks and rewards, but has transferred control.

A financial liability is derecognised from the balance sheet when the TSB Bank Group has discharged its obligations, the contract is cancelled or the contract expires.

(1) *Loans and receivables*

Loans and receivables include loans and advances to banks and customers and other eligible assets. Loans and receivables are initially recognised when cash is advanced to the borrowers at fair value inclusive of transaction costs or, for other eligible assets, their fair value at the date of acquisition. Financial assets classified as loans and receivables are accounted for at amortised cost using the effective interest method less provision for impairment.

Where the TSB Bank Group enters into securitisation and similar transactions to finance certain loans and advances to customers using a structured entity funded by the issue of debt, these loans and advances continue to be recognised by the TSB Bank Group together with a corresponding liability for the funding where the TSB Bank Group has control of the structured entity.

The TSB Bank Group is deemed to retain control where it has:

- power over the structured entity, which is described as having existing rights that give the current ability to direct the activities of the entity that significantly affect the entity's returns;
- exposure, or rights, to variable returns from its involvement with the entity; and
- the ability to exert power over the investee to affect the amount of the investor's returns.

(2) *Borrowings*

Borrowings (which include deposits from banks and customer deposits) 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.

(d) Derivative financial instruments and hedge accounting

All derivatives 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.

Derivatives embedded in financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit and loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

2 Accounting policies (continued)

(d) Derivative financial instruments and hedge accounting (continued)

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 hedge accounting policy, the TSB Bank Group follows the 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 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.

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.

(e) Impairment of financial assets

Accounted for at amortised cost

At each balance sheet date, the TSB Bank 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 effective interest rate. If an asset has a variable interest rate, the discount rate used for measuring the impairment loss is the current effective interest rate.

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 effective interest rate 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.

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.

Homogenous groups of loans

Impairment is assessed on a collective basis for homogenous groups of loans that are not considered impaired. The asset is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment.

The criteria that the TSB Bank 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;

2 Accounting policies (continued)

(e) Impairment of financial assets (continued)

- restructuring of debt to reduce the burden on the borrower;
- breach of loan covenants or conditions; and
- initiation of bankruptcy or individual voluntary arrangement proceedings.

In respect of the TSB Bank Group's secured mortgage portfolios, the impairment allowance is calculated based on a definition of impaired loans which are those six months or more in arrears (or in certain cases where the borrower is bankrupt or is in possession). The estimated cash flows are calculated based on historical experience and are dependent on estimates of the expected value of collateral which takes into account expected future movements in house prices, less costs to sell.

For unsecured personal lending portfolios, the impairment trigger is generally when the balance is two or more instalments in arrears or where the customer has exhibited one or more of the impairment characteristics set out above. While the trigger is based on the payment performance or circumstances of each individual asset, the assessment of future cash flows uses historical experience of cohorts of similar portfolios such that the assessment is considered to be collective. Future cash flows are estimated on the basis of the contractual cash flows of the assets in the cohort and historical loss experience for similar assets. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the TSB Bank Group to reduce any differences between loss estimates and actual loss experience.

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.

(f) Property, plant and equipment

Property, plant and equipment are included 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 and 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: 10-20 years.
- Other equipment and motor vehicles: two to eight 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.

2 Accounting policies (continued)

(g) Operating leases

As lessee

The leases entered into by the TSB Bank Group as lessee are solely 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.

As lessor

Operating lease assets are included within property, plant and equipment at cost and depreciated over their estimated useful lives, which equates to the lives of the leases, after taking into account anticipated residual values. Operating lease rental income is recognised on a straight-line basis over the life of the lease.

The TSB Bank Group evaluates non-lease arrangements such as outsourcing and similar contracts to determine if they contain a lease, which is then accounted for separately.

(h) Pensions and other post-retirement benefits

Employees providing services to the TSB Bank Group are members of a number of Lloyds Banking Group post-retirement benefit schemes, including both defined benefit and defined contribution pension plans. A defined benefit scheme is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, dependent on one or more factors such as age, years of service and salary. A defined contribution plan is a pension plan into which the TSB Bank Group pays fixed contributions; there is no legal or constructive obligation to pay further contributions.

Full actuarial valuations of Lloyds Banking Group's principal defined benefit schemes are carried out every three years by qualified independent actuaries. Interim reviews are performed annually on an IFRS basis, updating these valuations to 31 December each year.

For the purposes of these annual updates, the present value of the defined benefit obligation, the related current service cost (and where applicable the past service cost) is determined measured on an actuarial basis using the projected unit credit method. The defined benefit scheme liabilities are discounted using rates equivalent to the market yields at the balance sheet date on high quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

The fair value of any plan assets is deducted from the present value of the defined benefit obligation in determining the surplus or deficit.

The TSB Bank Group's income statement charge includes the current and past service cost of providing pension benefits and net interest expense/(income).

Net interest on the net defined benefit liability/(asset) is charged to the income statement. Net interest on the net defined benefit liability/(asset) is the change during the period in the net defined benefit liability/(asset) that arises from the passage of time. Net interest on the net defined benefit liability/(asset) is determined by multiplying the net defined benefit liability/(asset) by the discount rate described above, both as determined at the start of the annual reporting period, taking account of any changes in the net defined benefit liability/(asset) during the period as a result of contribution and benefit payments.

Remeasurements of the net defined benefit liability/(asset) are reflected immediately in the balance sheet with a charge or a credit recognised in other comprehensive income in the period in which they occur. These comprised actuarial gains and losses; the return on plan assets, excluding amounts included in net interest (as described above) on the net defined benefit liability/(asset); and any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability/(asset). Remeasurements recognised in other comprehensive income are reflected immediately in retained profits and will not subsequently be reclassified to profit or loss.

2 Accounting policies (continued)

(h) Pensions and other post-retirement benefits (continued)

The TSB Bank Group's balance sheet includes the net surplus or deficit, being the difference between the fair value of scheme assets and the discounted value of scheme liabilities at the balance sheet date. Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes.

The costs of the TSB Bank Group's defined contribution plans are charged to the income statement in the period in which they fall due.

(i) Taxation

Current income 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.

However, deferred tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised. The tax effects of losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses 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.

(j) Provisions and contingent liabilities

Provisions are recognised in respect of present obligations arising from past events where it is probable that outflows of resources will be required to settle the obligations and they can be reliably estimated.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

Contingent assets are possible assets that arise from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the TSB Bank 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.

(k) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash and non-mandatory balances with central banks and amounts due from banks with a maturity of less than three months.

3 Critical accounting estimates and judgements

The preparation of combined financial information 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.

3 Critical accounting estimates and judgements (continued)

As noted in "*Basis of Preparation*" above, TSB Bank represents certain businesses which formed part of different Lloyds Banking Group subsidiaries during the periods. Had the TSB Bank Group been fully integrated throughout the periods presented, the financial position, results of operations and cash flows of the TSB Bank Group may have been different. Accordingly, the combined historic financial information may not be indicative of the TSB Bank Group's future performance and do not necessarily reflect what its combined results of operations, financial position and cash flows would have been had the TSB Bank Group operated as an independent business during the periods presented. To the extent that an asset, liability, revenue or expense is directly associated with the TSB Bank Group, it is reflected in the accompanying combined financial statements.

The significant judgements made by management in applying accounting policies and the key sources of estimation uncertainty in these financial statements, which together are deemed critical to the results and financial position, are as follows.

Allowance for impairment losses on loans and receivables

At 31 December 2013 gross loans and receivables of the TSB Bank Group totalled £23,583 million (2012: £24,454 million, 2011: £23,865 million) against which impairment allowances of £98 million (2012: £106 million, 2011: £142 million) had been made (see note 12). The TSB Bank Group's accounting policy for losses arising on financial assets classified as loans and receivables is described in note 2e; this note also provides an overview of the methodologies applied.

The allowance for impairment losses on loans and receivables is management's best estimate of losses incurred in the portfolio at the balance sheet date, determined collectively. In addition, a collective unimpaired provision is made for loan losses that have been incurred but have not been separately identified at the balance sheet date. This provision is sensitive to changes in the time between the loss event and the date the impairment is specifically identified. This period is known as the loss emergence period.

Collective impairment allowances are established across homogenous portfolios. The collective 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, however, inherently difficult to estimate how changes in one or more of these factors might impact the collective impairment allowance.

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 were 10 per cent. lower than those estimated at 31 December, the impairment charge would increase by approximately £5 million for the TSB Bank Group in respect of mortgages for 2013 (2012: £6 million; 2011: £7 million).

Retirement benefit obligations

Costs in relation to retirement benefit obligations have been apportioned to the TSB Bank Group on the basis of current service costs during the periods, and an allocation of the defined benefit pension scheme assets and liabilities has been recognised in the balance sheet. The net (liability)/asset recognised in the HFI balance sheet at 31 December 2013 in respect of retirement benefit obligations was £(33 million) (2012: £(37 million), 2011: £22 million). As explained in note 17, actuarial gains and losses (remeasurements) arising from the valuation of defined benefit schemes are recognised when they occur in other comprehensive income.

The value of the defined benefit pension schemes' liabilities requires management to make a number of assumptions. The key areas of estimation uncertainty are the discount rate applied to future cash flows, the assumed rate of inflation and the expected lifetime of the schemes' members. The accounting surplus or deficit and net interest expense are sensitive to changes in the discount rate, which is affected by market conditions and therefore potentially subject to significant variation. The cost of the benefits payable by the schemes will also depend upon the longevity of the members. Assumptions are made regarding the expected lifetime of scheme members based upon recent experience and the extrapolation of the improving trend; however, given the rate of advance in medical science and increasing levels of obesity, it is uncertain whether they will ultimately reflect actual experience.

3 Critical accounting estimates and judgements (continued)

The effect of changes to the principal actuarial assumptions on the net accounting surplus or deficit and on the pension charge in the TSB Bank Group's income statement are set out in note 17.

Recoverability of deferred tax assets

At 31 December 2013, the TSB Bank Group recognised deferred tax assets of £135 million (2012: £19 million, 2011: £10 million). The significant increase reflects temporary differences that arose from the application of taxation transfer pricing rules to the transfer of assets and liabilities from Lloyds Banking Group during 2013. In assessing the carrying value of the deferred tax asset arising from the transfer, management judgement was required in estimating the market value of the transferred balances which took into account an independent valuation of the transferred balances. Recoverability of the deferred tax asset also requires management judgement in assessing future levels of taxable profits expected to arise against which these temporary differences can be offset. The TSB Bank Group's expectations of the level of future taxable profits take into account the TSB Bank Group's long term strategic and financial plans and account is taken of the five year Board approved plan and future risk factors, including future economic outlook and regulatory change. At 31 December 2013, the deferred tax asset arising from the transfer of assets and liabilities from Lloyds Banking Group was recognised in full.

Effective interest rate

TSB Bank uses the effective interest rate (EIR) method to recognise interest expense on certain financial liabilities held at amortised cost. To calculate the appropriate EIR recognition, the TSB Bank Group makes assumptions of the expected lives of financial instruments and the level of expense to be recognised considering payment of bonus rates on certain deposit accounts.

A change to the TSB Bank Group's effective rate interest assumptions during 2012 resulted in an additional charge of £25 million to the income statement.

4 Segmental analysis

IFRS 8 requires operating segments to be identified on the basis of internal reports and components of the TSB Bank Group regularly reviewed by the chief operating decision maker to allocate resources to segments and to assess their performance. For this purpose, the chief operating decision maker of the TSB Bank Group is the Executive Committee.

Operating segments are reported in a manner which is consistent with internal reporting provided to the Executive Committee as follows:

- TSB Franchise – comprising the retail banking business carried out in the UK under the TSB brand.
- Mortgage enhancement – a separate portfolio of mortgage assets which are beneficially owned by the TSB Bank Group (as of 28 February 2014), but managed by Bank of Scotland and not branded as TSB.

4 Segmental analysis (continued)

A number of volatile or one-off factors have a significant effect on the results of TSB Bank Group. For the purposes of management's internal reporting, these items are excluded from the appropriate statutory financial statement line items to derive an underlying profit. The segmental disclosure below is presented in accordance with the internal reporting of the TSB Bank Group and is on a Management Basis. This is considered by management to provide a more meaningful view of business performance. The reconciliations and footnotes to the disclosure explain how the Management Basis reconciles to the statement of comprehensive income

	Management Basis		
2013	**TSB Franchise**	**Mortgage Enhancement**	**Total**
		(£m)	
Net interest income[1]	**603**	**32**	**635**
Other income (net of fee and commission expense)[2]	163	—	163
Total underlying income	**766**	**32**	**798**
Operating expenses	(575)	(1)	(576)
Impairment loss on loans and advances to customers	(109)	—	(109)
Underlying profit[3]	**82**	**31**	**113**
Fair value movements on instruments held at fair value			(46)
Profit before taxation			**67**
Taxation			105
Profit after taxation			**172**
Total assets	24,947	3,386	28,333
Total liabilities	(23,391)	—	(23,391)

	Management Basis		
2012	**TSB Franchise**	**Mortgage Enhancement**	**Total**
		(£m)	
Net interest income	**533**	**25**	**558**
Other income (net of fee and commission expense)	179	—	179
Total underlying income	**712**	**25**	**737**
Operating expenses	(579)	(1)	(580)
Impairment loss on loans and advances to customers	(118)	—	(118)
Underlying profit	**15**	**24**	**39**
Taxation			(11)
Profit after taxation			**28**
Total assets	21,688	3,180	24,868
Total liabilities	(23,111)	—	(23,111)

	Management Basis		
2011	**TSB Franchise**	**Mortgage Enhancement**	**Total**
		(£m)	
Net interest income	**634**	**25**	**659**
Other income (net of fee and commission expense)	197	—	197
Total underlying income	**831**	**25**	**856**
Operating expenses	(590)	(1)	(591)
Impairment loss on loans and advances to customers	(183)	—	(183)
Underlying profit	**58**	**24**	**82**
Taxation			(25)
Profit after taxation			**57**
Total assets	21,616	2,654	24,270
Total liabilities	(21,946)	—	(21,946)

Notes:

(1) Net interest income for the year ended 31 December 2013 includes interest received on interest rate derivatives that are not in designated hedging relationships of £10 million, which is presented in other income within the statement of comprehensive income.

4 Segmental analysis (continued)

(2) Other income within the statement of comprehensive income for the year ended 31 December 2013 includes fair value losses of £46 million relating to interest rate derivatives that are not in designated hedging relationships. For the purposes of the segment presentation of results, this loss is recorded below underlying profit.

(3) Underlying profit is presented excluding fair value movements on instruments held at fair value relating to fair value movements on derivatives reflecting the basis on which the results are reported to the Executive Committee. No comparative is presented for other gains and losses for the years ended 31 December 2011 and 2012 because no derivatives were held by the TSB Bank Group during this period. As a result profit before tax is the same as underlying profit for the years ended 31 December 2012 and 2011.

5 Net interest income

	2013	2012	2011
		(£m)	
Interest and similar income:			
Loans and advances to banks	4	—	—
Loans and advances to customers – TSB Franchise	903	944	987
Loans and advances to customers – Mortgage Enhancement	128	113	95
Total interest and similar income	**1,035**	**1,057**	**1,082**
Interest and similar expense:			
Customer deposits	(271)	(299)	(233)
Funds Transfer Pricing charge – TSB Franchise	(43)	(112)	(120)
Funds Transfer Pricing charge – Mortgage Enhancement	(96)	(88)	(70)
Total interest and similar expense	**(410)**	**(499)**	**(423)**
Net interest income	**625**	**558**	**659**

Included within interest and similar income is £12 million (2012: £7 million, 2011: £9 million) in respect of impaired financial assets.

6 Net fee and commission income

	2013	2012	2011
		(£m)	
Fee and commission income:			
Current accounts	95	100	95
Credit and debit card fees	64	62	64
Insurance commission income	38	47	68
Other	23	22	17
Total fee and commission income	**220**	**231**	**244**
Fee and commission expense	(62)	(57)	(57)
Net fee and commission income	**158**	**174**	**187**

As discussed in note 2, fees and commissions which are an integral part of the effective interest rate form part of net interest income shown in note 5. Included in net fee and commission income above is £38 million (2012: £47 million, 2011: £68 million) receivable from Lloyds Banking Group companies in respect of insurance commission income and £nil (2012: £nil, 2011: £nil) payable to Lloyds Banking Group companies in respect of fee and commission expense.

7 Other operating (expense) / income

	2013	2012	2011
		(£m)	
Fair value movements on instruments held at fair value through profit or loss	(36)	—	—
Rent receivable	1	1	1
Other income	4	4	9
Total other operating (expense)/income	**(31)**	**5**	**10**

8 Operating expenses

	2013	2012	2011
		(£m)	
Staff costs:			
Wages and salaries	151	165	166
Social security costs	12	13	13
Pensions and other post-retirement benefit schemes – defined contribution (note 17)	8	8	8
Pensions and other post-retirement benefit schemes – defined benefit (note 17)	21	4	13
Other	—	—	1
	192	190	201
Premises and equipment:			
Rent and rates	40	46	44
Repairs and maintenance	9	9	10
Other	13	6	5
Other expenses:			
Financial Services Compensation Scheme levy	19	15	7
Indirect central costs	265	273	283
Other	22	27	26
Depreciation and amortisation:			
Depreciation of property, plant and equipment (note 14)	15	13	14
Total operating expense – TSB Franchise	**575**	**579**	**590**
Incremental indirect central costs – Mortgage enhancement	1	1	1
Total operating expense	**576**	**580**	**591**

The average number of people directly attributable to the operation of the TSB Bank Group business on a full time equivalent basis during the year, in the UK, was as follows:

	2013	2012	2011
Total	5,402	5,670	5,950

9 Taxation

(a) Analysis of tax credit/(charge) for the year

	2013	2012	2011
		(£m)	
UK corporation tax:			
Current tax on profit for the year	(10)	(1)	(25)
Current tax charge	(10)	(1)	(25)
Deferred tax (note 15):			
Origination and reversal of temporary differences	(6)	(9)	1
Reduction in UK corporation tax rate	(21)	(1)	(1)
Transfer of business	142	—	—
Deferred tax credit/(charge)	115	(10)	—
Tax credit/(charge)	**105**	**(11)**	**(25)**

The charge for tax on the profit for 2013 is based on a standard UK corporation tax rate of 23.25 per cent. (2012: 24.5 per cent., 2011: 26.5 per cent.). The deferred tax credit, in relation to "Transfer of business", arises from the origination of temporary differences arising from the Part VII transfer of assets and liabilities from Lloyds Banking Group companies during 2013 (see note 15).

9 Taxation (continued)

(b) Factors affecting the tax credit/(charge) for the year

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

	2013	2012	2011
		(£m)	
Profit before taxation	67	39	82
Tax charge thereon at standard UK corporation tax rate	(16)	(10)	(22)
Factors affecting credit/(charge):			
UK corporation tax rate change	(21)	(1)	(1)
Transfer of business	142	—	—
Disallowed and non-taxable items	—	—	(2)
Tax credit/(charge) on profit on ordinary activities	**105**	**(11)**	**(25)**

10 Loans and advances to banks

	2013	2012	2011
		(£m)	
Total loans and advances to banks	4,125	—	—

At 31 December 2013 no loans and advances to banks (2012: £nil, 2011: £nil) had a contractual residual maturity of greater than one year. All loans and advances relate to balances with Lloyds Banking Group companies.

11 Loans and advances to customers

	2013	2012	2011
		(£m)	
Mortgages – TSB Franchise	17,729	18,666	18,435
Mortgages – Mortgage Enhancement	3,387	3,181	2,655
Total Mortgages	21,116	21,847	21,090
Personal Unsecured	2,143	2,232	2,395
Small Business Banking	324	375	380
Total loans and advances to customers before allowance for impairment losses	**23,583**	**24,454**	**23,865**
Allowance for impairment losses (note 12)	(98)	(106)	(142)
Total loans and advances to customers	**23,485**	**24,348**	**23,723**

At 31 December 2013 £21,112 million of loans and advances to customers (2012: £20,372 million, 2011: £20,246 million) had a contractual residual maturity of greater than one year.

12 Allowance for impairment losses on loans and receivables

	Loans and advances to customers
	(£m)
At 1 January 2011	180
Advances written off	(241)
Recoveries of advances written off in previous years	21
Unwinding of discount	(1)
Charge to the income statement	183
At 31 December 2011	142
Advances written off	(196)
Recoveries of advances written off in previous years	34
Unwinding of discount	8
Charge to the income statement	118
At 31 December 2012	106
Advances written off	(149)
Recoveries of advances written off in previous years	30
Unwinding of discount	2
Charge to the income statement	109
At 31 December 2013	**98**

Of the TSB Bank Group's total allowance in respect of loans and advances to customers, £75 million (2012: £81 million, 2011: £111 million) related to lending that had been determined to be impaired at the reporting date.

13 Derivative financial instruments

The TSB Bank Group holds derivatives in the normal course of its banking business for interest rate risk and margin stabilisation purposes. On 1 November 2013, the TSB Bank Group entered into a series of interest rate swaps with Lloyds Bank plc designed to preserve the outcome of the Lloyds Banking Group's approach to economic hedging of the TSB Bank Group's balance sheet. During 2013, the TSB Bank Group did not designate any of its derivatives in hedge accounting relationships under IAS 39 *"Financial Instruments: Recognition and Measurement"*. Derivatives are held at fair value on the TSB Bank Group's balance sheet. A description of the methodology used to determine the fair value of derivative financial instruments is set out in note 21.

The fair values and notional amounts of derivative instruments are set out in the following table:

	2013		
	Contract/ notional amount	Fair value assets	Fair value liabilities
		(£m)	
Interest rate swaps	13,491	99	(86)
Total derivative asset/(liabilities)	**13,491**	**99**	**(86)**

Derivative assets of £77 million (2012: £nil, 2011: £nil) are expected to be recovered after more than one year. Derivative liabilities of £74 million (2012: £nil, 2011: £nil) are expected to be settled after more than one year. At 31 December 2012 and 2011, the TSB Bank Group held no derivative financial instruments.

14 Property, plant and equipment

	Premises	Equipment	Total
		(£m)	
Cost:			
At 1 January 2011	174	146	320
Additions	13	5	18
At 31 December 2011	187	151	338
Additions	18	5	23
At 31 December 2012	205	156	361
Additions	32	16	48
Disposals	(1)	(17)	(18)
At 31 December 2013	**236**	**155**	**391**
Accumulated depreciation:			
At 1 January 2011	120	124	244
Depreciation charge for the year (note 8)	10	4	14
At 31 December 2011	130	128	258
Depreciation charge for the year (note 8)	8	5	13
At 31 December 2012	138	133	271
Depreciation charge for the year (note 8)	10	5	15
Disposals	(1)	(17)	(18)
At 31 December 2013	**147**	**121**	**268**
Balance sheet amount at 31 December 2013	**89**	**34**	**123**
Balance sheet amount at 31 December 2012	67	23	90
Balance sheet amount at 31 December 2011	57	23	80

15 Deferred tax

	2013	2012	2011
		(£m)	
Asset at 1 January	19	10	16
Income statement credit/(charge):			
Deferred tax from transfer of business	142	—	—
Due to change in UK corporation tax rate	(21)	(1)	(1)
Other	(6)	(9)	1
	115	(10)	—
Amount credited/(charged) to equity:			
Post retirement benefit scheme remeasurements	1	19	(6)
Asset at 31 December	**135**	**19**	**10**

In May 2013, approximately 3.5 million customers and related deposits and unsecured lending balances were transferred from Lloyds Banking Group companies to the TSB Bank Group under Part VII of the FSMA and in July 2013 a further transfer of secured mortgage balances took place. As explained in note 3, these business combinations resulted in the origination of temporary differences from the application of taxation transfer pricing rules to the transferred balances and resulted in the TSB Bank Group recognising a deferred tax asset of £142 million which, following the substantive enactment of the Finance Act 2013, was subsequently reduced to £122 million at 31 December 2013.

The Finance Act 2013 (the "**Act**") was substantively enacted on 2 July 2013. The Act further reduced the main rate of corporation tax from 23 per cent to 21 per cent with effect from 1 April 2014 and to 20 per cent. with effect from 1 April 2015. Accordingly, deferred tax balances have been revalued to the lower rate of 20 per cent in this historical financial information, which has resulted in a charge to the income statement of £21 million (2012: £1 million, 2011: £1 million).

15 Deferred tax (continued)

The deferred tax credit/(charge) in the income statement comprises the following temporary differences:

	2013	2012	2011
		(£m)	
Accelerated capital allowances	(1)	(2)	1
Deferred tax from transfer of business	122	—	—
Pensions and other post retirement benefits	(5)	(7)	—
Other temporary differences	(1)	(1)	(1)
	115	**(10)**	**—**

Deferred tax assets are comprised as follows:

	2013	2012	2011
		(£m)	
Deferred tax assets:			
Deferred tax on transfer of business	122	—	—
Pensions and other post retirement benefits	7	12	—
Accelerated capital allowances	4	5	6
Other temporary differences	2	2	4
Total deferred tax assets	**135**	**19**	**10**

Taxation involves estimation techniques to assess the liability in terms of possible outcomes. The assessment of the recoverability or otherwise of deferred tax assets is based mainly on the premise that the TSB Bank Group will generate sufficient profits in the medium term to realise the deferred tax assets.

This is reviewed at each reporting date by management with a detailed exercise to establish the validity of profit forecasts and other relevant information including timescales over which the profits are expected to arise. Deferred tax is determined using tax rates that have been enacted or substantively enacted by the balance sheet date which are expected to apply when the related deferred tax is realised or the deferred tax liability is settled.

16 Customer deposits

	2013	2012	2011
		(£m)	
Non-interest bearing current accounts	4,373	4,197	4,215
Interest-bearing current accounts	2,129	1,670	1,347
Savings and investment accounts	16,603	17,042	16,241
Total customer deposits	**23,105**	**22,909**	**21,803**

At 31 December 2013, £1,116 million (2012: £1,137 million, 2011: £934 million) of customer deposits of the TSB Bank Group had a contractual residual maturity of greater than one year.

17 Retirement benefit obligations

Defined contribution schemes

During the period, the TSB Bank Group has paid contributions in respect of a number of defined contribution pension schemes. For existing employees, until 31 July 2011 this was principally the defined contribution sections of the Lloyds Bank Pension Schemes No. 1 and No. 2 and, from 1 August 2011 the defined contribution scheme Your Tomorrow and the Your Tomorrow defined contribution section of the Lloyds Bank Pension Scheme No. 1. New employees from 1 July 2010 were offered membership of the defined contribution scheme Your Tomorrow.

During the year ended 31 December 2013, the charge to operating expenses in the statement of comprehensive income in respect of these schemes was £8 million (2012: £8 million, 2011: £8 million), representing the contributions payable by the employer in accordance with each scheme's rules. There are no outstanding or prepaid contributions at 31 December 2013.

17 Retirement benefit obligations (continued)

Defined benefit schemes

During the periods the TSB Bank Group has paid contributions in respect of a number of Lloyds Banking Group defined benefit pension schemes for TSB employees.

Lloyds Banking Group has established a number of defined benefit pension schemes in the UK and overseas. The majority of the TSB Bank Group's employees were members of the defined benefit sections of the Lloyds Bank Pension Schemes No. 1 and No. 2 until 31 March 2014. These are funded schemes providing retirement benefits calculated as a percentage of final salary depending upon the length of service. The minimum retirement age under the rules of the schemes is 55 (except for members with a legacy protected minimum pension age of 50).

The latest full valuations of the two main schemes were carried out as at 30 June 2012; these have been updated to 31 December 2013 by qualified independent actuaries.

The amounts shown below relate to the TSB Bank Group's share of obligations arising from membership by its employees of the defined benefit schemes operated by the TSB Bank Group's ultimate parent company.

(a) The amount included in the balance sheet:

	2013	2012	2011
		(£m)	
Share of present value of defined benefit obligations	(1,409)	(1,218)	(1,040)
Share of fair value of scheme assets	1,376	1,181	1,062
Net (liability)/asset arising from defined benefit obligations	**(33)**	**(37)**	**22**

The movements in the (liability)/asset recognised in the balance sheet are as follows:

	2013	2012	2011
		(£m)	
At 1 January	(37)	22	(18)
Net charge to the income statement	(21)	(4)	(13)
Remeasurements	(5)	(82)	22
Contributions paid	30	27	31
At 31 December	**(33)**	**(37)**	**22**

(b) Amounts recognised in operating expenses in respect of these defined benefit schemes are as follows:

	2013	2012	2011
		(£m)	
Current service cost	16	15	14
Past service cost and loss/(gain) from settlements	3	(10)	(1)
Net interest expense/(income)	1	(2)	(1)
Plan administration costs incurred during the year	1	1	1
Total defined benefit expense	**21**	**4**	**13**

The total defined benefit expense has been included within operating expenses (see note 8). The remeasurement of the net defined benefit liability is included in the statement of comprehensive income.

17 Retirement benefit obligations (continued)

(c) Change in defined benefit obligation:

	2013	2012	2011
		(£m)	
At 1 January	(1,218)	(1,040)	(990)
Current service cost	(16)	(15)	(14)
Interest expense	(124)	(54)	(53)
Remeasurements:			
Actuarial gains/(losses) – experience	8	(19)	(10)
Actuarial gains/(losses) – demographic assumptions	1	(9)	—
Actuarial (losses) – financial assumptions	(62)	(73)	(9)
Benefits paid	45	39	34
Past service cost	—	(1)	(1)
Employee contributions	—	—	—
Curtailments	(4)	10	1
Settlements	3	1	1
Exchange and other adjustments[1]	(42)	(57)	1
At 31 December	**(1,409)**	**(1,218)**	**(1,040)**

Note:

(1) An allocation method has been used to determine TSB Bank's share of Lloyds Banking Group's gross pension assets and liabilities. Changes in the allocation percentage between the beginning and end of a financial year are recorded in "Exchange and other adjustments".

(d) Change in the fair value of scheme assets:

	2013	2012	2011
		(£m)	
At 1 January	1,181	1,062	972
Return on plan assets	48	19	41
Interest income	123	56	54
Employer contributions	30	27	31
Employee contributions	—	—	—
Benefits paid	(45)	(39)	(34)
Settlements	(2)	—	—
Administrative costs paid	(1)	(1)	(1)
Exchange and other adjustments[1]	42	57	(1)
At 31 December	**1,376**	**1,181**	**1,062**

Note:

(1) An allocation method has been used to determine TSB Bank's share of Lloyds Banking Group's gross pension assets and liabilities. Changes in the allocation percentage between the beginning and end of a financial year are recorded in "Exchange and other adjustments".

(e) Composition of scheme assets:

	2013			2012			2011		
	Quoted	Unquoted	Total	Quoted	Unquoted	Total	Quoted	Unquoted	Total
					(£m)				
Equity instruments	54	—	54	79	—	79	56	—	56
Debt instruments	543	—	543	416	—	416	397	—	397
Property	—	45	45	—	43	43	—	37	37
Pooled investment vehicles	198	451	649	169	427	596	152	366	518
Money market instruments, derivatives and other assets	21	64	85	20	27	47	17	37	54
At 31 December	**816**	**560**	**1,376**	**684**	**497**	**1,181**	**622**	**440**	**1,062**

17 Retirement benefit obligations (continued)

(f) Amounts recognised in the statement of comprehensive income are as follows:

	2013	2012	2011
		(£m)	
The return on scheme assets (excluding amounts included in net interest expense)	48	19	41
Actuarial losses	(53)	(101)	(19)
Remeasurement on gain/(loss) of the net defined benefit liability/(asset)	**(5)**	**(82)**	**22**

(g) The principal actuarial and financial assumptions used in valuations of all of the Lloyds Banking Group's defined benefit pension schemes, including the Lloyds Bank Pension Scheme No. 1 and No. 2, were as follows:

	Valuation at		
	2013	2012	2011
		(%)	
Discount rate	4.60	4.60	5.00
Rate of inflation:			
Retail Prices Index	3.30	2.90	3.00
Consumer Prices Index	2.30	2.00	2.00
Rate of salary increases	2.00	2.00	2.00
Rate of increase for pensions in payment	2.80	2.70	2.80
		(years)	
Life expectancy for member aged 60, on the valuation date:			
Men	27.4	27.4	27.3
Women	29.7	29.7	28.4
Life expectancy for member aged 60, 15 years after the valuation date:			
Men	28.6	28.5	28.8
Women	31.0	30.9	30.0

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with actual experience of the relevant schemes.

An analysis of the impact on Lloyds Banking Group of a reasonable change in these assumptions is provided in the 2013 financial statements of Lloyds Banking Group. Copies of Lloyds Banking Group plc's 2013 annual report and accounts may be obtained from the Company Secretary's Department, Lloyds Banking Group plc, 25 Gresham Street, London, EC2V 7HN.

18 Other provisions

	2013	2012	2011
		(£m)	
At 1 January	15	7	9
Provisions utilised	(22)	(7)	(9)
Charge for the year	19	15	7
At 31 December	**12**	**15**	**7**

Other provisions in 2011, 2012 and 2013 relate to the FSCS levy. The 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 levies on the industry (and recoveries and borrowings where appropriate). The levies raised comprise both management expenses levies and, where necessary, compensation levies on authorised firms. Following the default of a number of deposit takers in 2008, the FSCS borrowed funds from HM Treasury to meet the compensation costs for customers of those firms. Although the substantial majority of this loan, which totalled approximately £17 billion at 31 March 2013, will be repaid from funds the FSCS receives from asset sales, surplus cash flow or other recoveries in relation to the assets of the firms that defaulted, any shortfall will be funded by deposit-taking participants of the FSCS. In July 2013, the FSCS confirmed that it expects to raise compensation costs levies of approximately £1.1 billion on

18 Other provisions (continued)

all deposit-taking participants over a three-year measurement period from 2012 to 2014 to enable it to repay the balance of the HM Treasury loan which matures in 2016. The TSB Bank Group has provided and paid for its share of the 2012 and 2013 element of the levy.

The interest rate on the borrowings with HM Treasury, which total circa £20 billion, increased from 12-month LIBOR plus 30 basis points to 12-month LIBOR plus 100 basis points on 1 April 2012. Each deposit-taking institution contributes towards the FSCS levies in proportion to their share of total protected deposits on 1 April at the beginning of the scheme year, which runs from 1 April to 31 March.

In determining an appropriate accrual in respect of the management expenses levy, certain assumptions have been made, including the proportion of total protected deposits held by the TSB Bank Group, the level and timing of repayments to be made by the FSCS to HM Treasury and the interest rate to be charged by HM Treasury.

19 Related party transactions

(a) Key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of an entity; the TSB Bank Group's key management personnel are the members of the TSB Board.

	2013	2012	2011
		(£m)	
Compensation			
Salaries and other short-term benefits	1	1	1
Post-employment benefits	—	—	—
Share-based payments	—	—	—
Total compensation	**1**	**1**	**1**

The aggregate of the emoluments of the directors was £1 million (2012: £1 million; 2011: £1 million).

The number of directors to whom retirement benefits were accruing under defined contribution and defined benefit pension schemes was nil and nil respectively (2012: nil and nil, 2011: nil and nil). No share options were exercised or settled.

	2013	2012	2011
Number of share options held in respect of shares in Lloyds Banking Group			
Granted	1,200,648	1,584,832	842,055
Exercised	—	—	—
Vested	—	386,107	18,836
Lapsed	332,010	386,107	41,357

Although some employees participate in a number of share-based compensation plans operated by Lloyds Banking Group, these recharges are not material and no accounting policy has been disclosed.

The tables below detail, on an aggregated basis, balances outstanding at the year end and related income and expense, together with information relating to other transactions between the TSB Bank Group and its key management personnel:

	2013	2012	2011
		(£'000)	
Deposits			
At 1 January	440	330	253
Placed	295	545	356
Interest applied during year	3	5	2
Withdrawn	(469)	(440)	(281)
At 31 December	**269**	**440**	**330**

19 Related party transactions (continued)

(a) Key management personnel (continued)

At 31 December 2013, transactions, arrangements and agreements entered into by the TSB Bank Group with Directors and connected persons included amounts outstanding in respect of credit card transactions of £1,000 with one director and no connected persons (2012: £1,000 with one director and no connected persons; 2011: £1,000 with one director and no connected persons).

At 31 December 2013, the TSB Bank Group did not provide any guarantees in respect of key management personnel (2012 £nil; 2011 £nil).

(b) Balances and transactions with fellow Lloyds Banking Group undertakings

The TSB Bank Group, as a result of its position as a member of a banking group, has a large number of transactions with several of Lloyds Banking Group's subsidiary undertakings; these are included on the balance sheet of the TSB Bank Group as follows:

	2013	2012	2011
		(£m)	
Related party assets:			
Derivative financial instruments	99	—	—
Loans and advances to banks	4,125	—	—
Retirement benefit assets	—	—	22
	4,224	**—**	**22**
Related party liabilities:			
Derivative financial instruments	86	—	—
Retirement benefit obligations	33	37	—
	119	**37**	**—**

Due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. During 2013, the TSB Bank Group earned interest income of £4 million (2012: £nil, 2011: £nil) on the above loans and advances to banks and received net interest of £10 million (2012: £nil, 2011: £nil) on the derivative financial instruments. During 2013, the TSB Bank Group incurred a net charge under the FTP mechanism of £139 million (2012: £200 million, 2011: £190 million). The net investment from Lloyds Banking Group represents a combination of the overall receivables and payables with Lloyds Banking Group, funding balances with Lloyds Banking Group and equity investment by Lloyds Banking Group in the TSB Bank Group, which are not possible to be separately identified or allocated through the Track Record Period. During 2013, the TSB Bank Group received £3,017 million from Lloyds Banking Group (2012: provided £532 million, 2011: provided £125 million).

In addition, the TSB Bank Group received fees of £38 million (2012: £47 million, 2011: £68 million), and paid charges of £295 million (2012: £286 million, 2011: £305 million), for various services provided between the TSB Bank Group and its fellow Lloyds Banking Group members.

There are no contingent liabilities and commitments entered into on behalf of fellow Lloyds Banking Group undertakings.

Derivative financial instruments reflect the fair value of derivatives where a Group company is the counterparty to the arrangement. At 31 December 2013, all derivatives held by the TSB Bank Group have been executed with a Lloyds Banking Group company. During 2013, the TSB Bank Group recognised an expense of £46 million (2012: £nil, 2011: £nil) in respect of derivative financial instruments held with a Group company.

(c) UK Government

In January 2009, the UK Government through HM Treasury became a related party of Lloyds Banking Group plc, the TSB Bank Group's ultimate parent company, following its subscription for ordinary shares issued under a placing and open offer. As at 31 December 2013, HM Treasury held a 32.7 per cent. (2012: 39.2 per cent.; 2011: 40.2 per cent.) interest in Lloyds Banking Group plc's ordinary share capital and consequently HM Treasury remained a related party of the TSB Bank Group during the year ended 31 December 2013.

19 Related party transactions (continued)

(c) UK Government (continued)

From 1 January 2011, in accordance with IAS 24, UK Government-controlled entities became related parties of the TSB Bank Group. The TSB Bank Group regards the Bank of England and entities controlled by the UK Government, including The Royal Bank of Scotland Group plc, Northern Rock (Asset Management) plc and Bradford & Bingley plc, as related parties.

There were no significant transactions between the TSB Bank Group and the UK Government or UK Government-controlled entities (including UK Government-controlled banks) during the years to 31 December 2013, 31 December 2012 and 31 December 2011 that were not made in the ordinary course of business or that were unusual in their nature or conditions. Details of the Lloyds Banking Group participation in UK Government schemes is provided in the 2013 financial statements of the Lloyds Banking Group.

Since 31 December 2011, the TSB Bank Group has had the following significant transactions with the UK Government or UK Government-related entities:

Central bank facilities

In the ordinary course of business, the TSB Bank Group may from time to time access market-wide facilities provided by central banks.

Other Government-related entities

Other than the transactions referred to above, there were no other significant transactions with the UK Government and UK Government-controlled entities (including UK Government-controlled banks) during the period that were not made in the ordinary course of business or that were unusual in their nature or conditions.

20 Contingent liabilities and commitments

(a) Commitments

	2013	2012	2011
		(£m)	
Undrawn formal standby facilities, credit lines and other commitments to lend:			
Less than 1 year original maturity			
Mortgage offers made	205	318	353
Cards	2,451	2,397	2,464
Other commitments	794	799	787
1 year or over original maturity	—	—	—
Total commitments	**3,450**	**3,514**	**3,604**

Of the amounts above, £215 million (2012: £337 million; 2011, £373 million) were irrevocable.

(b) Capital commitments

At 31 December 2013, capital expenditure that was authorised and contracted for, but not provided and incurred, was £nil (2012: £nil, 2011: £nil).

(c) Operating lease commitments

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

	2013	2012	2011
		(£m)	
Payable within 1 year	29	30	29
1 to 5 years	92	97	97
Over 5 years	78	94	97
Total operating lease commitments	**199**	**221**	**223**

20 Contingent liabilities and commitments (continued)

(c) Operating lease commitments (continued)

Operating lease payments represent rental payable by the TSB Bank 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.

(d) The Financial Services Compensation Scheme (FSCS)

The TSB Bank Group is subject to future levies from the FSCS as described in note 18. The amount of future compensation levies payable by the TSB Bank Group depends on a number of factors, including participation in the market at 1 April, the level of protected deposits and the population of deposit-taking participants.

(e) Legal and regulatory matters

During the ordinary course of business, the TSB Bank 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 the TSB Bank 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 properly to assess the merits of the case and no provisions are held against such matters. However, the TSB Bank 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.

21 Financial instruments

(1) Measurement basis of financial assets and liabilities

The accounting policies in note 2 describe how different classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following tables analyse the carrying amounts of the financial assets and liabilities by category and by balance sheet heading. During 2011 and 2012 the TSB Bank Group had no assets or liabilities which were held at fair value.

	Fair value	Loans and receivables	Held at amortised cost	Total
		(£m)		
At 31 December 2013				
Financial assets				
Cash and balances at central banks	—	—	200	200
Items in the course of collection from banks	—	—	116	116
Loans and receivables:				
Loans and advances to banks	—	4,125	—	4,125
Loans and advances to customers	—	23,485	—	23,485
Derivative financial instruments	99	—	—	99
Total financial assets	**99**	**27,610**	**316**	**28,025**
Financial liabilities				
Customer deposits	—	—	23,105	23,105
Items in the course of transmission to banks	—	—	64	64
Derivative financial instruments	86	—	—	86
Total financial liabilities	**86**	**—**	**23,169**	**23,255**

21 Financial instruments (continued)

(1) Measurement basis of financial assets and liabilities (continued)

	Fair value	Loans and receivables	Held at amortised cost	Total
			(£m)	
At 31 December 2012				
Financial assets				
Cash and balances at central banks	—	—	205	205
Items in the course of collection from banks	—	—	156	156
Loans and receivables:				
Loans and advances to customers	—	24,348	—	24,348
Total financial assets	**—**	**24,348**	**361**	**24,709**
Financial liabilities				
Customer deposits	—	—	22,909	22,909
Items in the course of transmission to banks	—	—	62	62
Total financial liabilities	**—**	**—**	**22,971**	**22,971**

	Fair value	Loans and receivables	Held at amortised cost	Total
			(£m)	
At 31 December 2011				
Financial assets				
Cash and balances at central banks	—	—	196	196
Items in the course of collection from banks	—	—	194	194
Loans and receivables:				
Loans and advances to customers	—	23,723	—	23,723
Total financial assets	**—**	**23,723**	**390**	**24,113**
Financial liabilities				
Customer deposits	—	—	21,803	21,803
Items in the course of transmission to banks	—	—	57	57
Total financial liabilities	**—**	**—**	**21,860**	**21,860**

(2) Fair values of financial assets and liabilities

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

	Fair value	Carrying value
	(£m)	
At 31 December 2013		
Financial assets		
Loans and advances to customers – TSB Franchise	20,153	20,099
Loans and advances to customers – Mortgage Enhancement	3,333	3,386
Derivative financial instruments	99	99
Financial liabilities		
Customer deposits	23,147	23,105
Derivative financial instruments	86	86

	Fair value	Carrying value
	(£m)	
At 31 December 2012		
Financial assets		
Loans and advances to customers – TSB Franchise	20,904	21,168
Loans and advances to customers – Mortgage Enhancement	3,151	3,180
Financial liabilities		
Customer deposits	22,972	22,909

21 Financial instruments (continued)

(2) Fair values of financial assets and liabilities (continued)

	Fair value	Carrying value
	(£m)	
At 31 December 2011		
Financial assets		
Loans and advances to customers – TSB Franchise	21,134	21,069
Loans and advances to customers – Mortgage Enhancement	2,642	2,654
Financial liabilities		
Customer deposits	21,901	21,803

The carrying amount of the following financial instruments is a reasonable approximation of fair value: cash and balances at central banks, items in the course of collection from banks, loans and advances to banks, and items in the course of transmission to banks.

(3) Fair Value Measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

As quoted market prices are not available for the TSB Bank Group's financial instruments, fair values have been determined using valuation techniques which, to the extent possible, use market observable inputs, but in some cases use non-market observable inputs. Valuation techniques used include discounted cash flow analysis and pricing models and, where appropriate, comparison to instruments with characteristics similar to those of the instruments held by the TSB Bank Group.

Assets and 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.

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. Examples of such financial instruments include most over-the-counter derivatives.

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.

Valuation of assets and liabilities carried at fair value

Derivative financial instruments are the only assets and liabilities of the TSB Bank Group that are carried at fair value. During 2011 and 2012, the TSB Bank Group had no assets or liabilities which were held at fair value. The TSB Bank Group's derivative financial instruments 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. Accordingly, these have been classified as level 2.

21 Financial instruments (continued)

(3) Fair Value Measurement (continued)

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 TSB Bank Group which are carried at amortised cost.

	Level 1	Level 2	Level 3	Total fair values	Total carrying value
			(£m)		
At 31 December 2013					
Assets					
Loans and advances to customers – TSB Franchise	—	—	20,153	20,153	20,099
Loans and advances to customers – Mortgage enhancement	—	—	3,333	3,333	3,386
Liabilities					
Deposits from customers	—	23,147	—	23,147	23,105

Valuation methodology

Loans and advances to customers

The TSB Bank Group provides loans and advances to businesses and personal customers at both fixed and variable rates. 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.

Deposits from customers

The fair value of deposits repayable on demand is considered to be equal to their carrying value. The fair value for all other deposits is estimated using discounted cash flows applying either market rates, where applicable, or current rates for deposits of similar remaining maturities.

(4) Offsetting financial assets and financial liabilities

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

31 December 2013	Gross amounts	Amounts offset	Net amounts reported on the balance sheet	Related financial instrument amounts not offset	Potential net amount
			(£m)		
Financial assets					
Derivative financial assets	99	—	99	(86)	13
Total	**99**	**—**	**99**	**(86)**	**13**
Financial liabilities					
Derivative financial liabilities	(86)	—	(86)	86	—
Total	**(86)**	**—**	**(86)**	**86**	**—**

Netting arrangements relate to derivatives. No derivatives existed for the years ended 31 December 2011 and 31 December 2012 and as such no comparatives have been provided.

22 Financial risk management

Financial instruments are fundamental to the TSB Bank Group's activities and, as a consequence, the risks associated with financial instruments represent a significant component of the risks faced by the TSB Bank Group.

22 Financial risk management (continued)

The primary risks affecting the TSB Bank Group through its use of financial instruments are credit risk and market risk, which includes interest rate risk and liquidity risk. Information about the TSB Bank Group's management of these risks is given below.

Credit risk

Credit risk appetite is set at Board level and is described and reported through a suite of metrics devised from a combination of accounting and credit portfolio performance measures, which include the use of various credit risk rating systems as inputs and measure the credit risk of loans and advances to customers and banks at a counterparty level using three components: (i) the probability of default by the counterparty on its contractual obligations; (ii) the current exposures to the counterparty and their likely future development, from which the TSB Bank Group derives the exposure at default; and (iii) the likely loss ratio on the defaulted obligations, the loss given default. The TSB Bank Group uses a range of approaches to mitigate credit risk, including internal control policies, obtaining collateral, using master netting agreements for derivative financial instruments and other credit risk transfers, such as asset sales. The TSB Bank Group's credit risk exposure, which arises wholly in the United Kingdom, is set out below.

(a) Maximum credit exposure

The maximum credit risk exposure of the TSB Bank Group in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held and the maximum exposure to loss is considered to be the balance sheet carrying amount or, for non-derivative off-balance sheet transactions and financial guarantees, their contractual nominal amounts.

	2013	2012	2011
		(£m)	
Items in the course of collection	116	156	194
Loans and receivables:			
Loans and advances to banks	4,125	—	—
Loans and advances to customers, net[1]	23,485	24,348	23,723
Derivative financial assets	99	—	—
Irrevocable loan commitments (Note 20(a))	215	337	373
Maximum credit risk exposure	**28,040**	**24,841**	**24,290**

Note:
(1) Amounts shown net of related impairment allowances.

(b) Credit quality of assets

Loans and receivables

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

	Loans and advances to customers				
	Mortgages – TSB Franchise	Mortgages – Mortgage Enhancement	Other	Total	Loans and advances to banks
			(£m)		
31 December 2013					
Neither past due nor impaired	17,264	3,387	2,312	22,963	4,125
Past due but not impaired	326	—	53	379	—
Impaired – no provision required	58	—	—	58	—
Provision held	81	—	102	183	—
Gross	**17,729**	**3,387**	**2,467**	**23,583**	**4,125**
Allowance for impairment losses	(24)	(1)	(73)	(98)	—
Total loans and advances	**17,705**	**3,386**	**2,394**	**23,485**	**4,125**

22 Financial risk management (continued)

	Loans and advances to customers			
	Mortgages – TSB Franchise	Mortgages – Mortgage Enhancement	Other	Total
		(£m)		
31 December 2012				
Neither past due nor impaired	18,174	3,135	2,439	23,748
Past due but not impaired	337	46	53	436
Impaired – no provision required	71	—	—	71
Provision held	84	—	115	199
Gross	**18,666**	**3,181**	**2,607**	**24,454**
Allowance for impairment losses	(22)	(1)	(83)	(106)
Total loans and advances	**18,644**	**3,180**	**2,524**	**24,348**

	Loans and advances to customers			
	Mortgages – TSB Franchise	Mortgages – Mortgage Enhancement	Other	Total
		(£m)		
31 December 2011				
Neither past due nor impaired	17,897	2,561	2,559	23,017
Past due but not impaired	335	92	63	490
Impaired – no provision required	91	2	—	93
Provision held	112	—	153	265
Gross	**18,435**	**2,655**	**2,775**	**23,865**
Allowance for impairment losses	(22)	(1)	(119)	(142)
Total loans and advances	**18,413**	**2,654**	**2,656**	**23,723**

Loans and advances which are neither past due nor impaired

	Loans and advances to customers				
	Mortgages – TSB Franchise	Mortgages – Mortgage Enhancement	Other	Total	Loans and advances to banks
			(£m)		
31 December 2013					
Good quality	17,243	3,387	1,662	22,292	4,125
Satisfactory quality	21	—	535	556	—
Lower quality	—	—	56	56	—
Below standard, but not impaired	—	—	59	59	—
Total loans and advances which are neither past due nor impaired	**17,264**	**3,387**	**2,312**	**22,963**	**4,125**
31 December 2012					
Good quality	18,138	3,132	1,896	23,166	—
Satisfactory quality	33	3	433	469	—
Lower quality	3	—	51	54	—
Below standard, but not impaired	—	—	59	59	—
Total loans and advances which are neither past due nor impaired	**18,174**	**3,135**	**2,439**	**23,748**	**—**
31 December 2011					
Good quality	17,850	2,559	1,833	22,242	—
Satisfactory quality	43	2	564	609	—
Lower quality	3	—	70	73	—
Below standard, but not impaired	1	—	92	93	—
Total loans and advances which are neither past due nor impaired	**17,897**	**2,561**	**2,559**	**23,017**	**—**

22 Financial risk management (continued)

Classifications of retail lending incorporate 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.

Loans and advances which are past due but not impaired

	Loans and advances to customers				
	Mortgages – TSB Franchise	Mortgages – Mortgage Enhancement	Other	Total	Loans and advances to banks
			(£m)		
31 December 2013					
0-30 days	161	—	33	194	—
30-60 days	65	—	14	79	—
60-90 days	40	—	2	42	—
90-180 days	60	—	4	64	—
Over 180 days	—	—	—	—	—
Total loans and advances which are past due but not impaired	**326**	**—**	**53**	**379**	**—**
31 December 2012					
0-30 days	167	44	42	253	—
30-60 days	71	1	11	83	—
60-90 days	42	1	—	43	—
90-180 days	57	—	—	57	—
Over 180 days	—	—	—	—	—
Total loans and advances which are past due but not impaired	**337**	**46**	**53**	**436**	**—**
31 December 2011					
0-30 days	166	83	47	296	—
30-60 days	69	4	15	88	—
60-90 days	47	2	1	50	—
90-180 days	53	3	—	56	—
Over 180 days	—	—	—	—	—
Total loans and advances which are past due but not impaired	**335**	**92**	**63**	**490**	**—**

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

Derivative assets

An analysis of derivative assets is presented in note 13. All derivative financial instruments entered into by the TSB Bank Group are interest rate swaps with Lloyds Bank. The TSB Bank Group did not hold any derivative financial instruments at 31 December 2012 and 2011.

(c) Collateral held as security for financial assets

The TSB Bank 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 loan-to-value ratio of the TSB Bank Group's residential mortgage lending is provided below. The value of collateral used in determining the loan-to-value 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.

22 Financial risk management (continued)

	TSB Franchise			Mortgage Enhancement			
	Neither past due nor impaired	Past due but not impaired	Impaired	Neither past due nor impaired	Past due but not impaired	Impaired	Total Gross
				(£m)			
At 31 December 2013							
Less than 70%	11,449	165	60	2,497	—	—	14,171
70% to 80%	3,036	52	21	889	—	—	3,998
80% to 90%	1,658	46	19	1	—	—	1,724
90% to 100%	692	31	16	—	—	—	739
Greater than 100%	429	32	23	—	—	—	484
Total	**17,264**	**326**	**139**	**3,387**	**—**	**—**	**21,116**
At 31 December 2012							
Less than 70%	10,042	144	56	1,599	23	—	11,864
70% to 80%	3,606	54	22	988	14	—	4,684
80% to 90%	2,392	50	16	537	9	—	3,004
90% to 100%	1,212	37	22	9	—	—	1,280
Greater than 100%	922	52	39	2	—	—	1,015
Total	**18,174**	**337**	**155**	**3,135**	**46**	**—**	**21,847**
At 31 December 2011							
Less than 70%	9,923	139	77	1,254	45	1	11,439
70% to 80%	3,671	57	28	776	28	—	4,560
80% to 90%	2,143	51	27	500	18	1	2,740
90% to 100%	1,304	40	25	24	1	—	1,394
Greater than 100%	856	48	46	7	—	—	957
Total	**17,897**	**335**	**203**	**2,561**	**92**	**2**	**21,090**

Unsecured retail and small business

At 31 December 2013, unimpaired unsecured retail and small business lending amounted to £2,365 million (2012: £2,492 million, 2011: £2,622 million).

At 31 December 2013, impaired unsecured lending amounted to £46 million, net of an impairment allowance of £56 million (2012: £51 million, net of an impairment allowance of £64 million, 2011: £59 million, net of an impairment allowance of £94 million). Non-mortgage retail lending is unsecured, with no collateral held in respect of retail credit cards, overdrafts or unsecured personal loans.

For small businesses 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 2013, credit risk is mitigated by collateral held of £245 million.

(d) Collateral repossessed

	2013	2012	2011
		(£m)	
Residential property	13	17	17
	13	**17**	**17**

In respect of retail portfolios, the TSB Bank 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.

22 Financial risk management (continued)

(e) Treatment of customers experiencing financial stress

The TSB Bank Group operates a number of schemes to assist borrowers who are experiencing financial stress. The material elements of these schemes through which the TSB Bank Group has granted a concession, whether temporarily or permanently, are set out below.

Types of forbearance

The TSB Bank Group classifies the treatments offered to retail customers who have experienced financial difficulty into the following categories:

- Reduced contractual monthly payment: a temporary account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payments, for example temporary interest-only arrangements and short-term payment holidays granted in collections. Any arrears existing at the commencement of the arrangement are retained.
- Reduced payment arrangements: a temporary arrangement for customers in financial distress where arrears accrue at the contractual payment, for example short-term arrangements to pay.
- Term extensions: a permanent account change for customers in financial distress where the overall term of the loan is extended, resulting in a lower contractual monthly payment.
- Repair: a permanent account change used to repair a customer's position when they have emerged from financial difficulty, for example capitalisation of arrears.

Forbearance identification and classification

The TSB Bank Group classifies a retail account as forborne at the time a customer in financial difficulty is granted a concession. Accounts are classified as forborne only for the period of time which the exposure is known to be, or may still be, in financial difficulty. Where temporary forbearance is granted, exit criteria are applied to include accounts until they are known to no longer be in financial difficulty. Where the treatment involves a permanent change to the contractual basis of the customer's account such as a capitalisation of arrears or term extension, the Bank classifies the balance as forborne for a period of 24 months, after which no distinction is made between these accounts and others where no change has been made.

Collective impairment assessment of retail secured loans subject to forbearance

Loans which are forborne are grouped with other assets with similar risk characteristics and assessed collectively for impairment as described below. The loans are not considered as impaired loans unless they meet the TSB Bank Group's definitions of an impaired asset.

The TSB Bank Group's approach is to ensure that provisioning models, supported by management judgement, appropriately reflect the underlying loss risk of exposures. The TSB Bank Group uses sophisticated behavioural scoring to assess customers' credit risk. The underlying behavioural scorecards consider many different characteristics of customer behaviour, both static and dynamic, from internal sources and also from credit bureaux data, including characteristics that may identify when a customer has been in arrears on products held with other firms. Hence, these models take a range of potential indicators of customer financial distress into account.

The performance of such models is monitored and challenged on an ongoing basis, in line with the TSB Bank Group's model governance policies. The models are also regularly recalibrated to reflect up to date customer behaviour and market conditions. Specifically, regular detailed analysis of modelled provision outputs, for the secured portfolio, is undertaken to demonstrate that the risk of forbearance or other similar activities is recognised, that the outcome period adequately captures the risk and that the underlying risk is appropriately reflected. Where this is not the case, additional provisions are applied to capture the risk.

22 Financial risk management (continued)

Collective impairment assessment of retail unsecured loans and advances subject to forbearance

Credit risk provisioning for the retail unsecured portfolio is undertaken on a purely collective basis. The approach used is based on segmented cash flow models, divided into two primary streams for loans judged to be impaired and those that are not. Accounts subject to repayment plans and collections refinance loans are among those considered to be impaired.

For exposures that are judged to be impaired, provisions are determined through modelling the expected cure rates, write-off propensity and cash flows with segments explicitly relating to repayment plans and refinance loan treatments. Payments of less than the monthly contractual amount are reflected in reduced cash flow forecasts when calculating the impairment allowance for these accounts.

The outputs of the models are monitored and challenged on an ongoing basis. The models are run monthly meaning that current market conditions and customer processes are reflected in the output. Where the risks identified are not captured in the underlying models, appropriate additional provisions are made.

Market risk

Interest rate risk

Definition and Exposure

Market risk is the risk that the TSB Bank Group's earnings or regulatory capital is adversely impacted by movements in interest rates. Interest rate positions primarily arise from mismatches in the re-pricing profile of the TSB Bank Group's banking liabilities and assets.

Liabilities are either insensitive to interest rate movements or are sensitive to interest rate changes but bear rates which may be varied at the TSB Bank Group's discretion which, for competitive reasons, generally reflect changes in the Bank of England's base rate. There is a relatively small volume of deposits whose rate is contractually fixed for their term to maturity. Many banking assets are, however, sensitive to interest rate movements. For example, a large proportion are managed rate assets such as variable rate mortgages which may be considered as a natural offset to the interest rate risk arising from the managed rate liabilities. A proportion of the TSB Bank Group's lending assets bear interest rates which are contractually fixed for periods of up to five years or longer.

During 2011, 2012 and in the 10 months to October 2013, the management of interest rate risk was undertaken by Lloyds Banking Group on behalf of the TSB Bank Group. On 1 November 2013, the TSB Bank Group established its own treasury function, assumed direct responsibility for the management of the TSB Bank Group's interest rate risk management activities and entered into a series of derivatives with Lloyds Bank designed to reflect the continuity of the TSB Bank Group's economic hedging approach. As described in note 13, the TSB Bank Group did not designate any of its derivatives in hedge accounting relationships in 2013.

Measurement and monitoring

Market risk is managed within a TSB Board-approved risk appetite and governance framework. High level market risk exposure is reported regularly to the TSB Bank Group's Asset and Liability Committee and Risk Committee.

Sensitivity Analysis

Sensitivity measures are used monthly to monitor the TSB Bank Group's market risk positions and exposure. This methodology considers all re-pricing mismatches in the balance sheet and measures the sensitivity of changes in the market values that would arise from a set of defined interest rate changes. Where re-pricing maturity is based on assumptions of customer behaviour these assumptions are also reviewed monthly. A limit structure exists to ensure that risks arising from existing positions or from changes in assumptions regarding customer behaviour remain within the TSB Bank Group's risk appetite. The following table quantifies the TSB Bank Group's sensitivities at 31 December 2013 to a change in interest rates. The table shows the impact of a 25 basis point movement in each direction. Comparatives for 2011 and 2012 are not provided as interest rate risk was managed on the TSB Bank Group's behalf by Lloyds Banking Group.

22 Financial risk management (continued)

	2013	
	Up 25 bps	Down 25 bps
	(£m)	
Market value sensitivity	2.4	(2.4)

The market value is calculated on the basis of the balance sheet with re-pricing dates adjusted according to behavioural assumptions. The above sensitivities show how this projected market value would change in response to an immediate parallel shift to all relevant interest rates – market and administered. This is a risk-based disclosure and the amounts shown would be amortised in the income statement (within 'Net interest income') over the duration of the portfolio. The measure, however, is simplified in that it assumes a parallel shift in all interest rates at the same time and by the same amount. Stress testing and scenario analysis serve to demonstrate the impact of market shocks and a slowdown in economic activity; the results provide senior management with an assessment of the financial effects that such events would have on the profitability of the TSB Bank Group.

Liquidity risk

Definition and Exposure

Liquidity risk is defined as the risk that the TSB Bank Group has insufficient financial resources to meet its financial obligations as they fall due, or can only secure them at excessive cost. Funding risk is defined as the risk that the TSB Bank Group does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient. Liquidity exposure represents the mismatch of potential outflows in any future period measured against expected inflows. Liquidity risk is managed, monitored and measured from both an internal and regulatory perspective.

During the track record period to 31 December 2013, this risk was managed on a group basis by Lloyds Banking Group and the discussion below relates to these arrangements. For changes since 31 December 2013, see Note 26.

Risk appetite

The TSB Bank Group formed part of a UK liquidity group comprising the main UK subsidiaries of the Lloyds Banking Group. This arrangement included formalised liquidity arrangements amongst the constituent entities. The Funding and Liquidity risk appetite for the TSB Bank Group is set and approved annually by the TSB Bank Group's Board in conjunction with the Lloyds Banking Group. Risk is reported against this appetite through various metrics to enable the TSB Bank Group to manage liquidity and funding constraints. The risk appetite is established under a liquidity risk management framework that ensures that the TSB Bank Group has sufficient financial resources of appropriate quality for the TSB Bank Group's funding profile.

Measurement and monitoring

A series of measures are used across the TSB Bank Group to monitor both short-term and long-term liquidity. Liquidity is measured quantitatively and qualitatively on a daily basis and reported both internally and to the Lloyds Banking Group which holds and manages liquidity for that Group's entities. Liquidity reporting is actively monitored and routine reporting is in place to senior management monthly. All Liquidity policies and procedures are subject to periodic independent internal oversight.

Sources of Funding

The TSB Bank Group's funding and liquidity position is underpinned by its significant customer deposit base. A substantial proportion of the retail deposit base is made up of customer current and savings accounts which, although repayable on demand, have historically in aggregate provided a stable source of funding.

The TSB Bank Group actively manages the structural position of the balance sheet. The loan to deposit ratio is one of the risk appetite measures that is used to monitor the shape of the balance sheet. The loan to deposit ratio has improved to 102 per cent. as at 31 December 2013, driven by strong deposit growth and stable lending portfolio (2012: 106 per cent., 2011: 109 per cent.).

22 Financial risk management (continued)

The TSB Bank Group has funding arrangements in place which formalise the basis of funding received from Lloyds Bank, a parent company. These include an arrangement which involves lending funds to Lloyds Bank in order to manage liquidity risk. These arrangements have continued throughout the year.

Liquidity portfolio

The TSB Bank Group manages liquidity internally as a single pool; the portfolio comprises highly liquid unencumbered assets available and immediately accessible to meet cash outflows. Following the introduction of the PRA individual liquidity guidance under ILAS, the TSB Bank Group now manages its liquidity position internally as a coverage ratio (proportion of stressed outflows covered by primary liquid assets).

Contractual maturities for financial liabilities form an important source of information for the management of liquidity risk. The table below analyses the financial liabilities of the TSB Bank Group by relevant maturity grouping on an undiscounted future cash flow basis based on the remaining period at the balance sheet date. Balances with no fixed maturity are included in the "over 5 years" category. Derivative financial instruments are all expected to be settled on a net basis. Certain balances, included in the table below on the basis of their residual maturity, are repayable on demand upon payment of a penalty.

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
			(£m)			
At 31 December 2013						
Customer deposits	20,706	753	613	1,119	—	23,191
Items in the course of transmission to banks	64	—	—	—	—	64
Gross settled derivatives – inflows	5	12	41	218	7	283
Gross settled derivatives – outflows	(4)	(9)	(40)	(134)	(6)	(193)
Total non-derivative financial liabilities	**20,771**	**756**	**614**	**1,203**	**1**	**23,345**

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
			(£m)			
At 31 December 2012						
Customer deposits	20,703	163	971	1,189	—	23,026
Items in the course of transmission to banks	62	—	—	—	—	62
Total non-derivative financial liabilities	**20,765**	**163**	**971**	**1,189**	**—**	**23,088**

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
			(£m)			
At 31 December 2011						
Customer deposits	19,706	264	997	982	—	21,949
Items in the course of transmission to banks	57	—	—	—	—	57
Total non-derivative financial liabilities	**19,763**	**264**	**997**	**982**	**—**	**22,006**

	Within 1 year	1-3 years	3-5 years	Over 5 years	Total
			(£m)		
At 31 December 2013					
Lending commitments	3,450	—	—	—	3,450
Total contingents and commitments	**3,450**	**—**	**—**	**—**	**3,450**
At 31 December 2012					
Lending commitments	3,514	—	—	—	3,514
Total contingents and commitments	**3,514**	**—**	**—**	**—**	**3,514**
At 31 December 2011					
Lending commitments	3,604	—	—	—	3,604
Total contingents and commitments	**3,604**	**—**	**—**	**—**	**3,604**

22 Financial risk management (continued)

Encumbered Assets

The TSB Bank Group monitors and manages total balance sheet encumbrance via a risk appetite metric. The TSB Bank Group's encumbrance will arise from assets that are pledged as collateral against an existing liability. The TSB Bank Group currently has no assets encumbered.

Liquidity regulation

In December 2010, the Basel Committee on Banking Supervision published the 'Internal framework for liquidity risk measurement, standards and monitoring' (revised January 2013). The framework comprises two liquidity ratios: the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR). The TSB Bank Group currently calculates pro-forma Basel III liquidity ratios; these will be refined as the regulatory guidance evolves and the TSB Bank Group's associated reporting systems are enhanced.

23 Capital management

Capital is actively managed for the whole of Lloyds Banking Group at a group level. Regulatory ratios are a key factor in the TSB Bank Group's budgeting and planning processes with expected ratios reviewed by the Lloyds Banking Group Senior Asset and Liability Committee. Capital policies and procedures are subject to Board approval. As a carve-out business, capital is included within the net investment from Lloyds Banking Group as described in Note 2.

The legal entities which, in part, fell within the Perimeter complied with their regulatory capital requirements at all times.

24 Cash flow statements

(a) Change in operating assets

	2013	2012	2011
		(£m)	
Change in loans and receivables			
Change in loans and advances to banks	(4,125)	—	—
Change in loans and advances to customers	871	(589)	99
Change in derivative financial assets	(99)	—	—
Change in other operating assets	(76)	24	(23)
Change in operating assets	**(3,429)**	**(565)**	**76**

(b) Change in operating liabilities

	2013	2012	2011
		(£m)	
Change in items in the course of transmission to bank	2	5	(33)
Change in customer deposits	196	1,106	65
Change in derivative financial liabilities	86	—	—
Change in other operating liabilities	33	8	24
Change in operating liabilities	**317**	**1,119**	**56**

(c) Non-cash and other items

	2013	2012	2011
		(£m)	
Depreciation and amortisation	15	13	14
Allowance for loan losses	(8)	(36)	(38)
Other non-cash items	92	(7)	(32)
Total non-cash and other items	**99**	**(30)**	**(56)**

24 Cash flow statements (continued)

(d) Analysis of cash and cash equivalents as shown in the balance sheet

	2013	2012	2011
		(£m)	
Cash and balances with central banks	200	205	196
Less: mandatory reserve deposits[1]	(26)	(24)	(24)
Total cash and cash equivalents	**174**	**181**	**172**

Note:

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

25 Future accounting developments

Pronouncement	Nature of Change	IASB effective date
IFRS 9: "Financial Instruments"[1]	Replaces those parts of IAS 39 "*Financial Instruments: Recognition and Measurement*" relating to the classification, measurement and derecognition of financial assets, liabilities and hedge accounting. IFRS 9 requires financial assets to be classified into two measurement categories, fair value and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instruments and eliminates the available-for-sale financial asset and held-to-maturity investment categories in IAS 39. The requirements for derecognition are broadly 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. The hedge accounting requirements are more closely aligned with risk management practices and follow a more principle-based approach.	At its November 2013 meeting, the IASB tentatively chose a "placeholder" for the mandatory effective date as no earlier than annual periods beginning on or after 1 January 2018.
IFRIC Interpretation 21 'Levies'	Clarifies the obligating event that gives rise to a liability to pay a government levy is the activity that triggers the payment of the levy as set out in the relevant legislation. An entity does not have a constructive obligation to pay a levy that will be triggered by operating in a future period. This interpretation will not have an impact on the TSB Bank Group as current accounting is in line with IFRIC 21 and IAS 37 "*Provisions, Contingent Liabilities and Contingent Assets*".	Annual periods beginning on or after 1 January 2014.

Note:

(1) IFRS 9 is the standard which will replace IAS 39. Further changes to IFRS 9 are expected, dealing with impairment of financial assets measured at amortised cost, which will be based on expected rather than incurred credit losses, and limited amendments to classification and measurement which include the

25 Future accounting developments (continued)

introduction of a third measurement category, fair value through other comprehensive income. Until the standard is complete, it is not possible to determine the overall impact of the standard on the financial statements.

26 Post balance sheet events

On 9 June 2014, TSB Bank signed a Transitional Services Agreement ("TSA") and Long Term Services Agreement ("LTSA") for the provision of a variety of support services to TSB expiring on 31 December 2016 and no later than 30 June 2024 respectively. The TSA and LTSA will replace the indirect cost allocations from Lloyds Banking Group which have been allocated within the HFI as disclosed in note 8.

The employees allocated to the TSB Bank Group transferred from employment with Lloyds Banking Group companies to TSB Bank under the Transfer of Undertakings (Protection of Employment) Regulations 2006 on 31 March 2014. Certain of those employees participated in Lloyds Banking Group's defined benefit pension schemes before transfer. The transferring employees ceased to participate in Lloyds Banking Group's defined benefit pension schemes on 31 March 2014 when their employment transferred to TSB. TSB Bank does not have any liabilities in respect of the Lloyds Banking Group defined benefit pension schemes and is not required to make any contributions to the schemes. This has the impact of removing the entire pensions deficit from the balance sheet. From 1 April 2014, the TSB Bank Group contributed to defined contribution schemes only.

On 20 May 2014, TSB Bank entered into a £2,500 million Retail Mortgage Backed Security facility (the "RMBS Funding Facility"). £10 million of the RMBS Funding Facility was drawn immediately from Lloyds Bank with a further £240 million of the RMBS Funding Facility drawn from Lloyds Bank on 2 June 2014; on the same date TSB repaid the unsecured funding facility of £1,535 million that had been put in place on 4 March 2014. The terms of the RMBS Funding Facility included a commitment fee of 30 basis points ("bps") and a charge of three month LIBOR plus 60 bps on amounts drawn.

A holding company ("TSB Banking Group plc") was incorporated on 31 January 2014 with subscriber share capital of £50,000, being 50,000 ordinary shares of £1. The shares were subsequently split, with 100 ordinary shares of one pence being created for each ordinary share of £1. On 25 April 2014, it acquired the entire share capital of TSB Bank from Lloyds Bank for consideration of a further 50,000,000 Ordinary Shares of one pence each. On 19 May 2014, share capital was further increased by the issue of 445 million ordinary shares of one pence by TSB Banking Group plc to Lloyds Bank for cash consideration of £200 million. TSB Bank then issued 445 million ordinary shares of one pence to TSB Banking Group plc for cash consideration of £200 million.

Following resolution by the Board, and approval from the Prudential Regulation Authority, the Chairman was appointed as a director of TSB Bank on 13 February 2014 and as a director of TSB Banking Group plc on 7 March 2014. Following resolution by the Board, and approval from the Prudential Regulation Authority, five non-executive Directors were appointed to TSB Banking Group plc on 16 May 2014 and a further non-executive Director was appointed on 6 June 2014, conditional upon, and from the date of receipt of, PRA approvals.

On 1 May 2014, Tier 2 Securities were settled by Lloyds Bank for net proceeds of £383 million. TSB Bank plc then issued a similar instrument to TSB Banking Group plc for net proceeds of £383 million. After taking account the impact of the interest rate swap entered into on the same date, the Tier 2 Securities incur interest at 3 month LIBOR plus 354 bps.

On 1 May 2014, TSB Bank left the liquidity group headed by Lloyds Banking Group and established its own liquid asset buffer with the Bank of England.

27 Ultimate controlling party

The ultimate controlling party of the TSB Bank Group is Lloyds Banking Group plc which is incorporated in Scotland. Copies of the consolidated annual report and accounts of Lloyds Banking Group plc may be obtained from Lloyds Banking Group's head office at 25 Gresham Street, London EC2V 7HN or downloaded via www.lloydsbankinggroup.com.

PART XVII
CONDENSED COMBINED INTERIM FINANCIAL INFORMATION (UNAUDITED)

The condensed combined interim financial information in this Part XVII has not been audited and no review report has been prepared or issued in respect thereof.

Statement of Comprehensive Income for the three months ended 31 March 2014

	Note	Three months ended 31 March 2014 *(unaudited)*
		(£m)
Interest and similar income		254
Interest and similar expense		(68)
Net interest income	5	**186**
Fee and commission income		52
Fee and commission expense		(15)
Net fee and commission income		37
Other operating income		1
Other income		**38**
Total income		**224**
Operating expenses	6	(121)
Impairment losses on loans and advances to customers		(27)
Profit before taxation		**76**
Taxation		(16)
Profit for the period		**60**
Other comprehensive income		
Items that will not be reclassified subsequently to profit or loss:		
Post-retirement defined benefit scheme re-measurements before taxation		—
Taxation		—
Other comprehensive income for the period, net of taxation		
Total comprehensive income for the period		**60**

Balance Sheet as at 31 March 2014

	Note	As at 31 March 2014 *(unaudited)*	As at 31 December 2013 *(audited)*
		(£m)	
Assets			
Cash and balances at central banks		159	200
Items in course of collection from banks		203	116
Loans and receivables:			
Loans and advances to banks		2,766	4,125
Loans and advances to customers – TSB Franchise		19,749	20,099
Loans and advances to customers – Mortgage enhancement		3,290	3,386
Loans and advances to customers – total	7	23,039	23,485
Derivative financial instruments		84	99
Property, plant and equipment		120	123
Deferred tax assets		122	135
Other assets		68	50
Total assets		**26,561**	**28,333**
Liabilities			
Deposits from banks	8	1,535	—
Customer deposits	9	23,260	23,105
Items in course of transmission to banks		140	64
Derivative financial instruments		67	86
Other liabilities		116	86
Retirement benefit obligations		—	33
Current tax liabilities		7	5
Other provisions		12	12
Total liabilities		**25,137**	**23,391**
Net investment from Lloyds Banking Group		1,424	4,942
Net investment from Lloyds Banking Group and liabilities		**26,561**	**28,333**

Statement of Change in Net Investment from Lloyds Banking Group for the three months ended 31 March 2014

	Three months ended 31 March 2014 *(unaudited)*
	(£m)
Balance at 1 January	4,942
Comprehensive income	
Profit for the period	60
Other comprehensive income	—
Total comprehensive income	**60**
Transactions with Lloyds Banking Group:	
Net funding provided to Lloyds Banking Group	(3,578)
Balance at 31 March	**1,424**

Notes to the Interim Financial Information for the three months ended 31 March 2014

1 Introduction

The unaudited interim financial information for TSB Bank Group for the three months ended 31 March 2014 set out below contains selected primary statements and note disclosures and should be read in conjunction with the basis of preparation set out in note 2 to the historical financial information in Part XVI: "*Historical Financial Information*". This interim financial information has not been prepared in accordance with the full disclosure requirements of International Accounting Standard 34 – *"Interim Financial Reporting"*. In particular, comparative financial information for the three-month period ended 31 March 2013 has not been presented due to the fact that, prior to separation, TSB Bank Group's business was managed as part of Lloyds Banking Group and many of its operations and central functions were highly integrated with the Lloyds Banking Group business. There are, therefore, a number of items contained within the historical financial track record for the three years to 31 December 2013 that will either not be reflected in the first three months to 31 March 2014 or will be subject to further change thereafter. Further information on the effects of these items is set out in Part XIII: "*Operating and Financial Review – Comparability of Historical Financial Information and Future Results*".

2 Accounting policies

The accounting policies adopted are consistent with those of the historical financial information for the year ended 31 December 2013, with the exception that taxes on income in the interim periods are accrued using the tax rate that would be applicable to expected total annual profit or loss.

3 Financial risk management

From 1 January 2014, the TSB Bank Group designated derivative financial instruments as hedges under IAS 39 "*Financial Instruments: Recognition and Measurement*". 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. 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.

A proportion of the TSB Bank Group's derivatives are designated as hedges of the fair value of the particular risks inherent in recognised assets or liabilities (fair value hedges). Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the statement of comprehensive income, 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 statement of comprehensive income. The cumulative adjustment that has been made to the carrying amount of the hedged item is amortised to the statement of comprehensive income using a straight-line method over the period to maturity.

4 Segmental analysis

IFRS 8 "*Operating Segments*" requires operating segments to be identified on the basis of internal reports and components of the TSB Bank Group regularly reviewed by the chief operating decision-maker to allocate resources to segments and to assess their performance. For this purpose, the chief operating decision-maker of the TSB Bank Group is the Executive Committee.

Operating segments are reported in a manner which is consistent with internal reporting provided to the chief operating decision-maker as follows:

- TSB Franchise – comprising the retail banking business carried out in the UK under the TSB brand.
- Mortgage enhancement – a separate portfolio of mortgage assets which are beneficially owned by the TSB Bank Group (as of 28 February 2014), but managed by Bank of Scotland and not branded as TSB. This portfolio was legally transferred to TSB Bank plc during the period for a consideration of £3,359 million.

4 Segmental analysis (continued)

A number of volatile or one-off factors have a significant effect on the results of TSB Bank plc. For the purposes of management's internal reporting, these items are excluded from the appropriate statutory financial statement line items to derive an underlying profit. The segmental disclosure below is presented in accordance with the internal reporting of the TSB Bank Group ("**Management Basis**"). This is considered by management to provide a more meaningful view of business performance. The reconciliations and footnotes to the disclosure explain how the Management Basis reconciles to the statement of comprehensive income.

	Management Basis		
Three months ended 31 March 2014 *(unaudited)*	**TSB Franchise**	**Mortgage enhancement**	**Total**
		(£m)	
Net interest income[1]	179	16	195
Other income (net of fee and commission expense)[2]	37	—	37
Total underlying income	**216**	**16**	**232**
Operating expenses	(153)	—	(153)
Impairment loss on loans and advances to customers	(27)	—	(27)
Underlying profit[3]	**36**	**16**	**52**
Fair value movements on instruments held at fair value			(8)
Gain on settlement of defined benefit pension scheme			32
Profit before taxation			**76**
Taxation			(16)
Profit after taxation			**60**
Total assets	23,271	3,290	26,561
Total liabilities	23,602	1,535	25,137

Notes:

(1) Net interest income for the three months ended 31 March 2014 includes interest received on interest rate derivatives that are not in designated hedging relationships of £9 million, which is presented in other income within the statement of comprehensive income.

(2) Other income within the statement of comprehensive income for the three months ended 31 March 2014 includes fair value losses of £8 million relating to interest rate derivatives that are not in designated hedging relationships. For the purposes of the segment presentation of results, this loss is recorded below underlying profit.

(3) Underlying profit is presented excluding fair value movements on instruments held at fair value and gain on settlement of the defined benefit pension scheme liability. Both adjustments reflect the basis on which the results are reported to the Executive Committee.

5 Net interest income

	Three months ended 31 March 2014 *(unaudited)*
	(£m)
Interest and similar income:	
Loans and advances to banks	5
Loans and advances to customers – TSB Franchise	217
Loans and advances to customers – Mortgage enhancement	32
Total interest and similar income	**254**
Interest and similar expense:	
Customer deposits	(52)
Deposits from banks	(1)
Funding costs and funds transfer pricing charge – Mortgage enhancement	(15)
Total interest and similar expense	**(68)**
Net interest income	**186**

6 Operating expenses

The employees of the business transferred from employment with Lloyds Banking Group companies to TSB Bank under the Transfer of Undertakings (Protection of Employment) Regulations 2006 on 31 March 2014. The staff costs of these employees are included in the income statement for the three months ended 31 March 2014 and comparative historical financial information. Following the transfer of employees from Lloyds Banking Group companies to TSB Bank, the transferring employees have ceased to participate in any Lloyds Banking Group defined benefit pension scheme on joining TSB Bank. This has resulted in the following changes: the defined benefit scheme assets and liabilities have been de-recognised from the TSB Bank balance sheet and settled with nil cash consideration resulting a one off gain of £32 million; the defined benefit scheme charge has been replaced with a defined contribution scheme cost.

A Transitional Services Agreement ("**TSA**") between Lloyds Bank and TSB Bank was agreed on 9 June 2014 for the provision of a variety of support services to TSB Bank for the period to 31 December 2016. This has resulted in a cessation of recharges from Lloyds Banking Group, which in aggregate were £265 million for the year ended 31 December 2013 and which have been replaced by TSA contract costs. The agreed core service charge under the TSA is £92 million per annum (subject to an adjustment for pass-through costs in 2014 and inflation thereafter).

	Three months ended 31 March 2014 *(unaudited)*
	(£m)
Staff costs:	
Wages and salaries	56
Social security costs	6
Pensions and other post-retirement benefit schemes – defined contribution	4
Pensions and other post-retirement benefit schemes – defined benefit	5
Settlement gain on withdrawal from defined benefit pension	(32)
Other	10
	49
Premises and equipment:	
Rent and rates	11
Repairs and maintenance	2
Other	5
Other expenses:	
Group recharges based on the Transitional Service Agreement Schedule	26
Indirect central costs	—
Other	24
	68
Depreciation and amortisation:	
Depreciation of property, plant and equipment	4
Total operating expenses	**121**

7 Loans and advances to customers

	31 March 2014 *(unaudited)*	31 December 2013 *(audited)*
	(£m)	
Mortgages – TSB Franchise	17,415	17,729
Mortgages – Mortgage enhancement	3,290	3,387
Total mortgages	20,705	21,116
Personal unsecured	2,116	2,143
Small business banking	313	324
Total loans and advances to customers before allowance for impairment losses	**23,134**	**23,583**
Allowance for impairment losses	(95)	(98)
Total loans and advances to customers	**23,039**	**23,485**

8 Deposits from banks

	31 March 2014 *(unaudited)*	31 December 2013 *(audited)*
	(£m)	
Mortgage Enhancement funding	1,535	—
Total deposits from banks	**1,535**	**—**

Deposits from banks represent an unsecured funding facility drawn down from Lloyds Bank in respect of the Mortgage Enhancement portfolio.

9 Customer Deposits

	31 March 2014 *(unaudited)*	31 December 2013 *(audited)*
	(£m)	
Non-interest bearing current accounts	4,411	4,373
Interest-bearing current accounts	2,377	2,129
Savings and investment accounts	16,472	16,603
Total customer deposits	**23,260**	**23,105**

10 Reconciliation of income reported in the HFI to income recorded by TSB Bank plc legal entity

The Historical Financial Information is prepared using the basis set out in note 1 and, accordingly, there are a number of differences between income reported in the HFI and that recorded by the TSB Bank plc legal entity for the three months ended 31 March 2014. The table below sets out the reconciliation on a Management Basis consistent with the TSB Bank Group's segmental reporting between the income statement prepared under the HFI and the income statement prepared from the unaudited statutory results of TSB Bank plc.

Three months ended 31 March 2014 *(unaudited)*	**HFI (see note 4)**	**Differences**	**Statutory results of TSB Bank plc**
		(£m)	
Net interest income[1]	195	(6)	189
Other income (net of fee and commission expense[2]	37	1	38
Total underlying income	**232**	**(5)**	**227**
Operating Expenses	(153)	—	(153)
Impairment loss on loans and advances to customers	(27)	—	(27)
Underlying profit	**52**	**(5)**	**47**
Fair value movements on instruments held at fair value	(8)	—	(8)
Gain on settlement of defined benefit pension scheme[3]	32	32	64
Profit before taxation	**76**	**27**	**103**
Taxation	(16)	(5)	(21)
Profit after taxation	**60**	**22**	**82**

Notes:

(1) The Mortgage Enhancement portfolio of loans was transferred to the TSB Bank plc legal entity with an effective date of 28 February 2014 and reflects interest and similar income and expense from this date. The HFI includes interest and similar income for the three months ended 31 March 2014, and funds transfer pricing for January and February 2014, whereas the statutory results reflect the net interest income from the date of the legal transfer only. The adjustment of £6 million reflects the net interest income on the Mortgage Enhancement portfolio for January and February 2014.

(2) A gain of £1 million was recognised from the repurchase by TSB Bank plc's immediate parent company of debt securities issued by TSB Bank plc. This gain is not recorded in the HFI, because the debt securities are not included within the divesting perimeter of TSB, but have been recorded in the statutory results.

(3) The measurement of the defined benefit pension scheme liability differs between the HFI and the statutory results. The HFI is based on a carve-out of the overall Lloyds Banking Group pension position and assumes full liability for the pension costs of all eligible TSB employees up to the date of the pension settlement

10 Reconciliation of income reported in the HFI to income recorded by TSB Bank plc legal entity (continued)

explained in Note 6. The statutory results recognise the current service cost for the eligible period for the period of time during which they were employed by the TSB Bank plc legal entity and excludes certain re-measurement gains and losses which are included in the HFI. Accordingly, the settlement gain in the statutory results is £32 million higher than in the HFI.

11 Reconciliation of net investment from Lloyds Banking Group to the statutory shareholders' equity of TSB Bank plc

The HFI and Interim Financials have been prepared in accordance with IFRS and on a combined basis as described in Notes 1 and 2 to the HFI and the Interim Financials. Accordingly, the statutory shareholders' equity of the Statutory Group is not recorded on the balance sheet. The table below sets out the reconciliation between Net Investment and the statutory shareholders' equity as presented in the unaudited underlying accounting records of the Statutory Group results at 31 March 2014.

	(unaudited)
	(£m)
Net Investment from Lloyds Banking Group at 31 March 2014	1,424
Differences in basis of preparation[1]	(47)
Statutory shareholders' equity at 31 March 2014	**1,377[2]**

Notes:

(1) Differences include: £45 million relating to the treatment of certain intercompany liabilities included within net investment from Lloyds Banking Group under the HFI but within total liabilities on a statutory basis; and a net £2 million difference relating to differences in the calculation of the FSCS liability and the related current and deferred tax effects.

(2) Shareholders' equity was further increased by £200 million on 20 April 2014. The effect this increase has on the regulatory capital measures and TSB's book value is described in Part XVIII: "Unaudited Pro forma Financial Information".

12 Related party transactions

(a) Balances and transactions with fellow Lloyds Banking Group undertakings

The TSB Bank Group, as a result of its position as a member of a banking group, has a large number of transactions with several of the Parent's subsidiary undertakings; these are included on the balance sheet of the TSB Bank Group as follows:

	31 March 2014 *(unaudited)*	**31 December 2013 *(audited)***
	(£m)	
Related party assets:		
Derivatives financial instruments	84	99
Loans and advances to banks	2,766	4,125
	2,850	**4,224**
Related party liabilities:		
Deposits with banks	1,535	—
Derivative financial instruments	67	86
Retirement benefit obligations	—	33
	1,602	**119**

12 Related party transactions (continued)

Due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. During the three months ended March 2014 the TSB Bank Group incurred a net charge under the FTP mechanism and interest payable on deposits from Lloyds Banking Group of £15 million. A number of items in the statement of comprehensive income and on the balance sheet are presented as allocations of transactions of the wider Lloyds Banking Group. The net investment from Lloyds Banking Group represents a combination of the overall receivables and payables with Lloyds Banking Group, funding balances with Lloyds Banking Group and equity investment by Lloyds Banking Group in the TSB Bank Group. During the three months ended 31 March 2014, the TSB Bank Group provided £3,578 million to Lloyds Banking Group.

In addition, the TSB Bank Group received fees of £6 million and paid fees of £32 million for various services provided between the TSB Bank Group and its fellow Lloyds Banking Group members.

There are no contingent liabilities and commitments entered into on behalf of fellow Lloyds Banking Group undertakings.

Derivative financial instruments reflect the fair value of derivatives where a Group company is the counterparty to the arrangement. At 31 March 2014, all derivatives held by the TSB Bank Group have been executed with a Group company. During the period to 31 March 2014, the TSB Bank Group recognised an expense of £8 million in respect of derivative financial instruments held with a Group company.

PART XVIII
SECTION A: UNAUDITED PRO FORMA FINANCIAL INFORMATION

The unaudited pro forma net assets statement as at 31 March 2014 of the TSB Group has been prepared to illustrate the effect of certain capital, liquidity and funding actions undertaken between 31 March 2014 and Admission as if each of the foregoing had taken place on 31 March 2014.

The unaudited pro forma income statement for the three months ended 31 March 2014 of the TSB Group has been prepared to illustrate the effect of those actions as if each had taken place on 1 January 2014, the start of the financial period.

*The unaudited pro forma net assets statement and the unaudited pro forma income statement and footnotes thereto (together "**unaudited pro forma financial information**") have been prepared for illustrative purposes only and, because of their nature, address a hypothetical situation and, therefore, do not represent the TSB Group's actual financial position or results. The unaudited pro forma financial information does not constitute financial statements within the meaning of section 434 of the Companies Act 2006.*

Investors should read the whole of this Prospectus and not rely solely on the unaudited financial information contained in this Part XVIII: "Unaudited Pro forma Financial Information". PricewaterhouseCoopers LLP's report on the unaudited pro forma financial information is set out in Section B of this Part XVIII.

Unaudited pro forma net assets statement at 31 March 2014

	TSB Group as at 31 March 2014[1]	Issue of share capital and Tier 2 securities[2]	Establish standalone liquid assets[3]	Recognition of RMBS Funding Facility[4]	Pro forma Net Assets as at 31 March 2014
		(£m, except where indicated)			
Assets					
Cash and balances at central banks	159	—	1,950	—	2,109
Items in the course of collection from banks	203	—	—	—	203
Derivative financial instruments	84	—	—	—	84
Loans and advances to banks	2,766	583	(1,950)	(1,285)	114
Loans and advances to customers – Retail	19,749	—	—	—	19,749
Loans and advances to customers – Mortgage enhancement	3,290	—	—	—	3,290
Property, plant and equipment	120	—	—	—	120
Deferred tax assets	122	—	—	—	122
Other assets	68	—	—	—	68
Total assets	**26,561**	**583**	**—**	**(1,285)**	**25,859**
Liabilities					
Items in course of transmission to banks	(140)	—	—	—	(140)
Deposits from banks	(1,535)	—	—	1,535	—
Customer deposits	(23,260)	—	—	—	(23,260)
Derivative financial instruments	(67)	—	—	—	(67)
Debt securities in issue	—	—	—	(250)	(250)
Subordinated liabilities	—	(383)	—	—	(383)
Other liabilities	(116)		—	—	(116)
Current tax liabilities	(7)	—	—	—	(7)
Other provisions	(12)	—	—	—	(12)
Total liabilities	**(25,137)**	**(383)**	**—**	**1,285**	**(24,235)**
Net assets	**1,424**	**200**	**—**	**—**	**1,624**
Key capital and liquidity measures					
Risk-weighted assets[5]	7,401	117	(390)	(257)	6,871
Common Equity Tier 1 Capital Ratio[5]	17.3%				21.6%
Total Capital Ratio[5]	17.3%				27.1%
Leverage Ratio[6]	4.7%				5.6%
Liquidity Coverage Ratio[7]	—				146%

Unaudited pro forma income statement for the three months ended 31 March 2014

	TSB Group Income Statement for the three months ended 31 March 2014[8]	Issue of share capital and Tier 2 securities[2]	Recognition of RMBS Funding Facility[4]	Pro forma Income Statement for the three months ended 31 March 2014[8]
		(£m)		
Interest and similar income	254	1	(3)	252
Interest and similar expense	(68)	(4)	13	(59)
Net interest income	**186**	**(3)**	**10**	**193**
Fee and commission income	52	—	—	52
Fee and commission expense	(15)	—	—	(15)
Net fee and commission income	**37**	**—**	**—**	**37**
Other operating income	1	—	—	1
Other income	**38**	**—**	**—**	**38**
Total income	224	(3)	10	231
Operating expenses	(121)	—	—	(121)
Impairment loss on loans and advances to customers	(27)	—	—	(27)
Profit before taxation	**76**	**(3)**	**10**	**83**
Taxation	(16)	1	(2)	(17)
Profit for the period	**60**	**(2)**	**8**	**66**

Notes:

(1) The net assets position of TSB Bank Group as at 31 March 2014 is extracted from the condensed combined interim financial information (unaudited) set out in Part XVII: "*Condensed Combined Interim Financial Information (Unaudited)*". The Company was incorporated on 31 January 2014 with a share capital of £50,000. The net asset statement of TSB Group as at 31 March 2014 is, therefore, equivalent to the aggregated net asset statements of TSB Bank Group and the Company at 31 March 2014.

(2) On 19 May 2014, share capital of £200 million was issued to Lloyds Bank for cash consideration. On 1 May 2014 Tier 2 Securities were settled by Lloyds Bank for net proceeds of £383 million. After taking into account the impact of an interest rate swap entered into on the same date, the Tier 2 Securities incur interest at 354 bps over three-month LIBOR. The proceeds were placed on deposit earning interest at three-month LIBOR. The impact on the net interest income for the period, had this occurred on 1 January 2014, is to decrease net interest income by £3 million.

(3) On 1 May 2014, TSB Bank Group left the defined liquidity group headed by Lloyds Banking Group and liquid assets of £1,950 million were transferred by the business to the Bank of England. Cash held at the Bank of England is assumed to earn interest at base rate. Had it occurred on 1 January 2014, the impact on the net interest income for the period would have been less than £1 million.

(4) On 20 May 2014, TSB Bank Group entered into the £2.5 billion RMBS Funding Facility. On 20 May 2014, £10 million of the facility was drawn down from Lloyds Bank. A further £240 million was drawn down from Lloyds Bank on 2 June 2014. On 2 June 2014, TSB Bank Group repaid the unsecured funding facility of £1,535 million that had been put in place on 4 March 2014, after the execution of the Mortgage Enhancement Agreements, in part through the £250 million drawn down from Lloyds Bank under the RMBS Funding Facility. The remainder of the repayment, equal to £1,285 million, was funded by liquid cash resources. The terms of the RMBS Funding Facility include a commitment fee of 30 bps on undrawn amounts and a charge of LIBOR plus 60 bps on amounts drawn as well as certain increased margins payable in certain circumstances, which may be beyond TSB's control. The increase to net interest income of £10 million is based on the assumption that the Mortgage Enhancement purchase had been funded by TSB Bank Group throughout the three months ended 31 March 2014, rather than by allocation of FTP costs from Lloyds Banking Group. The unsecured funding facility of £1,535 million at 31 March 2014 is assumed to have been replaced by £250 million of the RMBS Funding Facility and cash funding for the entire period.

(5) Key balance sheet measures include regulatory capital resources and ratios of TSB Bank Group. These measures are presented immediately before and after the transactions described in footnotes (2), (3) and (4) as if these transactions had occurred at 31 March 2014.

Risk weighted assets, Common Equity Tier 1 Capital, Common Equity Tier 1 Capital Ratio, Total Capital and Total Capital Ratio are calculated based on TSB Bank Group's interpretation of the final CRD IV text and PRA Policy Statement, PS 7/13, which outlines the approach to implementing CRD IV in the UK. The final impact of CRD IV is dependent on technical standards to be finalised by the European Banking Authority and on the final UK implementation of those rules.

RWAs have been calculated on the basis expected to be adopted by TSB Bank Group at Admission. A standardised approach is applied to all banking assets, with the exception of the TSB Franchise mortgages, which will continue to apply an IRB waiver methodology. RWAs for loans and advances to banks are calculated on the basis that cash is held with external banks, receiving a 20 per cent. risk weight. Note that this method differs from the actual capital position of TSB Bank Group at 31 March 2014, which treats cash held with Lloyds Banking Group as an intragroup asset.

TSB Bank Group's Common Equity Tier 1 Capital and Tier 2 Capital at 31 March 2014 are calculated as follows:

	Capital resources	Issue of share capital and Tier 2 securities[2]	Pro forma capital resources
Share capital and premium	75	200	275
Reserves	1,220	—	1,220
Shareholders' equity	**1,295**	**200**	**1,495**
Excess expected loss adjustments	(14)	—	(14)
Common Equity Tier 1 Capital	**1,281**	**200**	**1,481**
Debt securities in issue	—	383	383
Excess default provisions	—	1	1
Tier 2 capital	**—**	**384**	**384**
Total capital	**1,281**	**584**	**1,865**

Shareholders' equity for use in calculation of the Common Equity Tier 1 Capital represents the statutory equity and reserves of TSB Bank Group at 31 March 2014, but is adjusted to exclude unverified profits for the three months ended 31 March 2014. Were these profits to be verified and included, the total shareholders' equity on a pro forma basis would be £1,577 million. A difference of £47 million exists between this balance and the pro forma net assets of £1,624 million and is described in note 11 of the condensed combined interim financial information (unaudited) as set out in Part XVII of this Prospectus.

(6) TSB Bank Group's Leverage Ratio is calculated in accordance with TSB Bank Group's interpretation of the final CRD IV text and is defined as the ratio of Common Equity Tier 1 Capital, described in footnote (5), to the total of assets, off balance sheet exposures and excess expected loss, as defined by the CRD IV text, totalling £27,249 million on an unadjusted basis and £26,547 million on a pro forma basis. The decrease of £702 million is identical to the decrease in total assets of £702 million set out in the unaudited pro forma net assets statement.

(7) TSB Bank Group's Liquidity Coverage Ratio is calculated in accordance with TSB Bank Group's interpretation of the Basel III guidance issued in January 2013 and is calculated as the stock of high quality liquid assets (£1,950 million on a pro forma basis) expressed as a percentage of net cash outflows over a 30-day period (£1,337 million). Liquidity Coverage Ratio is not presented on an unadusted basis as at 31 March 2014, because it is not a meaningful figure prior to TSB's exit from the Lloyds Banking Group defined liquidity group, described in note (3).

(8) The Income Statement of TSB Bank Group for the three months ended 31 March 2014 is the condensed combined interim financial information (unaudited) set out in Part XVII: "*Condensed Combined Interim Financial Information (Unaudited)*". The Company has not traded since incorporation and, therefore, the income statement of TSB Group for the three months ended 31 March 2014 is equivalent to the aggregated income statements of TSB Bank Group and the Company for the same period.

(9) All of the adjustments which impact the pro forma Income Statement are continuing. No account has been made of any trading activity post 31 March 2014.

The Directors
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25 Bank Street
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9 June 2014

Dear Sirs

TSB Banking Group plc (the "Company")

We report on the pro forma financial information (the "**Pro forma financial information**") set out in Part XVIII: "*Unaudited Pro forma Financial Information*" of the Company's prospectus dated 9 June 2014 (the "**Prospectus**"), which has been prepared on the basis described in the notes to the Pro forma financial information, for illustrative purposes only, to provide information about how the proposed admission of the ordinary shares of the Company to the Official List maintained by the Financial Conduct Authority (the "**FCA**") and the proposed admission of those shares to trading on the London Stock Exchange's main market for listed securities, might have affected the financial information presented on the basis of the accounting policies to be adopted by the Company in preparing the financial statements for the period ending 31 December 2014. This report is required by item 7 of Annex II to the PD Regulation and is given for the purpose of complying with that PD Regulation and for no other purpose.

Responsibilities

It is the responsibility of the directors of the Company to prepare the Pro forma financial information in accordance with Annex II to the PD Regulation.

It is our responsibility to form an opinion, as required by item 7 of Annex II to the PD Regulation Rules as to the proper compilation of the Pro forma financial information and to report our opinion to you.

In providing this opinion we are not updating or refreshing any reports or opinions previously made by us on any financial information used in the compilation of the Pro forma financial information, nor do we accept responsibility for such reports or opinions beyond that owed to those to whom those reports or opinions were addressed by us at the dates of their issue.

Save for any responsibility which we may have to those persons to whom this report is expressly addressed and for any responsibility arising under item 5.5.3R(2)(f) of the Prospectus Rules to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result

PricewaterhouseCoopers LLP is a limited liability partnership registered in England with registered number OC303525. The registered office of PricewaterhouseCoopers LLP is 1 Embankment Place, London WC2N 6RH. PricewaterhouseCoopers LLP is authorised and regulated by the Financial Conduct Authority for designated investment business.

of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with item 23.1 of Annex I to the PD Regulation, consenting to its inclusion in the Prospectus.

Basis of opinion

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. The work that we performed for the purpose of making this report, which involved no independent examination of any of the underlying financial information, consisted primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments and discussing the Pro forma financial information with the directors of the Company.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Pro forma financial information has been properly compiled on the basis stated and that such basis is consistent with the accounting policies of the Company.

Our work has not been carried out in accordance with auditing standards or other standards and practices generally accepted in the United States of America or auditing standards of the Public Company Accounting Oversight Board (United States) and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.

Opinion

In our opinion:

(a) the Pro forma financial information has been properly compiled on the basis stated; and

(b) such basis is consistent with the accounting policies of the Company.

Declaration

For the purposes of Prospectus Rule 5.5.3 R(2)(f), we are responsible for this report as part of the Prospectus and we declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Prospectus in compliance with Item 1.2 of Annex I to the PD Regulation.

Yours faithfully

PricewaterhouseCoopers LLP
Chartered Accountants

PART XIX
SUPERVISION AND REGULATION

1 UK Regulators

TSB falls under the ambit of UK banking regulators and regulation.

1.1 The Prudential Regulation Authority, the Financial Conduct Authority and the Financial Policy Committee

Under the Financial Services Act 2012, a range of structural reforms to UK financial regulatory bodies were implemented, with the Financial Services Authority (for the purposes of this Part XIX, the "**FSA**") being replaced from 1 April 2013 by the following bodies: (i) the Prudential Regulation Authority; (ii) the Financial Conduct Authority; and (iii) the Financial Policy Committee.

The PRA, a subsidiary of the Bank of England, has responsibility for micro-prudential regulation of financial institutions that manage significant risks on their balance sheets, including banks, insurers and some large investment firms. The FCA has responsibility for conduct of business regulation in relation to all authorised firms and the prudential regulation of firms not regulated by the PRA. The FCA has also inherited the majority of the FSA's market regulatory functions, and it represents the UK's interests in markets regulation at the European Securities and Markets Authority. TSB Bank is authorised by the PRA and is regulated by both the PRA and the FCA.

The FPC, which sits within the Bank of England, is tasked with macro-prudential regulation, or regulation of the stability and resilience of the financial system as a whole.

For the purposes of this Part XIX, the terms "**Relevant Regulator**" and "**Relevant Regulators**" refer, as the context requires, to one or more of the PRA, FCA and/or FPC.

The PRA's general objective

In discharging its general functions, the PRA's general objective is promoting the safety and soundness of PRA-authorised persons. The PRA is required to advance this objective primarily by seeking to:

- ensure that the business of PRA-authorised persons is carried on in a way which avoids any adverse effect on the stability of the UK financial system; and
- minimise the adverse effect that the failure of a PRA-authorised person could be expected to have on the stability of the UK financial system.

When discharging its general functions in a way that advances its objectives, the PRA must, so far as is reasonably possible, act in a way which, as a secondary objective, facilitates effective competition in the markets for services provided by PRA-authorised persons carrying on regulated activities.

The FCA's objectives

When discharging its general functions of rule-making, preparing and issuing rules under the FSMA, giving general guidance or determining general policy and principles, the FCA must, so far as is reasonably possible, act in a way which is compatible with its strategic objective of ensuring that relevant markets function well, and which advances one or more of its operational objectives of:

- securing an appropriate degree of protection for consumers (the consumer protection objective);
- promoting effective competition in the interests of consumers in financial markets (the competition objective); and
- protecting and enhancing the integrity of the UK financial system (the integrity objective).

So far as is compatible with its consumer protection and integrity objectives, the FCA must discharge its general functions in a way which promotes competition.

1.2 The UK Government

The UK Government has no operational responsibility for the activities of the PRA, the FCA or the FPC. However, there are a variety of circumstances where the PRA, the FCA and the FPC will need to alert HM Treasury (as the representative of the UK Government) about possible problems, for example, in terms of the PRA, where there may be a need for a support operation or a problem arises which could cause wider economic disruption and, in terms of the FCA, where there has been a significant regulatory failure to secure appropriate consumer protection.

1.3 The Financial Ombudsman Service (the "FOS")

The Financial Services and Markets Act 2000 (the "**FSMA**") established the FOS, which determines complaints by eligible complainants in relation to authorised financial services firms, consumer credit licensees and certain other businesses in respect of activities and transactions under its jurisdiction. The FOS determines complaints on the basis of what, in its opinion, is fair and reasonable in all the circumstances of the case. The maximum level of money award by the FOS is £150,000 for complaints received by the FOS on or after 1 January 2012 (£100,000 for earlier complaints) plus interest and costs. The FOS may also make directions awards which direct the relevant business to take steps which the FOS considers just and appropriate.

2 UK Regulation

2.1 Overview of the UK financial services regulation

2.1.1 Financial Services and Markets Act 2000

The cornerstone of the regulatory regime in the UK is the FSMA, which came into force on 1 December 2001. However, the framework for supervision and regulation of banking and financial services in the UK has been, and continues to be, heavily influenced by European Union legislation.

The FSMA prohibits any person from carrying on a "regulated activity" (as defined in the FSMA) by way of business in the UK unless that person is authorised or exempt under the FSMA (the "**General Prohibition**"). Regulated activities include deposit-taking, mortgage activities (such as entering into, administering, or advising or arranging in respect of, regulated mortgage contracts), effecting and carrying out contracts of insurance as well as insurance mediation, consumer credit activities and investment activities (such as dealing in investments as principal or as agent, arranging deals in investments and managing investments).

The UK regulators are responsible for the authorisation and supervision of institutions that provide regulated financial products and services as defined in the FSMA in the UK. TSB Bank is authorised by the PRA with permission to undertake, among other things, deposit-taking, mortgage and certain investment activities. The FSMA also prohibits financial promotions in the UK unless the promotion is issued or approved by an authorised person or exempt from such requirements.

Authorised firms must at all times meet certain "threshold conditions" specified by the FSMA, which were modified to reflect the new regulatory structure under the FSA 2012. Dual-regulated firms, such as TSB Bank, need to meet both the PRA's threshold conditions and the FCA's threshold conditions. The FCA threshold conditions for PRA-authorised firms are: effective supervision; appropriate non-financial resources; suitability and business model. At a high level, the PRA threshold conditions require: (i) a firm's head office and in particular its mind and management to be in the UK if it is incorporated in the UK; (ii) a firm's business to be conducted in a prudent manner and in particular that the firm maintains appropriate financial and non-financial resources; (iii) the firm itself to be fit and proper and appropriately staffed; and (iv) the firm and its group to be capable of being effectively supervised.

2.1.2 Financial services handbooks

The FSMA (as amended by the FSA 2012) imposes an ongoing system of regulation and control on banks. The detailed rules and prudential standards set by the FCA and the

PRA are contained in various parts of their respective handbooks (the "**FCA Handbook**" and the "**PRA Handbook**", and together the "**FCA and PRA Handbooks**"). In addition, the PRA is in the process of rewriting the PRA Handbook to create the PRA Rulebook.

Once authorised, and in addition to continuing to meet the threshold conditions for authorisation, firms are obliged to comply with the FCA and PRA's Principles for Businesses, which include conducting their business with due skill, care and diligence, treating customers fairly and communicating with customers in a manner that is clear, fair and not misleading. The 11 Principles for Businesses are set out in the FCA and PRA Handbooks.

Manuals of the FCA and PRA Handbooks which are of particular relevance to banks include the PRA Rulebook, the General Prudential sourcebook ("**GENPRU**"), the Prudential sourcebook for Banks, Building Societies and Investment Firms ("**BIPRU**"), the Senior Management Arrangements, Systems and Controls sourcebook ("**SYSC**"), the Conduct of Business sourcebook ("**COBS**"), the Consumer Credit sourcebook ("**CONC**"), the Banking: Conduct of Business sourcebook ("**BCOB**") and the Mortgages and Home Finance Conduct of Business sourcebook ("**MCOB**").

2.2 Supervision and Enforcement

2.2.1 **Supervision**

Each of the PRA and the FCA has wide powers, where relevant, to supervise and intervene in, the affairs of a firm authorised and regulated under, or pursuant to, the FSMA. These powers were extended under the FSA 2012.

The nature and extent of a Relevant Regulator's supervisory relationship with a firm depends on how much of a risk the Relevant Regulator considers that firm could pose to its statutory objectives. The PRA's supervisory interventions will focus on reducing the likelihood of a firm failing and on ensuring that if it does fail, it does so in an orderly manner. The PRA has introduced the 'Proactive Intervention Framework' to support early identification of risks to a firm's viability (and enable appropriate supervisory actions to be taken to address such risks if necessary) on the basis of information collected.

When taking action, the Relevant Regulator can, for instance, require firms to provide particular information or documents to it, require the production of a report by a "skilled person" (as defined in the glossary to the FCA and PRA Handbooks), appointed by either the authorised person or the Relevant Regulator, or formally investigate a firm. Where it will advance its objectives, the PRA has a broad power of direction over qualifying unregulated parent undertakings.

2.2.2 **Enforcement**

The Relevant Regulators have the power to take a range of enforcement actions, including the ability to sanction firms and individuals carrying out functions within them. Most notably, enforcement actions may include restrictions on undertaking new business, public censure, restitution, fines and, ultimately, revocation of permission to carry on regulated activities or of an approved person's status. The Relevant Regulators can also vary or revoke the permissions of an authorised firm that has not engaged in regulated activities for 12 months, or that fails to meet the threshold conditions.

2.2.3 **Challenging the PRA/FCA**

If TSB Bank wanted to challenge the decisions of the PRA or FCA, then in many cases it could make formal representations and also bring a case to tribunal (for the purposes of this Part XIX, the "**Tribunal**"). The amendments made to the FSMA which introduced the PRA and the FCA made a number of amendments to the appeal process which have broadly reduced the powers of the Tribunal. Although the grounds for making a reference have remained unchanged, the courses of action available to the Tribunal in the event that it disagrees with the PRA have been reduced. Under the previous system, the Tribunal had the power to make its own decision in place of one made by a regulator with which it disagrees. That remains the position for a disciplinary reference or a reference in connection with specific third party rights, but the Tribunal no longer has the power to substitute its own decision for that of the regulator in a supervisory context.

2.3 Capital adequacy and European Regulatory Landscape

TSB is subject to capital adequacy requirements and guidelines adopted by the PRA for a bank, which provide for a minimum ratio of total capital to risk weighted assets, expressed as a percentage. The PRA's capital adequacy requirements and guidelines for banks are found in the PRA Handbook and new PRA Rulebook, as well as the Capital Requirements Regulation.

By way of background, in March 2000, the adoption by the European Union of the Banking Consolidation Directive and the Capital Adequacy Directive (as recast in July 2006 and subsequently amended, together the "**Capital Requirements Directive**") resulted in the consolidation of the main pan-European banking legislation into a single directive (the "**EU Banking Consolidation Directive**"). The principal intention underlying the EU Banking Consolidation Directive is the harmonisation of banking regulation and supervision throughout the EEA.

The EU Banking Consolidation Directive prescribes minimum standards in key areas and requires EEA States to give mutual recognition to each other's standards of regulation. The EU Banking Consolidation Directive establishes the "passport" concept, which amounts to freedom for a credit institution authorised in its "home" state (as defined in the EU Banking Consolidation Directive) to establish branches in, and to provide cross-border services into, other EEA States. Although credit institutions are primarily regulated in their home state by a local prudential regulator, as suggested above, the EU Banking Consolidation Directive prescribes minimum criteria for regulation of the authorisation of credit institutions and the prudential supervision applicable to them. The local prudential regulator in the UK is the PRA.

European Union legislation transposing the current risk-adjusted capital guidelines, through the Capital Requirements Directive, was partially implemented at the start of 2007, with more advanced techniques in relation to the calculation of capital requirements for credit risk and operational risk implemented at the start of 2008. The Capital Requirements Directive has since been amended by CRD II. CRD II was implemented in the UK on 31 December 2010 and includes changes to the criteria for hybrid tier 1 capital, the control of large exposures and requirements relating to securitisation transactions. The requirements for hybrid capital to count as non-core tier 1 capital were toughened, as were the relative permissible proportions of core, non-core and innovative tier 1 capital. However, CRD II provided for a certain proportion of existing instruments that do not comply with the new rules to continue to count as capital for a long transitional period. The Capital Requirements Directive was further amended by CRD III, which further tightened the capital requirements for trading books and securitisations. CRD III entered into force on 15 December 2010 and, following its implementation, the last of its provisions came into force in the UK on 16 April 2012.

The Basel Committee subsequently approved the "Basel III" proposals in 2011, including new capital and liquidity requirements intended to reinforce capital standards, with heightened requirements for global systemically important banks, and to establish minimum liquidity standards for credit institutions. In particular, the changes refer to, amongst other things, new requirements for the capital base, measures to strengthen the capital requirements for counterparty credit exposures arising from certain transactions and the introduction of a leverage ratio as well as short-term and longer-term standards for funding liquidity (the "**Liquidity Coverage Ratio**" and the "**Net Stable Funding Ratio**").

It is intended that member countries will implement the new capital standards and the new Liquidity Coverage Ratio as soon as possible (with provisions for phased implementation, meaning that the measures will not apply in full until January 2019), and the Net Stable Funding Ratio from January 2018.

The European Commission published corresponding proposals to implement Basel III through CRD IV on 20 July 2011. The CRD IV draft legislation was approved by the European Council on 21 June 2013 and published in the Official Journal on 26 June 2013.

CRD IV substantially reflects the Basel III capital and liquidity standards, although certain details remain to be clarified in further binding technical standards to be issued by the European Banking Authority. CRD IV came into force in January 2014, but will only be fully implemented by January 2019; however, the proposals allow individual Member States to implement the stricter requirements of contributing instruments and/or levels of capital more quickly than is envisaged under Basel III. In the United Kingdom, the PRA has confirmed that it will accelerate

the introduction of certain of the enhanced capital requirements under CRD IV. In accordance with the PRA's rules and supervisory statements published on 19 December 2013, the PRA will require TSB to meet certain capital targets within certain prescribed time frames, without having regard to any transitional provisions in that respect. The actual impact of CRD IV on capital ratios may be materially different as the CRD IV requirements adopted in the United Kingdom may change, whether as a result of further changes to CRD IV agreed by EU legislators, binding regulatory technical standards to be adopted by the European Banking Authority (the "**EBA**") or changes to the way in which the PRA interprets or applies these requirements to UK banks (including as regards individual model approvals granted under CRD II and III).

The PRA's supervisory statement SS 3/13 (released on 29 November 2013) and policy statement PS 7/13 (released on 19 December 2013) set out the PRA's expectations in relation to capital and leverage ratios (in the case of SS 3/13) and the quality of capital (in the case of PS 7/13). The PRA's policy statement PS 7/13 sets out, among other things, changes to the PRA rules in order to implement certain aspects of CRD IV in the UK and PS 7/13, contrary to previous indications from the PRA, stated that UK banks will be able to meet any future Pillar 2A requirements with a blend of regulatory capital, including common equity tier 1 capital, in addition to the minimum capital requirements under CRD IV.

In October 2013, the Bank of England released a discussion paper proposing a new framework for annual, concurrent stress tests of participants in the UK banking system. On 29 April 2014, the Bank of England published further details of the key elements of its proposed stress test, which the eight major UK banks and building societies will be required to undertake during the course of 2014. The results of the stress test are expected to be published towards the end of the fourth quarter of 2014 following release of the results of the concurrent EU-wide stress test being conducted by the EBA.

Furthermore, on 30 April 2014, the PRA published its policy statement PS 3/14 and supervisory statement SS 6/14, responding to its August 2013 consultation paper CP 5/13 regarding the capital buffers requirement under CRD IV. Policy statement PS 3/14 provides feedback to the responses raised following the consultation paper and sets out the PRA's final rules implementing the capital buffer requirements of the PRA; supervisory statement SS 6/14 accompanies the policy statement and sets out the PRA's expectations on the CRD IV capital buffers and provides clarifications of the PRA rules. The PRA expects to provide further information regarding the application of the buffers and their integration with Pillar 2 requirements during a consultation process to be launched later in 2014.

2.4 Recovery and resolution

In light of the crisis in the financial markets, the Banking Act received Royal Assent in February 2009 and certain provisions, including those relating to bank insolvency and bank administration, came into force at that time. The Banking Act provides the PRA, the Bank of England and HM Treasury with tools for dealing with failing institutions. These tools consist of three stabilisation options, which are designed to address a distressed bank which is failing or is likely to fail to meet the threshold conditions and which cannot be assisted through normal regulatory action or market-based solutions. The Banking Act also makes provision for special insolvency processes which authorities can utilise to deal with failing banks. For more information, see Part II: "*Risk Factors – As a result of any of the foregoing risks, TSB may be subject to the provisions of the Banking Act 2009 in the future*" for risks associated with the Banking Act.

2.5 Consumer credit regulation

Recent reforms have brought the UK consumer credit regime under the umbrella of the FSMA and transferred the responsibility for the oversight and regulation of consumer credit from the OFT to the FCA with effect from 1 April 2014. The reformed regulatory framework comprises the FSMA and its secondary legislation, retained provisions in the CCA and rules and guidance in the FCA Handbook, including the CONC (for the purposes of this section, collectively the "**New Regime**").

Under the New Regime, the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the "**RAO**") has been amended to extend the definition of "regulated activities"

to consumer credit activities including entering into a "regulated credit agreement" as lender. A regulated credit agreement is any "credit agreement" that is not an "exempt agreement". A credit agreement is any agreement between an individual or relevant recipient of credit ("A") and any other person ("B"), under which B provides A with "credit" of any amount. Credit is widely defined and includes cash loans and any other form of financial accommodation. Exempt agreements include those predominantly for the purposes of a business, those secured on land or otherwise by mortgage and those where a local authority or other specified type of organisation is the lender. Other consumer credit activities which are now regulated include credit broking, debt-related consumer credit activities, entering into a regulated consumer hire agreement as owner or lender, operating an electronic system in relation to lending and providing credit information services and credit references.

Consumer credit activities are therefore now subject to the General Prohibition and the FSMA authorisation regime discussed earlier in this Part XIX.

Key changes to the UK consumer credit regime that have arisen from this reform include:

- Authorisation: to become authorised by the FCA, firms must meet threshold conditions which are more demanding than the old regime, report more information which will be subject to greater scrutiny by the FCA and obtain pre-approval for those in key roles in the applicant firm;
- Supervision: under the New Regime there will be close supervision of firms engaged in higher risk consumer credit activities and a less intensive supervision regime for lower risk firms. Firms are subject to regular reporting requirements in relation to their consumer credit activities and the FCA will engage in thematic work in response to systemic issues;
- Rules: the CCA statutory regulations and OFT guidance were replaced by FCA general standards, rules (breaches of which can be penalised), guidance and retained consumer protections in the CCA. Guidance published by the OFT has been replicated as FCA Handbook rules so that it now has the force of law. The FSMA financial promotions regime also applies. This is more stringent than the previous CCA advertising requirements. The FCA has also imposed new financial promotion rules for high cost short term credit, cold calling and debt management companies. The financial promotions regime does not apply to second charge loans by firms that also carry on first charge residential lending, the financial promotion requirements in relation to these firms remain similar to previous requirements until they are transferred to the longer-term mortgage regime;
- Enforcement: the FCA has greater powers of enforcement than the OFT and those include bringing criminal, civil and disciplinary proceedings, power to withdraw authorisations, ban firms from financial services, suspend firms or individuals for 12 months and the power to issue unlimited fines. It is also able to use its product intervention powers in the consumer credit market which can include restrictions on product features and selling practices or product bans; and
- Complaints and redress: consumers continue to have access to the FOS. The FCA also has the power to require firms to reimburse consumers who have suffered loss due to a firm's actions.

2.5.1 **Interim permission regime**

To facilitate transition to the New Regime, the UK Government has introduced an interim permission regime.

Unauthorised firms are able to transfer into the FSMA regime first and adapt to its requirements before seeking full authorisation. Therefore while such firms were not required to be fully authorised before 1 April 2014, the FCA is still able to use considerable enforcement powers during the interim period. Firms with existing FCA or PRA authorisations were not automatically given interim permission. If such firms notified the FCA of their wish to obtain an interim permission prior to 31 March 2014, and supplied the required information in the required form by the deadline, they received an interim variation of permission to continue to carry on consumer credit activities alongside their other regulated activities. TSB Bank has obtained such interim permission.

The FCA have indicated an application period of three months (1 January 2015 to 31 March 2015) during which TSB will be required to apply for authorisation or variation of existing permissions for its consumer credit activities.

2.5.2 **European regulatory landscape**

In April 2008, the European Parliament and the Council of the European Union adopted a second directive on consumer credit (Directive 2008/48/EC) which provided that, subject to exemptions, loans not exceeding €75,000 must be regulated. This directive repealed and replaced the first consumer credit directive and required Member States to implement the directive by measures in force by 11 June 2010. Loan agreements secured by land mortgage are exempted from the consumer credit directives.

2.6 Mortgage lending

The FSMA regulates mortgage credit within the definition of "regulated mortgage contract" and also regulates certain other types of home finance. A credit agreement is a regulated mortgage contract if it is entered into on or after 31 October 2004 and, at the time it is entered into: (i) the credit agreement is one under which the lender provides credit to an individual or to trustees; (ii) the contract provides for the repayment obligation of the borrower to be secured by a first legal mortgage on land (other than timeshare accommodation) in the UK; and (iii) at least 40 per cent. of that land is used, or is intended to be used, as or in connection with a dwelling by the borrower or (in the case of credit provided to trustees) by an individual who is a beneficiary of the trust, or by a related person.

If prohibitions under the FSMA as to authorisation or financial promotions are contravened, then the relevant regulated mortgage contract (and, in the case of financial promotions, other credit secured on land) is unenforceable against the borrower without a court order. The MCOB sets out rules in respect of regulated mortgage contracts and certain other types of home finance. Under MCOB rules, an authorised firm (such as TSB Bank) is restricted from repossessing a property unless all other reasonable attempts to resolve the position have failed, which can include the extension of the term of the mortgage, product type changes and deferral of interest payments.

In March 2009, the Turner Review, "*A regulatory response to the global banking crisis*", was published and set out a detailed analysis of how the global financial crisis began along with a number of recommendations for future reforms and proposals for consultation. As part of the Turner Review, the FSA published a discussion paper outlining proposals for reform of the mortgage market.

Subsequently, the FSA commenced a wide ranging consultation on mortgage lending: the FSA's Mortgage Market Review ("**MMR**"). The MMR concluded with the publication of final rules by the FSA on 25 October 2012 that amended the existing conduct rules for mortgage lending in the FCA Handbook; the new rules came into effect on 26 April 2014.

Principal changes centre upon responsible lending and include:

- more thorough verification of borrowers' income (no self-certification of income, mandatory third party evidence of income required);
- assessment of affordability of interest-only loans on a capital and interest basis unless there is a clearly understood and believable alternative source of capital repayment;
- application of interest rate stress tests – lenders must consider likely interest rate movements over a minimum period of five years from the start of the mortgage term;
- when making underwriting assessments, lenders must take account of future changes to income and expenditure that a lender knows of or should have been aware of from information gathered in the application process; and
- lenders may base their assessment of customers' income on actual expected retirement age rather than state pension age. Lenders will be expected to assess income into retirement to judge whether the affordability tests can be met.

There are also significant changes to mortgage distribution and advice requirements in sales, arrears management and requirements on contract variations such as when additional borrowing is requested.

2.6.1 **European regulatory landscape**

The Directive on credit agreements relating to residential property, also commonly known as the Mortgage Credit Directive ("**MCD**") came into effect on 20 March 2014. The MCD was to some extent modelled on the second directive on consumer credit and requires, among other things, standard pre-contractual information, calculation of the annual percentage rate of charge in accordance with a prescribed formula, and a right of the borrower to make early repayment.

Member States have two years to implement the MCD into national law. The FCA has indicated that it intends to publish a consultation on the implementation of the MCD "mid-year" in 2014. Until the UK implementing legislation is published, it is not certain what effect the adoption and implementation of the MCD will have on TSB's mortgage businesses.

2.7 FSCS and the EU Deposit Guarantee Scheme Directive ("EU DGSD")

2.7.1 **FSCS**

The FSMA established the FSCS, which pays compensation to eligible customers of authorised financial services firms which are unable, or are likely to be unable, to pay claims against them. The levels of compensation are, for example, for claims against firms declared in default on or after 1 January 2010 (31 December 2010 for deposits): (i) for deposits, 100 per cent. of the first £85,000; (ii) for mortgage advice and arranging, 100 per cent. of the first £50,000; and (iii) for insurance, 90 per cent. of the claim with no upper limit (except that compulsory insurance is protected in full). The FSCS only pays compensation for financial loss. Compensation limits are per person, per firm and per type of claim. Directive 2009/14/EC, amending Directive 94/19/EC on deposit guarantee schemes, requires Member States to set the minimum level of compensation for deposits, for firms declared in default on or after 1 January 2011, at €100,000.

2.7.2 **EU DGSD**

The EC published a legislative proposal to revise the EU DGSD in July 2010. The main changes proposed included a tightened definition of deposits, a risk based approach to contributions from firms, a requirement that the deposit guarantee scheme repay customers within one week and that banks must be able to provide information on the aggregated deposits of a depositor at any time. The EU DGSD was adopted by the Council of the EU on 3 March 2010 and by the European Parliament on 15 April 2014. Member States will have one year to implement it into national law following its publication in the Official Journal.

An Impact Assessment conducted by the EC indicates that the revisions will impose greater administrative and financial burdens on participating firms. Direct cost increases will result from increased contributions to the schemes and greater indirect costs are likely to arise from necessary changes to procedures and IT systems. Until the UK implementing legislation is published, the specific implications for TSB's business arising from the adoption and implementation of the EU DGSD are uncertain.

2.8 Competition regulation

TSB is subject to supervision and oversight by a number of competition regulators, including the CMA, sectoral regulators and the European Commission. The FCA and the Payment Systems Regulator will, in the future, assume concurrent powers with the CMA to enforce competition rules in the UK insofar as they relate to the provision of financial services and participation in payment systems, respectively. These regulatory bodies have, or are anticipated to have, broad powers to launch market studies or conduct investigations.

The CMA is currently conducting market studies in respect of PCAs and SME banking, and the FCA has launched studies of general insurance add-ons and retirement income and cash savings plans. While the outcome of such studies, and the scope any future studies, is inherently uncertain, they may ultimately result in the application of behavioural and/or structural remedies by the regulator.

2.9 Other relevant legislation and regulation

The UK Money Laundering Regulations 2007 place a requirement on TSB to verify the identity and address of customers opening accounts with it, and to keep records to help prevent money laundering and fraud.

Guidance in respect of the Money Laundering Regulations 2007 is contained in the Guidance Notes of the Joint Money Laundering Steering Group, including in respect of the identification of new clients, record keeping and otherwise. Directive 2005/60/EC, which underpins the Money Laundering Regulations 2007, was being reviewed by the European Commission between 2010 and 2012 and it found that there were no fundamental shortcomings in the regime.

In response to the European Commission's review, broad support was expressed for the proposed alignment to the revised 'Financial Action Task Force' standards and for greater clarification of certain issues, in particular in the area of data protection and cross-border transactions. In February 2013, the European Commission adopted proposals for a directive on the prevention of the use of the financial systems for the purpose of money laundering and terrorism financing and a regulation on information accompanying transfer of funds to secure due traceability of these transfers.

The UK Data Protection Act 1998 regulates the processing of data relating to individual customers.

The UK Unfair Terms in Consumer Contracts Regulations 1999 (together with, insofar as applicable, the Unfair Terms in Consumer Contracts Regulations 1994) apply to consumer contracts entered into on or after 1 July 1995. The main effect of these regulations is that a contract term which is "unfair" will not be enforceable against a consumer. This applies to, among other things, mortgages and related products and services. The FCA has issued statements of good practice in this regard in May 2005, January 2007 and January 2012, and works with the CMA to allocate responsibility for regulation of mortgage products.

TSB Bank participates in the unclaimed assets scheme established under the Dormant Bank and Building Society Accounts Act 2008. The purpose of this scheme is to enable money in dormant bank and building society accounts (i.e. balances in accounts that have been inactive or dormant for 15 years or more) to be distributed for the benefit of the community, while protecting the rights of customers to reclaim their money.

On 1 November 2009, the FSA introduced its 'Banking Conduct Regime' for retail banking. The central component of this regime is to establish FCA oversight of the conduct of business requirements contained in the Payment Services Regulations 2009 (the "**PSR**"), which apply to certain payment services made in euro or sterling.

On 1 November 2009, the British Bankers' Association, the Building Societies Association and The UK Cards Association launched 'The Lending Code', a voluntary code on unsecured lending to personal and small business customers, which is monitored and enforced by the Lending Standards Board. The voluntary Banking Code and the 'Business Banking Code' then ceased to have effect.

2.10 Proposed legislation

2.10.1 Structural and other reforms

On 14 June 2012, HM Treasury issued a White Paper entitled "*Banking reform: delivering stability and supporting a sustainable economy*" on how the UK Government intends to implement the measures recommended by Sir John Vickers' Independent Commission on Banking final report of 12 September 2011. Broadly, the White Paper covers the following areas: the ring-fencing of vital banking services from international and investment banking services; measures on loss absorbency and depositor preference; and proposals for enhancing competition in the banking sector.

On 19 June 2013, the Parliamentary Commission on Banking Standards published its final report, entitled "*Changing banking for good*". This was followed by the publication of the UK Government's response on 8 July 2013, accepting the overall conclusions of the report and all of its principal recommendations. Among other things,

this included proposals for a new banking standards regime governing the conduct of bank staff, the introduction of a criminal offence for reckless misconduct by senior bank staff, and steps to improve competition in the banking sector.

The UK Government published the Banking Reform Bill in October 2012 but, following the Parliamentary Commission on Banking Standards' final report published in June 2013, amendments to the Banking Reform Bill were tabled. The Banking Reform Bill received Royal Assent as the Financial Services (Banking Reform) Act 2013 on 18 December 2013. The UK Government intends for all relevant secondary legislation to be completed by May 2015 and banks will be expected to have implemented reforms by 2019 at the latest.

For more information, see Part II: "*Risk Factors – TSB is subject to the potential impacts of UK and European banking reform initiatives*".

2.10.2 **Recovery and resolution proposals**

In June 2012, the European Commission published a draft of the RRD, intended to establish an EU-wide framework for the recovery and resolution of credit institutions and investment firms. Political agreement on the RRD was reached between the European Parliament and EU Member States in December 2013 and on 16 April 2014, a provisional version of the RRD was published by the European Parliament. This version of RRD is expected to be implemented in Member States by 1 January 2015, except for certain bail-in provisions which are to be implemented by 1 January 2018. For more information, see Part II: "*Risk Factors – TSB is subject to substantial and changing prudential regulation*" and *"Risk Factors – TSB is subject to the potential impacts of UK and European Banking Reform Initiatives"*.

PART XX
TAXATION

GENERAL

The comments in this Part XX are of a general nature and are not intended to be exhaustive. Any prospective investors who are in any doubt about their tax position should consult their own professional advisers immediately.

SECTION A
UNITED KINGDOM

The comments set out below are based on current United Kingdom tax law and HM Revenue & Customs published practice (which may not be binding on HM Revenue & Customs) as at the date of this Prospectus, both of which are subject to change, possibly with retrospective effect. They assume that the Finance (No. 2) Bill 2013 – 2014, as ordered to be published on 27 March 2014, will be enacted without amendment. They are intended as a general guide and apply only to shareholders that are resident and, in the case of an individual, domiciled for tax purposes in (and only in) the United Kingdom and to whom "split year" treatment does not apply (except insofar as express reference is made to the treatment of non-United Kingdom tax resident shareholders), who hold their Ordinary Shares as an investment (but not through an Individual Savings Account or New Individual Savings Account or a Self-Invested Personal Pension) and who are the absolute beneficial owners of their Ordinary Shares and any dividends paid on them. In particular, shareholders holding their Ordinary Shares via a depositary receipt system or clearance service should note that they may not always be the absolute beneficial owners thereof. The discussion below does not address all possible tax consequences relating to an investment in the Ordinary Shares. Special rules may apply to certain categories of shareholders, including those carrying on certain financial activities, those subject to specific tax regimes or benefitting from certain reliefs or exemptions, those connected with the Company or the TSB Group, those for whom the Ordinary Shares are employment-related securities, those that hold the Ordinary Shares in connection with a trade, profession or vocation carried on in the UK (whether through a branch or agency or, in the case of a corporate shareholder, a permanent establishment or otherwise) and this summary does not apply to such shareholders.

Prospective investors who are in any doubt about their tax position, or who are resident or otherwise subject to taxation in a jurisdiction outside the United Kingdom, should consult their own professional advisers immediately.

For the avoidance of doubt, for the purpose of this Part XX Section A, the term "shareholder" shall include a holder of Bonus Shares, and the term "Ordinary Shares" shall include Bonus Shares.

1 Taxation of Dividends

The Company will not be required to withhold amounts on account of United Kingdom tax at source when paying a dividend. Liability to tax on dividends will depend on the individual circumstances of a shareholder.

A United Kingdom tax resident individual shareholder who receives a dividend from the Company will generally be entitled to a tax credit which may be set off against the shareholder's total United Kingdom income tax liability. The tax credit will be equal to 10 per cent. of the aggregate of the cash dividend and the tax credit (the "**gross dividend**"), which is also equal to one-ninth of the cash dividend received. Such an individual shareholder who is liable to income tax at a rate or rates not exceeding the basic rate will be subject to income tax on the dividend at the rate of 10 per cent. of the gross dividend, so that the tax credit will satisfy in full such shareholder's liability to income tax on the dividend. Where the tax credit exceeds the shareholder's tax liability, the shareholder cannot claim repayment of the tax credit from HM Revenue & Customs.

Such an individual shareholder who is liable to income tax at the higher rate will be subject to income tax on the gross dividend at the rate of 32.5 per cent. In this situation, the tax credit will be set against but not fully discharge the shareholder's tax liability on the gross dividend and such shareholder will have to account for additional income tax equal to 22.5 per cent. of the gross dividend (which is also equal to 25 per cent. of the cash dividend received) to the extent that the gross dividend when treated as the top slice of the shareholder's income exceeds the threshold for higher rate income tax but falls below the threshold for the additional rate of income tax.

Such an individual shareholder who is subject to income tax at the additional rate will be subject to income tax on the gross dividend at the rate of 37.5 per cent. In this situation, the tax credit will also be set against but not fully discharge the shareholder's liability on the gross dividend and such shareholder will have to account for additional income tax equal to 27.5 per cent. of the gross dividend (which is also equal to approximately 30.6 per cent. of the cash dividend received) to the extent that the gross dividend when treated as the top slice of the shareholder's income exceeds the threshold for additional rate income tax.

United Kingdom resident taxpayers who are not liable to United Kingdom tax on dividends will not be entitled to claim repayment of the tax credit attaching to dividends paid by the Company.

Shareholders who are within the charge to United Kingdom corporation tax will be subject to corporation tax on dividends paid by the Company, unless (subject to special rules for such shareholders that are small companies) the dividends fall within an exempt class and certain other conditions are met. Each such shareholder's position will depend on its own individual circumstances, although it would normally be expected that the dividends paid by the Company would fall within an exempt class. Such shareholders will not be entitled to claim repayment of the tax credit attaching to dividends paid by the Company.

Non-United Kingdom tax resident shareholders will not generally be entitled to claim repayment from HM Revenue & Customs of any part of the tax credit attaching to dividends paid by the Company. A shareholder resident outside the United Kingdom may also be subject to foreign taxation on dividend income under local law. Shareholders who are not solely resident for tax purposes in the United Kingdom should obtain their own tax advice concerning their tax liabilities on dividends received from the Company.

2 Taxation of Capital Gains

Receipt of Bonus Shares

If a shareholder who meets the relevant qualification criteria in respect of the Bonus Share Scheme receives one or more Bonus Shares under the scheme, then for the purposes of UK taxation of chargeable gains, that receipt is likely to give rise to a deemed part disposal by the shareholder of the Ordinary Shares already held by the shareholder by virtue of which the Bonus Shares are acquired. Any such deemed disposal may give rise to a chargeable gain for the shareholder, subject to the availability of exemptions or reliefs and depending on the shareholder's circumstances. A tax liability could therefore arise on the receipt of the Bonus Shares, even though no cash amount will be received by the shareholder.

Sales and other disposals of Ordinary Shares

Shareholders who are tax resident in the United Kingdom, or, in the case of individuals, who cease to be tax resident in the United Kingdom or are treated as resident outside the United Kingdom for the purposes of a double tax treaty for a period of five years or less, may, depending on their circumstances (including the availability of exemptions or reliefs), be liable to United Kingdom taxation on chargeable gains in respect of gains arising from a sale or other disposal of Ordinary Shares.

3 Inheritance and Gift Taxes

The Ordinary Shares will be assets situated in the United Kingdom for the purposes of United Kingdom inheritance tax. A gift by, or the death of, an individual holder of such assets may (subject to certain exemptions and reliefs) give rise to a liability to United Kingdom inheritance tax, even if the holder is neither domiciled in the United Kingdom nor deemed to be domiciled there (under certain rules relating to long residence or previous domicile). Generally, United Kingdom inheritance tax is not chargeable on gifts to individuals if the transfer is made more than seven complete years prior to death of the donor. For inheritance tax purposes, a transfer of assets at less than full market value may be treated as a gift and particular rules apply to gifts where the donor reserves or retains some benefit. Special rules also apply to close companies and to trustees of settlements who hold Ordinary Shares bringing them within the charge to inheritance tax. Shareholders should consult an appropriate professional adviser if they make a gift (or deemed gift) of any kind or intend to hold any Ordinary Shares through such a company or trust arrangement. They should also seek professional advice in a situation where there is potential for a double charge to United Kingdom inheritance tax and an equivalent tax in another country or if they are in any doubt about their United Kingdom inheritance tax position.

4 Stamp Duty and Stamp Duty Reserve Tax ("SDRT")

The statements in this section are intended as a general guide to the current United Kingdom stamp duty and SDRT position. Investors should note that certain categories of person are not liable to stamp duty or SDRT and others may be liable at a higher rate or may, although not primarily liable for tax, be required to notify and account for SDRT under the Stamp Duty Reserve Tax Regulations 1986.

General

An agreement to transfer Ordinary Shares will normally give rise to a charge to SDRT at the rate of 0.5 per cent. of the amount or value of the consideration payable for the transfer. SDRT is, in general, payable by the purchaser or transferee.

An instrument effecting the transfer on sale of Ordinary Shares will generally be subject to stamp duty at the rate of 0.5 per cent. of the consideration given for the transfer (rounded up to the next £5). The purchaser or transferee normally pays the stamp duty.

If a duly stamped instrument of transfer completing an agreement to transfer is produced within six years of the date on which the agreement is made (or, if the agreement is conditional, the date on which the agreement becomes unconditional), any SDRT already paid is generally repayable, normally with interest, and any SDRT which had not been paid is cancelled.

CREST

Paperless transfers of Ordinary Shares within the CREST system are generally liable to SDRT, rather than stamp duty, at the rate of 0.5 per cent. of the amount or value of the consideration payable. CREST is obliged to collect SDRT on relevant transactions settled within the CREST system. Deposits of Ordinary Shares into CREST will not generally be subject to SDRT or stamp duty, unless the transfer into CREST is itself for consideration.

Depositary receipt systems and clearance services

Where Ordinary Shares are transferred (i) to, or to a nominee or an agent for, a person whose business is or includes the provision of clearance services or (ii) to, or to a nominee or an agent for, a person whose business is or includes issuing depositary receipts, stamp duty or SDRT will generally be payable at the higher rate of 1.5 per cent. of the amount or value of the consideration given or, in certain circumstances, the value of the Ordinary Shares (rounded up, if necessary, to the nearest multiple of £5 in the case of stamp duty).

There is an exception from the 1.5 per cent. charge on the transfer to, or to a nominee or agent for, a clearance service where the clearance service has made and maintained an election under section 97A(1) of the Finance Act 1986, which has been approved by HM Revenue & Customs. In these circumstances, SDRT at the rate of 0.5 per cent. of the amount or value of the consideration payable for the transfer will arise on any transfer of Ordinary Shares into such an account and on subsequent agreements to transfer such Ordinary Shares within such account.

Any liability for stamp duty or SDRT in respect of a transfer into a clearance service or depositary receipt system, or in respect of a transfer within such a service, which does arise will strictly be accountable by the clearance service or depositary receipt system operator or their nominee, as the case may be, but will, in practice, be payable by the participants in the clearance service or depositary receipt system.

The Offer

The sale of Offer Shares by the Selling Shareholder under the Offer will give rise to a liability to stamp duty and/or SDRT as described above. The Selling Shareholder has agreed to pay: (i) any stamp duty chargeable on (a) a transfer on the initial sale of Offer Shares to investors pursuant to the Offer and/or (b) a transfer on an initial sale of Over-allotment Shares to investors pursuant to the Over-allotment Option, and/or (ii) any SDRT chargeable on (a) an agreement to transfer Offer Shares on the initial sale of Offer Shares to investors pursuant to the Offer and/or (b) an agreement to transfer Over-allotment Shares on an initial sale of Over-allotment Shares to investors pursuant to the Over-allotment Option (in each case, at a rate of 0.5 per cent.). The Selling Shareholder will not assume any liability in relation to any element of stamp duty or SDRT chargeable on a transfer of Offer Shares or Over-allotment Shares to a clearance service or depositary receipt issuer or to any agent or nominee thereof (currently imposed at a rate of 1.5 per cent.).

No additional stamp duty or any stamp duty reserve tax should be payable in respect of any agreement to transfer, or actual transfer of, Bonus Shares to a shareholder by the Selling Shareholder pursuant to the Bonus Share Scheme.

SECTION B
UNITED STATES

CERTAIN U.S. FEDERAL INCOME TAX CONSIDERATIONS

TO ENSURE COMPLIANCE WITH TREASURY DEPARTMENT CIRCULAR 230, SHAREHOLDERS ARE HEREBY NOTIFIED THAT: (A) ANY DISCUSSION OF U.S. FEDERAL TAX ISSUES IN THIS PROSPECTUS IS NOT INTENDED OR WRITTEN TO BE RELIED UPON, AND CANNOT BE RELIED UPON, BY SHAREHOLDERS FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON SHAREHOLDERS UNDER THE INTERNAL REVENUE CODE; (B) SUCH DISCUSSION IS INCLUDED HEREIN BY THE COMPANY IN CONNECTION WITH THE PROMOTION OR MARKETING (WITHIN THE MEANING OF CIRCULAR 230) BY THE COMPANY OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) SHAREHOLDERS SHOULD SEEK ADVICE BASED ON THEIR PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISER.

1 General

The following is a summary of certain material U.S. federal income tax consequences of the acquisition, ownership and disposition of Ordinary Shares by a U.S. Holder (as defined below). This summary deals only with initial purchasers of Ordinary Shares in the Institutional Offer that are U.S. Holders and that will hold the Ordinary Shares as capital assets. The discussion does not cover all aspects of U.S. federal income taxation that may be relevant to, or the actual tax effect that any of the matters described herein will have on, the acquisition, ownership or disposition of Ordinary Shares by particular investors, and does not address state, local, foreign or other tax laws. This summary also does not address tax considerations applicable to investors that own (directly or indirectly) 10 per cent. or more of the voting stock of the Company, nor does this summary discuss all of the tax considerations that may be relevant to certain types of investors subject to special treatment under the U.S. federal income tax laws (such as financial institutions, insurance companies, regulated investment companies, real estate investment trusts, investors liable for the alternative minimum tax or the net investment income tax, individual retirement accounts and other tax-deferred accounts, tax-exempt organisations, dealers in securities or currencies, traders in securities that elect mark to market treatment, investors that will hold the Ordinary Shares as part of straddles, hedging transactions or conversion transactions for U.S. federal income tax purposes or investors whose functional currency is not the U.S. dollar).

As used herein, the term "U.S. Holder" means a beneficial owner of Ordinary Shares that is, for U.S. federal income tax purposes: (i) an individual citizen or resident of the United States; (ii) a corporation created or organised under the laws of the United States or any State thereof or the District of Columbia; (iii) an estate the income of which is subject to U.S. federal income tax without regard to its source; or (iv) a trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust, or the trust has validly elected to be treated as a domestic trust for U.S. federal income tax purposes.

The U.S. federal income tax treatment of a partner in an entity treated as a partnership for U.S. federal income tax purposes that holds Ordinary Shares will depend on the status of the partner and the activities of the partnership. Prospective purchasers that are entities treated as partnerships for U.S. federal income tax purposes should consult their tax advisers concerning the U.S. federal income tax consequences to their partners of the acquisition, ownership and disposition of Ordinary Shares by the partnership.

The summary assumes that the Company is not a passive foreign investment company (a "**PFIC**") for U.S. federal income tax purposes, which the Company believes to be the case. The Company's possible status as a PFIC must be determined annually and therefore may be subject to change. If the Company were to be a PFIC in any year, materially adverse consequences could result for U.S. Holders.

This summary is based on the tax laws of the United States, including the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations thereunder, published rulings and court decisions, as well as on the income tax treaty between the United States and the United Kingdom (the "**Treaty**"), all as of the date hereof and all subject to change at any time, possibly with retroactive effect.

THE SUMMARY OF U.S. FEDERAL INCOME TAX CONSEQUENCES SET OUT BELOW IS FOR GENERAL INFORMATION ONLY. ALL PROSPECTIVE PURCHASERS SHOULD CONSULT THEIR TAX ADVISERS AS TO THE PARTICULAR TAX CONSEQUENCES TO THEM OF OWNING THE

ORDINARY SHARES, INCLUDING THEIR ELIGIBILITY FOR THE BENEFITS OF THE TREATY, THE APPLICABILITY AND EFFECT OF STATE, LOCAL, FOREIGN AND OTHER TAX LAWS AND POSSIBLE CHANGES IN TAX LAW.

2 Dividends

General

Distributions paid by the Company out of current or accumulated earnings and profits (as determined for U.S. federal income tax purposes) generally will be taxable to a U.S. Holder as foreign source dividend income, and will not be eligible for the dividends received deduction allowed to corporations. Distributions in excess of current and accumulated earnings and profits will be treated as a non-taxable return of capital to the extent of the U.S. Holder's basis in the Ordinary Shares and thereafter as capital gain. However, the Company does not maintain calculations of its earnings and profits in accordance with U.S. federal income tax accounting principles. U.S. Holders should therefore assume that any distribution by the Company with respect to Ordinary Shares will constitute ordinary dividend income. U.S. Holders should consult their own tax advisers with respect to the appropriate U.S. federal income tax treatment of any distribution received from the Company.

Dividends paid by the Company generally will be taxable to a non-corporate U.S. Holder at the special reduced rate normally applicable to long-term capital gains, provided the Company qualifies for the benefits of the Treaty. The Company expects to qualify for the benefits of the Treaty. A U.S. Holder will be eligible for this reduced rate only if it has held the Ordinary Shares for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date.

Foreign Currency Dividends

Dividends paid in pounds sterling will be included in income in a U.S. dollar amount calculated by reference to the exchange rate in effect on the day the dividends are received by the U.S. Holder, regardless of whether the pounds sterling are converted into U.S. dollars at that time. If dividends received in pounds sterling are converted into U.S. dollars on the day they are received, the U.S. Holder generally will not be required to recognise foreign currency gain or loss in respect of the dividend income.

3 Sale or other Disposition

Upon a sale or other disposition of Ordinary Shares, a U.S. Holder generally will recognise capital gain or loss for U.S. federal income tax purposes equal to the difference, if any, between the amount realised on the sale or other disposition and the U.S. Holder's adjusted tax basis in the Ordinary Shares. This capital gain or loss will be long-term capital gain or loss if the U.S. Holder's holding period in the Ordinary Shares exceeds one year. However, regardless of a U.S. Holder's actual holding period, any loss may be long term capital loss to the extent the U.S. Holder receives a dividend that qualifies for the reduced rate described above under "*Dividends – General*" and exceeds 10 per cent. of the U.S. Holder's basis in its Ordinary Shares. Any gain or loss generally will be U.S. source.

A U.S. Holder's tax basis in an Ordinary Share generally will be its U.S. dollar cost. The U.S. dollar cost of an Ordinary Share purchased with foreign currency will generally be the U.S. dollar value of the purchase price on the date of purchase, or the settlement date for the purchase, in the case of Ordinary Shares traded on an established securities market, within the meaning of the applicable treasury regulations, that are purchased by a cash basis U.S. Holder (or an accrual basis U.S. Holder that so elects). Such an election by an accrual basis U.S. Holder must be applied consistently from year to year and cannot be revoked without the consent of the U.S. Internal Revenue Service (the "**IRS**"). The amount realised on a sale or other disposition of Ordinary Shares for an amount in foreign currency will be the U.S. dollar value of this amount on the date of sale or disposition. On the settlement date, the U.S. Holder will recognise U.S. source foreign currency gain or loss (taxable as ordinary income or loss) equal to the difference (if any) between the U.S. dollar value of the amount received based on the exchange rates in effect on the date of sale or other disposition and the settlement date. However, in the case of Ordinary Shares traded on an established securities market that are sold by a cash basis U.S. Holder (or an accrual basis U.S. Holder that so elects), the amount realised will be based on the exchange rate in effect on the settlement date for the sale, and no exchange gain or loss will be recognised at that time.

4 Disposition of Foreign Currency

Foreign currency received on the sale or other disposition of an Ordinary Share will have a tax basis equal to its U.S. dollar value on the settlement date. Foreign currency that is purchased generally will have a tax basis equal to the U.S. dollar value of the foreign currency on the date of purchase. Any gain or loss recognised on a sale or other disposition of a foreign currency (including its use to purchase Ordinary Shares or upon exchange for U.S. dollars) will be U.S. source ordinary income or loss.

5 Passive Foreign Investment Company Considerations

The Company does not believe that it should be treated as, and does not expect to become, a PFIC for U.S. federal income tax purposes but the Company's possible status as a PFIC must be determined annually and therefore may be subject to change. If the Company were to be treated as a PFIC, U.S. Holders of Ordinary Shares would be required (i) to pay a special U.S. addition to tax on certain distributions and gains on sale and (ii) to pay tax on any gain from the sale of Ordinary Shares at ordinary income (rather than capital gains) rates in addition to paying the special addition to tax on this gain. Prospective purchasers should consult their tax advisers regarding the potential application of the PFIC regime.

6 Backup Withholding and Information Reporting

Payments of dividends and other proceeds with respect to Ordinary Shares by a U.S. paying agent or other U.S. intermediary will be reported to the IRS and to the U.S. Holder as may be required under applicable regulations. Backup withholding may apply to these payments if the U.S. Holder fails to provide an accurate taxpayer identification number or certification of exempt status or fails to report all interest and dividends required to be shown on its U.S. federal income tax returns. Certain U.S. Holders are not subject to backup withholding. U.S. Holders should consult their tax advisers as to their qualification for exemption from backup withholding and the procedure for obtaining an exemption.

7 Foreign Financial Asset Reporting

U.S. taxpayers that own certain foreign financial assets, including equity of foreign entities, with an aggregate value in excess of $50,000 at the end of the taxable year or $75,000 at any time during the taxable year (or, for certain individuals living outside the United States and married individuals filing joint returns, certain higher thresholds) may be required to file an information report with respect to such assets with their tax returns. The Ordinary Shares are expected to constitute foreign financial assets subject to these requirements unless the Ordinary Shares are held in an account at a financial institution (in which case the account may be reportable if maintained by a foreign financial institution). U.S. Holders should consult their tax advisers regarding the application of the rules relating to foreign financial asset reporting.

SECTION C
FATCA

Provisions of U.S. law commonly known as "FATCA" impose 30 per cent. withholding on, among other things, certain "foreign passthru payments" made by a non-U.S. financial institution that has entered into an agreement with the IRS (an "**IRS Agreement**") to perform certain diligence and reporting obligations with respect to the financial institution's U.S.-owned accounts (each such non-U.S. financial institution, a "**Participating Foreign Financial Institution**"). If the Company becomes a Participating Foreign Financial Institution, withholding may be imposed on payments on the Shares to any non-U.S. financial institution (including an intermediary through which a holder may hold Shares) that is not a Participating Foreign Financial Institution and is not otherwise exempt from FATCA, to the extent such payments are considered foreign passthru payments.

Under FATCA, withholding on foreign passthru payments would not be required before January 1, 2017 (at the earliest).

The United States has entered into an inter-governmental agreement with the UK (the "**IGA**") that will modify the FATCA withholding regime described above. The Company currently complies with the IGA and is taking the necessary steps to become a "Reporting FI" under the IGA. It is not yet clear how the IGA will address "foreign passthru payments" and whether it will relieve UK financial institutions of any obligation to withhold on "foreign passthru payments."

FATCA IS PARTICULARLY COMPLEX AND ITS APPLICATION TO THE ISSUER, THE SHARES AND THE HOLDERS IS SUBJECT TO CHANGE. EACH HOLDER OF SHARES SHOULD CONSULT ITS OWN TAX ADVISER TO OBTAIN A MORE DETAILED EXPLANATION OF FATCA AND TO LEARN HOW FATCA MIGHT AFFECT EACH HOLDER IN ITS PARTICULAR CIRCUMSTANCE.

SECTION D
THE PROPOSED EU FINANCIAL TRANSACTIONS TAX ("FTT")

The European Commission has published a proposal for a Directive for a common FTT in Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (the "**participating Member States**").

The proposed FTT has very broad scope and could, if introduced in its current form, apply to certain dealings in the Ordinary Shares (including secondary market transactions) in certain circumstances.

Under current proposals, the FTT could apply in certain circumstances to persons both within and outside of the participating Member States. Generally, it would apply to certain dealings in Ordinary Shares where at least one party is a financial institution, and at least one party is established in a participating Member State. A financial institution may be, or be deemed to be, "established" in a participating Member State in a broad range of circumstances, including (a) by transacting with a person established in a participating Member State or (b) where the financial instrument which is subject to the dealings is issued in a participating Member State.

The FTT proposal remains subject to negotiation between the participating Member States. It may therefore be altered prior to any implementation, the timing of which remains unclear. Additional EU Member States may decide to participate. Prospective shareholders are advised to seek their own professional advice in relation to the FTT.

PART XXI
THE OFFER

1 Summary of the Offer

Pursuant to the Offer, the Selling Shareholder is currently expected to sell 125,000,000 Ordinary Shares, representing 25 per cent. of the issued Ordinary Share capital of the Company on Admission. In addition, a number of Ordinary Shares representing up to 10 per cent. of the Offer Size (representing 2.5 per cent. of the issued Ordinary Share capital of the Company on Admission based on the Expected Offer Size) may be sold by the Selling Shareholder pursuant to the Over-allotment Option.

The Selling Shareholder estimates it will receive proceeds of £285.6 million (assuming the Offer Size is set at the Expected Offer Size, no exercise of the Over-allotment Option and that the Offer Price is set at the mid-point of the Offer Price Range), net of commissions payable (excluding discretionary commissions), other estimated fees and expenses in connection with the Offer (excluding any fees and expenses in relation to the transfer of any Bonus Shares pursuant to the Bonus Share Scheme), VAT and United Kingdom stamp duty and SDRT payable by the Selling Shareholder in the connection with the Offer of approximately £33.2 million. The number of Offer Shares sold by the Selling Shareholder pursuant to the Offer could be set above or, with the approval of the UK Listing Authority, below the Expected Offer Size (see *"Book-building, Offer Price, Offer Size and allocation"* below).

The Company will bear one-off fees and expenses of an amount of approximately £3 million (inclusive of amounts in respect of VAT) in connection with the Offer and Admission, and will receive no Offer proceeds. The Selling Shareholder will bear approximately £33.2 million of fees and expenses in connection with the Offer and Admission, including commissions payable (excluding any discretionary commissions), other estimated fees and expenses in connection with the Offer (excluding any fees and expenses in relation to the transfer of any Bonus Shares pursuant to the Bonus Share Scheme) and amounts in respect of VAT and United Kingdom stamp duty and SDRT (assuming the Offer Size is set at the Expected Offer Size, no exercise of the Over-allotment Option and that the Offer Price is set at the mid-point of the Offer Price Range) and will receive all of the net Offer proceeds.

The Offer is made by way of:

(i) the Institutional Offer to: (i) certain institutional and professional investors in the United Kingdom and elsewhere outside the United States in reliance on Regulation S under the Securities Act; and (ii) QIBs in the United States in reliance on Rule 144A under the Securities Act or another exemption from, or in a transaction not subject to, the registration requirements of the Securities Act; and

(ii) the Intermediaries Offer to the Intermediaries for onward distribution to retail investors located in the United Kingdom, the Channel Islands and the Isle of Man.

Under the Offer, all the Offer Shares will be sold, payable in full at the Offer Price.

The terms of the Intermediaries Offer provide for a Bonus Share Scheme pursuant to which investors who acquire Ordinary Shares in the Intermediaries Offer and continue to hold such Ordinary Shares for a continuous period of one year following Admission will, as at the date falling at the end of that one-year period (the "**Bonus Share Record Date**"), be entitled to receive one free and fully paid-up Bonus Share from the Selling Shareholder for every 20 Ordinary Shares so acquired and continuously held with the same Intermediary, subject to certain conditions (as set out below) and solely in respect of amounts up to £2000 invested in Ordinary Shares in the Intermediaries Offer (meaning that a maximum of £100 of Ordinary Shares (determined on the basis of the Offer Price) will be transferred to any investor as Bonus Shares).

The distribution of this Prospectus and the offer and sale of the Offer Shares are subject to the restrictions set out in *"Selling restrictions"* below.

When admitted to trading, the Ordinary Shares will be registered with ISIN number GB00BMQX2Q65 and SEDOL number BMQX2Q6. The rights attaching to the Ordinary Shares will be uniform in all respects and they will form a single class for all purposes.

Immediately following Admission, it is expected that not less than 25 per cent. of the Company's issued Ordinary Share capital will be held in public hands (within the meaning of Listing Rule 6.1.19).

The terms of the Offer are subject to change, and any terms to be varied shall be agreed between the Company, the Parent, the Selling Shareholder and the Joint Global Co-ordinators (on behalf of the Underwriters).

2 Reasons for the Offer and Admission

HM Treasury's financial support of Lloyds Banking Group in 2008-2009 was deemed by the European Commission to have constituted State aid. As a result of the European Commission decision in relation to the same, Lloyds Banking Group was required to dispose of a significant UK retail banking business that met certain criteria. Lloyds Banking Group intends to meet this commitment through the divestment of TSB (through its holding in the Company), which has been built and created to meet the agreed criteria. The original deadline for Lloyds Banking Group to complete the disposal was 30 November 2013. The European Commission has agreed to amendments to the perimeter of the divesting business, as well as a revised deadline of 31 December 2015 for full divestment of Lloyds Banking Group's interests in TSB, which may be extendable to 30 June 2016 or 31 December 2016 (depending on the proportion of Lloyds Banking Group's interest in TSB that has already been divested) in the event of Disorderly Markets. The reason for the Offer is that Lloyds Banking Group determined that its preferred strategy to satisfy its commitment to the European Commission was a divestment by way of an IPO of the Company (together with subsequent sales of its residual post-Admission interest in the Company).

In addition, the TSB Board believes that Admission will benefit the Company as it will:

- give the Company access to a wider range of capital-raising options which may be of use in the future; and
- assist in recruiting, retaining and incentivising key management and employees.

No expenses will be charged by the Company or the Selling Shareholder to any purchasers of the Offer Shares.

3 The Selling Shareholder

The Selling Shareholder is Lloyds Bank plc (registered number 00002065), a wholly-owned subsidiary of the Parent, whose registered office is at 25 Gresham Street, London, United Kingdom EC2V 7HN. The Company is, and prior to Admission will continue to be, a wholly-owned, indirect subsidiary of the Parent, whose interest is held through the Selling Shareholder.

4 Book-building, Offer Price, Offer Size and allocation

After the Offer Period has ended, the Offer Price and Offer Size (which excludes Over-allotment Shares and Bonus Shares) will be determined by the Parent and the Selling Shareholder, subject to agreement of the Joint Global Co-ordinators and are expected to be announced on or about 20 June 2014. The Pricing Statement, which will contain, among other things, the Offer Price and Offer Size, will be published in printed form and available free of charge at the Company's registered office at 20 Gresham Street, London EC2V 7JE and online at tsbshareoffer.equiniti.com.

It is currently expected that the Offer Price will be within the Offer Price Range and the Offer Size will be the Expected Offer Size, but these expectations are indicative only and the Offer Price may be set within, above or below the Offer Price Range and the Offer Size may be set above or, with the approval of the UK Listing Authority, below the Expected Offer Size. A number of factors will be considered in deciding the Offer Price and the Offer Size, including the level and the nature of the demand for Ordinary Shares in the book-building process, the level of demand in the Intermediaries Offer, prevailing market conditions and the objectives of encouraging the development of an orderly and liquid after-market in the Ordinary Shares. The Offer Price and Offer Size will be established at a level determined in accordance with these arrangements, taking into account indications of interest received (whether before or after the times and/or dates stated) from persons (including market-makers and fund managers) connected with the Joint Global Co-ordinators, in the case of the Institutional Offer, and the Intermediaries, in the case of the Intermediaries Offer.

In particular, in the event the Parent and the Selling Shareholder determine that the level and nature of demand for Ordinary Shares warrants it, the Offer Size may be set above the Expected Offer Size, up to a maximum of 175,000,000 Ordinary Shares, representing 35 per cent. of the issued Ordinary Share capital of the Company at Admission (the "**Maximum Offer Size**").

Unless required to do so by law or regulation, the Company does not envisage publishing any supplementary prospectus or pricing statement until announcement of the Offer Price and Offer Size. If the Offer Price is set above the Offer Price Range and/or the Offer Size is set below the Expected Offer Size or above the Maximum Offer Size then an announcement would be made via a Regulatory

Information Service and prospective investors would have a statutory right to withdraw their offer to purchase Ordinary Shares pursuant to section 87Q of FSMA. The arrangements for withdrawing offers to purchase Ordinary Shares would be made clear in the announcement.

The Underwriters will solicit from prospective investors indications of interest in acquiring Ordinary Shares under the Institutional Offer. Prospective institutional investors will be required to specify the number of Ordinary Shares which they would be prepared to acquire either at specified prices or at the Offer Price (as finally determined). Subject to the Parent and the Selling Shareholder determining allocations, there is no minimum or maximum number of Ordinary Shares which can be applied for.

Applications are expected to be sought by the Intermediaries from their retail investor clients under the Intermediaries Offer for Ordinary Shares on the basis that the exact number of Ordinary Shares the subject of such applications will vary depending on the final Offer Price. A global application will then be made by the Intermediaries on behalf of their clients, through J.P. Morgan Cazenove, and this demand will be taken into account by the Parent, the Selling Shareholder and the Joint Global Co-ordinators alongside indications of interest in the Institutional Offer in conducting the book-building described above in respect of the Offer.

After the Offer Period has ended, the Parent and the Selling Shareholder, after consultation with the Joint Global Co-ordinators, will determine the number of Ordinary Shares to be allocated in each of the Institutional Offer and the Intermediaries Offer. A number of factors will be considered by the Parent and the Selling Shareholder in determining the basis of allocation between the Institutional Offer and the Intermediaries Offer, including the level and nature of demand for Ordinary Shares in the Offer and the objective of encouraging an orderly and liquid after-market in the Ordinary Shares. If there is excess demand for Ordinary Shares, allocations may be scaled down and applicants may be allocated Ordinary Shares having an aggregate value which is less than the sum applied for. The Parent and the Selling Shareholder may allocate such shares at their discretion (subject to consultation with the Company and the Joint Global Co-ordinators) and there is no obligation for such shares to be allocated proportionally.

Completion of the Offer will be subject, *inter alia*, to the determination of the Offer Price and Offer Size. It will also be subject to the satisfaction of conditions contained in the Underwriting Agreement, including Admission occurring and the Underwriting Agreement not having been terminated prior to Admission. The Offer cannot be terminated after Admission.

5 The Institutional Offer

Under the Institutional Offer, Ordinary Shares will be offered to: (i) certain institutional and professional investors in the United Kingdom and elsewhere outside the United States in reliance on Regulation S; and (ii) QIBs in the United States in reliance on Rule 144A or another exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Certain restrictions that apply to the distribution of this Prospectus and the offer and sale of the Ordinary Shares in jurisdictions outside the United Kingdom are described in *"Selling restrictions"* below.

The latest time and date for indications of interest in acquiring Ordinary Shares under the Institutional Offer is set out in Part V: "*Expected Timetable of Principal Events*" but that time may be extended at the discretion of the Parent and the Selling Shareholder (with the agreement of the Joint Global Co-ordinators).

Participants in the Institutional Offer will be advised verbally or by electronic mail of their allocation as soon as practicable following pricing and allocation. Prospective investors in the Institutional Offer will be committed to acquire the number of Ordinary Shares allocated to them at the Offer Price and, to the fullest extent permitted by law, will be deemed to have agreed not to exercise any rights to rescind or terminate, or otherwise withdraw from, such commitment.

6 The Intermediaries Offer

Members of the general public will not be able to apply directly to the Parent or the Selling Shareholder for Ordinary Shares in the Offer. They may, however, be eligible to apply for Ordinary Shares through the Intermediaries by following their relevant application procedures. Underlying applicants are not allowed to make more than one application under the Intermediaries Offer (whether on their own behalf or through other means, including, but without limitation, through a trust or pension plan).

Only the Intermediaries' retail investor clients in the United Kingdom, the Channel Islands and the Isle of Man are eligible to participate in the Intermediaries Offer. No Ordinary Shares allocated under the Intermediaries Offer will be registered in the name of any person whose registered address is outside the United Kingdom, the Channel Islands and the Isle of Man except in certain limited circumstances with the consent of the Joint Global Co-ordinators.

An application for Ordinary Shares in the Intermediaries Offer means that the applicant agrees to acquire the Ordinary Shares applied for at the Offer Price.

Each applicant must comply with the appropriate money laundering checks required by the relevant Intermediary. Where an application is not accepted or there are insufficient Ordinary Shares available to satisfy an application in full, the relevant Intermediary will be obliged to refund the applicant as required and all such refunds shall be made without interest. The Parent, the Selling Shareholder, the Company and the Underwriters accept no responsibility with respect to the obligation of the Intermediaries to refund monies in such circumstances.

Each Intermediary has agreed, or will on appointment agree, to the Intermediaries Terms and Conditions, which regulate, *inter alia*, the conduct of the Intermediaries offer on market standard terms and provide for the payment of commission to any Intermediary that elects to receive commission from the Selling Shareholder.

Pursuant to the Intermediaries Terms and Conditions, in making an application, each Intermediary will also be required to represent and warrant that they are not located in the United States and are not acting on behalf of anyone located in the United States.

In addition, the Intermediaries may prepare certain materials for distribution or may otherwise provide information or advice to retail investors in the United Kingdom, the Channel Islands and the Isle of Man subject to the terms of the Intermediaries Terms and Conditions. Any such materials, information or advice are solely the responsibility of the relevant Intermediary and will not be reviewed or approved by any of the Underwriters, the Parent, the Selling Shareholder or the Company. Any liability relating to such documents shall be for the relevant Intermediaries only.

Each Intermediary will be informed by the Intermediaries Offer Co-ordinator by fax or e-mail of the aggregate number of Ordinary Shares allocated in aggregate to its underlying clients and the total amount payable in respect thereof. The aggregate allocation of Offer Shares as between the Institutional Offer and the Intermediaries Offer, and as between Intermediaries, will be determined by the Parent and the Selling Shareholder (after consultation with the Joint Global Co-ordinators and the Company).

Under the Intermediaries Offer, Ordinary Shares will be offered outside the United States only in Offshore Transactions as defined in, and in reliance on, Regulation S.

The publication of the Prospectus and any actions of the Parent, the Selling Shareholder, the Company, the Joint Global Co-ordinators, the Intermediaries Offer Co-ordinator, the Intermediaries or other persons in connection with the Offer should not be taken as any representation or assurance as to the basis on which the number of Ordinary Shares to be offered under the Intermediaries Offer or allocations within the Intermediaries Offer will be determined and all liabilities for any such action or statement are hereby disclaimed by the Parent, the Selling Shareholder, the Company, the Underwriters and the Intermediaries Offer Co-ordinator.

Pursuant to the Intermediaries Terms and Conditions, the Intermediaries have undertaken to make payment on their own behalf (not on behalf of any other person) of the consideration for the Ordinary Shares allocated, at the Offer Price, to J.P. Morgan Cazenove in accordance with details to be communicated to them, by means of the CREST system against delivery of the Ordinary Shares at the time and/or date set out in Part V: "*Expected Timetable of Principal Events*", or at such other time and/or date after the date of publication of the Offer Price as may be agreed by the Parent, the Company, the Selling Shareholder and the Joint Global Co-ordinators and notified to the Intermediaries by the Intermediaries Offer Co-ordinator.

The Intermediaries Terms and Conditions provide for the Intermediaries to have an option to be paid a commission by the Selling Shareholder in respect of the Offer Shares allocated to and paid for by them pursuant to the Intermediaries Offer.

Bonus Share Scheme

The terms of the Intermediaries Offer provide for a Bonus Share Scheme pursuant to which investors who acquire Ordinary Shares in the Intermediaries Offer and continue to hold such Ordinary Shares for a continuous period of one year following Admission will, as at the date falling at the end of that one-year period (the "**Bonus Share Record Date**"), be entitled to receive one free and fully paid-up Bonus Share from the Selling Shareholder for every 20 Ordinary Shares so acquired and continuously held with the same Intermediary, subject to certain conditions (as set out below) and solely in respect of amounts up to £2000 invested in Ordinary Shares in the Intermediaries Offer (meaning that a maximum of £100 of Ordinary Shares (determined on the basis of the Offer Price) will be transferred to any investor as Bonus Shares).

In order to qualify to receive Bonus Shares following the Bonus Share Record Date, each investor in the Intermediaries Offer:

(i) must have given the relevant Intermediary permission that the Intermediary is able to confirm to the Company, the Selling Shareholder and the Bonus Share Distribution Agent (including passing on relevant details of the number of Ordinary Shares acquired by such investor in the Intermediaries Offer and continuously held up until (and including) the Bonus Share Record Date) that such investor meets the qualification criteria for the Bonus Share Scheme set out in this document, with submission of an application for Shares in the Intermediaries Offer constituting such permission; and

(ii) will be required to have held (in uncertificated form) the relevant Ordinary Shares continuously with the same Intermediary through which such investor initially acquires the Ordinary Shares in the Intermediaries Offer (which may include transferring such Ordinary Shares into an ISA or SIPP held with that Intermediary).

The Selling Shareholder reserves the right not to transfer Ordinary Shares to any person pursuant to these arrangements unless the relevant investor's compliance with the qualification criteria has been demonstrated to the satisfaction of the Selling Shareholder.

Investors who dispose of, or transfer, the beneficial interest in all of the Ordinary Shares they acquire pursuant to the Intermediaries Offer on or before the Bonus Share Record Date (other than into an ISA or SIPP with the same Intermediary) will not be eligible to receive any Bonus Shares, even if further Ordinary Shares are subsequently acquired. Persons who dispose of, or transfer only some of, the Ordinary Shares they acquire pursuant to the Intermediaries Offer (other than into an ISA or SIPP with the same Intermediary) will be eligible to receive a proportionately reduced number of Bonus Shares.

The tax consequences connected to a receipt of Bonus Shares are described in Part XX "*Taxation*".

Entitlements to Bonus Shares will be rounded down to the next lowest whole number and fractions of Bonus Shares will not be transferred to Shareholders.

In the event of a change of control of the Company before the Bonus Share Record Date, the continuous period referred to above for which the Ordinary Shares must be held in order to be eligible for Bonus Shares will end on the day before such change of control occurs. If, following such a change of control, Bonus Shares are not transferred to a person who would otherwise have been eligible to receive them, the Selling Shareholder will make arrangements to compensate that person accordingly.

The Selling Shareholder will not be required to transfer any Bonus Shares to any person in circumstances where such transfer would constitute a separate offer of securities to the public or a breach of any applicable securities (or other) laws or regulations.

7 Representations and warranties

By receiving this Prospectus, each investor and, in the case of (viii) below, any person confirming his or her agreement to purchase Ordinary Shares on behalf of an investor or authorising the Underwriters to notify an investor's name to the Registrar in connection with the Offer, is deemed to represent and warrant to each of the Underwriters, the Registrar, the Parent, the Selling Shareholder and the Company that:

(i) if the investor is a natural person, such investor is not under the age of majority in the jurisdiction where they are located (18 years of age in the United Kingdom) on the date of such investor's agreement to purchase Ordinary Shares under the Offer and will not be any such person on the date any such Offer is accepted;

(ii) in agreeing to purchase Ordinary Shares under the Offer, the investor is relying on this Prospectus and, if applicable, any supplementary prospectus and the Pricing Statement, and not on any other information or representation concerning the Company or the Offer. Such investor agrees that none of the Parent, the Selling Shareholder, the Company, the Registrar, the Underwriters, the Intermediaries Offer Co-ordinator nor any of their respective officers or directors or the Prospective Non-executive Director will have any liability for any such other information or representation. The investor irrevocably and unconditionally waives any rights it may have in respect of any other information or representation;

(iii) the content of this Prospectus is exclusively the responsibility of the Company, its Directors and the Prospective Non-executive Director and none of the Parent, the Selling Shareholder, the Underwriters, the Registrar nor any person acting on their behalf nor any of their respective employees, directors, officer or affiliates is responsible for or shall have any liability for any information, representation or statement contained in this Prospectus or any information published by or on behalf of the Company, and none of the Parent, the Selling Shareholder, the Underwriters, the Registrar nor any person acting on their behalf nor any of their respective employees, directors, officer or affiliates will be liable for any decision by an investor to participate in the Offer based on any information, representation or statement contained in this Prospectus, any supplementary prospectus or otherwise. The investor irrevocably and unconditionally waives any rights it may have in respect of any other information or representation;

(iv) the investor has not relied on the Underwriters or any person affiliated with the Underwriters in connection with any investigation of the accuracy of any information contained in this Prospectus, any supplementary prospectus or their investment decision; it has relied only on the information contained in this Prospectus and any supplementary prospectus;

(v) it is a person to whom it is lawful for the offer of Ordinary Shares to be made under the terms of the jurisdiction in which that investor is located;

(vi) it is entitled to subscribe for Ordinary Shares under the laws of all relevant jurisdictions which apply to it; it has fully observed such laws and obtained all governmental and other consents which may be required under such laws and complied with all necessary formalities; it has paid all issue, transfer or other taxes due in connection with its acceptance in any jurisdiction, save for the stamp duty/stamp duty reserve tax that the Selling Shareholder has agreed to be liable for; and it has not taken any action or omitted to take any action which will or may result in any of the Parent, the Selling Shareholder, the Company, the Underwriters, the Registrar or any of their respective affiliates, directors, officers, agents, employees or advisers or the Prospective Non-executive Director acting in breach of the legal and regulatory requirements of any jurisdiction in connection with the Offer or, if applicable, its acceptance of or participation in the Offer;

(vii) in the case of a person who confirms to the Underwriters on behalf of an investor an agreement to purchase Ordinary Shares and/or who authorises the Underwriters to notify the investor's name to the Registrar, that person represents and warrants that he or she has authority to do so on behalf of the investor;

(viii) the investor is not, and is not applying as nominee or agent for, a person which is, or may be, mentioned in any of sections 67, 70, 93 and 96 of the UK Finance Act 1986 (depositary receipts and clearance services); and

(ix) in the case of investors in the Institutional Offer, it will pay to the Underwriters (or as they may direct) any amounts due from it in accordance with this Prospectus on the due time and date set out herein.

8 Dealing arrangements

The Offer is subject to the satisfaction of certain conditions contained in the Underwriting Agreement, which are typical for an agreement of this nature. Certain conditions relate to events which are outside the control of the Parent, the Selling Shareholder, the Company, the Directors, the Prospective Non-executive Director and the Underwriters. Further details of the Underwriting Agreement are described under the heading *"Underwriting arrangements"* below.

Application has been made to the FCA for the Ordinary Shares to be admitted to the premium listing segment of the Official List and to the London Stock Exchange for such Ordinary Shares to be admitted to trading on the London Stock Exchange's main market for listed securities.

It is expected that Admission will take place and unconditional dealings in the Ordinary Shares will commence on the London Stock Exchange at 8.00am (London time) on 25 June 2014. Settlement of dealings from that date will be on a three-day rolling basis. Prior to Admission, it is expected that dealings in the Ordinary Shares will commence on a conditional basis on the London Stock Exchange on 20 June 2014. The earliest date for such settlement of such dealings will be 25 June 2014. **All dealings in the Ordinary Shares before the commencement of unconditional dealings will be on a "when issued" basis and at the sole risk of the parties concerned. These dates and times may be changed without further notice.**

When admitted to trading, the Ordinary Shares will be registered with ISIN number GB00BMQX2Q65 and SEDOL number BMQX2Q6.

It is intended that Ordinary Shares allocated to investors will be delivered in uncertificated form and settlement will take place through CREST on Admission. Dealings in advance of crediting of the relevant CREST stock account shall be at the risk of the person concerned.

Immediately following Admission, it is expected that not less than 25 per cent. of the Company's issued ordinary share capital will be held in public hands (within the meaning of paragraph 6.1.19 of the Listing Rules).

In connection with the Offer, the Underwriters and any of their respective affiliates acting as an investor for their own accounts may purchase Ordinary Shares and in that capacity may retain, purchase, sell, offer to sell or otherwise deal for their own account such Ordinary Shares and any securities of the Company or related investments in connection with the Offer. Accordingly, references in this Prospectus to the Ordinary Shares being offered, acquired, placed or otherwise dealt in should be read as including any offer, acquisition, placing or dealing by of the Underwriters and any affiliate acting as an investor for its or their own account. The Underwriters do not intend to disclose the extent of any such investment or transactions otherwise than in accordance with any legal or regulatory obligation to do so.

9 Over-allotment and stabilisation

In connection with the Offer, J.P. Morgan Cazenove, as Stabilising Manager, or any of its agents may (but will be under no obligation to), to the extent permitted by applicable law, over-allot Ordinary Shares or effect other stabilisation transactions with a view to supporting the market price of the Ordinary Shares at a higher level than that which might otherwise prevail in the open market. The Stabilising Manager is not required to enter into such transactions and such stabilisation transactions may be effected on any securities market, over-the-counter market, stock exchange or otherwise and may be undertaken at any time during the period commencing on the date of the commencement of conditional dealings in the Ordinary Shares on the London Stock Exchange and ending no later than 30 calendar days thereafter. There is no assurance that stabilising transactions will be undertaken. Such transactions, if commenced, may be discontinued at any time without prior notice. In no event will measures be taken to stabilise the market price of the Ordinary Shares above the Offer Price. Except as required by law or regulation, neither the Stabilising Manager nor any of its agents intends to disclose the extent of any over-allotments made and/or stabilisation transactions conducted in relation to the Offer.

In connection with the Offer, the Stabilising Manager may, for stabilisation purposes, over-allot Ordinary Shares up to a maximum of 10 per cent. of the total number of Offer Shares. For the purposes of allowing the Stabilising Manager to cover short positions resulting from any such over-allotments and/or from sales of Ordinary Shares effected by it during the stabilising period, the Selling Shareholder has granted to it the Over-allotment Option, pursuant to which the Stabilising Manager may purchase or procure purchasers for additional Ordinary Shares up to a maximum of 10 per cent. of the total number of Offer Shares (the "**Over-allotment Shares**") at the Offer Price. The Over-allotment Option is exercisable in whole or in part, upon notice by the Stabilising Manager, at any time on or before the 30th calendar day after the commencement of conditional dealings in the Ordinary Shares on the London Stock Exchange. Any Over-allotment Shares made available pursuant to the Over-allotment Option will rank *pari passu* in all respects with the Ordinary Shares, including for all dividends and other distributions declared, made or paid on the Ordinary Shares, will be purchased on the same terms and conditions as the Ordinary Shares being sold in the Offer and will form a single class for all purposes with the other Ordinary Shares.

For a discussion of the stock lending arrangements entered into in connection with the Over-allotment Option, see Part XXII: "*Additional Information – Underwriting arrangements*".

10 CREST

CREST is a paperless settlement system in the UK enabling securities to be evidenced otherwise than by a certificate and to be transferred otherwise than by a written instrument. The Ordinary Shares are in registered form. With effect from Admission, the Articles will permit the holding of Ordinary Shares under the CREST system. The Company has applied for the Ordinary Shares to be admitted to CREST with effect from Admission. Accordingly, settlement of transactions in the Ordinary Shares following Admission may take place within the CREST system, if any shareholder so wishes.

CREST is a voluntary system and holders of Ordinary Shares who wish to receive and retain share certificates will be able to do so. An investor applying for Ordinary Shares in the Offer may, however, elect to receive Ordinary Shares in uncertificated form if that investor is a system-member (as defined in the CREST Regulations).

11 Underwriting arrangements

The Parent, the Selling Shareholder, the Company, the Directors, the Prospective Non-executive Director and the Underwriters have entered into the Underwriting Agreement pursuant to which, on the terms and subject to certain conditions contained in the Underwriting Agreement (which are customary in agreements of this nature), the Underwriters have agreed (severally and not jointly or jointly and severally) to procure:

(a) purchasers for the Institutional Offer Shares or, failing which, to purchase such Institutional Offer Shares themselves in their agreed proportions; and

(b) purchasers for any Intermediaries Offer Shares which an Intermediary fails to make payment for in accordance with the terms of the Intermediaries Offer or, failing which, to purchase such Intermediaries Offer Shares themselves in their agreed proportions,

in each case, at the Offer Price.

In addition, under the Underwriting Agreement, J.P. Morgan Cazenove has agreed to co-ordinate certain arrangements relating to the Intermediaries Offer.

The Underwriting Agreement contains provisions entitling the Joint Global Co-ordinators (on behalf of themselves and the other Underwriters) to terminate the Offer (and the arrangements associated with it) at any time prior to (but not after) Admission in certain circumstances. In addition, the Parent and the Selling Shareholder have the right at any time up until the Offer Price is determined to decide not to proceed with the Offer. If these termination rights are exercised, the Offer and the arrangements associated with it will lapse, Admission will not occur and any monies received in respect of the Offer will be returned to applicants without interest.

The Underwriting Agreement provides for the Underwriters to be paid commission (some of which is payable in the discretion of the Parent and the Selling Shareholder) in respect of the Offer Shares sold and any Over-allotment Shares sold following exercise of the Over-allotment Option. Any commissions received by the Underwriters may be retained by, and any Offer Shares acquired by them may be retained or dealt in, by them for their own account.

12 Lock-up arrangements

Each of the Company, the Selling Shareholder, each of the Directors and the Prospective Non-executive Director has agreed to certain lock-up arrangements.

Pursuant to the Underwriting Agreement, the Company has agreed that, subject to certain exceptions, during the period of 365 days from the date of Admission, it will not, without the prior written consent of the Joint Global Co-ordinators (on behalf of themselves and the other Underwriters), issue, offer, sell or contract to sell, or otherwise dispose of, directly or indirectly, any Ordinary Shares (or any interest therein or in respect thereof) or enter into any transaction with the same economic effect as, or agree to do, any of the foregoing. Further details are set out in Part XXII: "*Additional Information – Underwriting arrangements*".

Each of the Directors and the Prospective Non-executive Director has agreed that, subject to certain exceptions, during the period of 365 days from the date of Admission, he/she will not, without the prior consent of the Joint Global Co-ordinators (on behalf of themselves and the other Underwriters), offer, sell or contract to sell, or otherwise dispose of, directly or indirectly, or announce an offering of, any Ordinary Shares (or any interest therein or in respect thereof) or enter into any transaction with the same economic effect as, or agree to do, any of the foregoing. Further details are set out in Part XXII: "*Additional Information – Underwriting arrangements*".

Pursuant to the Underwriting Agreement, the Selling Shareholder has agreed that, subject to certain exceptions, during the period of 90 days from the date of Admission, it will not, without the prior consent of the Joint Bookrunners (on behalf of themselves and the other Underwriters) offer, sell or contract to sell, or otherwise dispose of, directly or indirectly, or announce an offering of, any Ordinary Shares (or any interest therein or in respect thereof) or enter into any transaction with the same economic effect as any of the foregoing. Further details are set out in Part XXII: "*Additional Information – Underwriting arrangements*".

13 Withdrawal rights

In the event that the Company is required to publish any supplementary prospectus, applicants who have applied for Ordinary Shares in the Offer shall have a statutory right to withdraw their offer to purchase Ordinary Shares in the Offer in its entirety before the end of a period of two Business Days commencing on the first Business Day after the date on which the supplementary prospectus is published (or such later date as may be specified in the supplementary prospectus).

In addition, in the event that the Offer Price is set above the Offer Price Range and/or the Offer Size is set below the Expected Offer Size or above the Maximum Offer Size, the applicants who have applied for Ordinary Shares would have a statutory right to withdraw their offer to purchase Ordinary Shares in the Offer in its entirety pursuant to section 87Q of FSMA before the end of a period of two Business Days commencing on the first Business Day after the date on which an announcement of this is published by the Company via a Regulatory Information Service announcement (or such later date as may be specified in that announcement).

The right to withdraw an application to purchase Ordinary Shares in the circumstances set out above will be available to all investors. If the application is not withdrawn within the period stipulated in any supplementary prospectus or announcement (as described above), any offer to apply for Ordinary Shares in the Offer will remain valid and binding.

Applicants who have applied for Ordinary Shares in the Intermediaries Offer through an Intermediary should contact the relevant Intermediary for details on how to withdraw an application.

Any supplementary prospectus will be published in accordance with the Prospectus Rules (and notification thereof will be made to a Regulatory Information Service) but will not be distributed to investors individually. Any such supplementary prospectus will be published online at tsbshareoffer.equiniti.com available in printed form free of charge at the registered office of the Company until 14 days after Admission.

14 Selling restrictions

The distribution of this Prospectus and the offer of Ordinary Shares in certain jurisdictions may be restricted by law and therefore persons into whose possession this Prospectus comes should inform themselves about and observe any restrictions, including those set out in the paragraphs that follow. Any failure to comply with these restrictions may constitute a violation of the securities laws of any such jurisdiction.

No action has been taken or will be taken in any jurisdiction that would permit a public offering or sale of the Ordinary Shares, or possession or distribution of this Prospectus (or any other offering or publicity material relating to Ordinary Shares), in any country or jurisdiction where action for that purpose is required or doing so may be restricted by law.

None of the Ordinary Shares may be offered for sale or purchase or be delivered, and this Prospectus and any other offering material in relation to the Ordinary Shares may not be circulated, in any jurisdiction where to do so would breach any securities laws or regulations of any such jurisdiction or give rise to an obligation to obtain any consent, approval or permission or to make any application, filing or registration.

Persons into whose possession this Prospectus comes should inform themselves about and observe any restrictions on the distribution of this Prospectus and any offering of the Ordinary Shares. Any failure to comply with these restrictions may constitute a violation of the securities laws of any such jurisdiction. This Prospectus does not constitute an offer to purchase any of the Ordinary Shares to any person in any jurisdiction to whom it is unlawful to make such offer of solicitation in such jurisdiction.

European Economic Area

In relation to each Relevant Member State, an offer to the public of any Ordinary Shares may not be made in that Relevant Member State, except that an offer to the public in that Relevant Member State of any Ordinary Shares may be made at any time under the following exemptions under the Prospectus Directive, if they have been implemented in that Relevant Member State:

(a) to any legal entity which is a qualified investor as defined under the Prospectus Directive;

(b) to fewer than 100 or, if the Relevant Member State has implemented the relevant provisions of the 2010 PD Amending Directive, 150 natural or legal persons (other than qualified investors as defined in the Prospectus Directive), subject to obtaining the prior consent of the Joint Global Co-ordinators; or

(c) in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of Ordinary Shares shall result in a requirement for the Company or any Underwriter to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive and each person who initially acquires any Ordinary Shares or to whom any offer is made will be deemed to have represented, warranted and agreed to with the Underwriters and the Company that it is a qualified investor within the meaning of the law in that Relevant Member State implementing Article 2(1)(e) of the Prospectus Directive.

For the purposes of this provision, the expression an "**offer to the public**" in relation to any Ordinary Shares in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the Offer and any Ordinary Shares to be offered so as to enable an investor to decide to purchase any Ordinary Shares, as the same may be varied for that Relevant Member State by any measure implementing the Prospectus Directive in that Relevant Member State.

In the case of any Ordinary Shares being offered to a financial intermediary as that term is used in Article 3(2) of the Prospectus Directive, each such financial intermediary will be deemed to have represented, acknowledged and agreed that the Ordinary Shares acquired by it in the Offer have not been acquired on a non-discretionary basis on behalf of, nor have they been acquired with a view to their offer or resale to, persons in circumstances which may give rise to an offer of any Ordinary Shares to the public in a Relevant Member State prior to the publication of a prospectus in relation to the Ordinary Shares which has been approved by the competent authority in that relevant member state or, where appropriate, approved in another Relevant Member State and notified to the competent authority in the Relevant Member State, all in accordance with the Prospectus Directive, other than their offer or resale to Qualified Investors or in circumstances in which the prior consent of the Joint Global Co-ordinators has been obtained to each such proposed offer or resale.

The Company, the Selling Shareholder, the Underwriters and their affiliates and others will rely upon the truth and accuracy of the foregoing representation, acknowledgement and agreement.

United States of America

This Prospectus is not an offer of securities for sale in the United States. The Ordinary Shares have not been, and will not be, registered under the Securities Act or with any securities regulatory authority of any State or other jurisdiction of the United States and may not be offered or sold in the United States except in transactions exempt from or not subject to the registration requirements of the Securities Act. Accordingly, the Joint Bookrunners may offer and sell Ordinary Shares only (1) in the United States only through their respective US-registered broker-dealer affiliates to persons reasonably believed to be QIBs in reliance on Rule 144A or pursuant to another exemption from, or in a transaction not subject to, the registration requirements of the Securities Act or (2) outside the United States in offshore transactions in reliance on Regulation S.

In addition, until 40 days after the commencement of the Offer, any offer or sale of Ordinary Shares within the United States by any dealer (whether or not participating in the Offer) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A or another available exemption from registration under the Securities Act.

Each purchaser of Ordinary Shares within the United States, pursuant to Rule 144A by accepting delivery of this Prospectus, will be deemed to have represented, agreed and acknowledged that it has received a copy of this Prospectus and such other information as it deems necessary to make an investment decision and that:

(a) it is (i) a QIB within the meaning of Rule 144A, (ii) acquiring the Ordinary Shares for its own account or for the account of one or more QIBs with respect to whom it has the authority to

make, and does make, the representations and warranties set forth herein, (iii) acquiring the Ordinary Shares for investment purposes, and not with view to further distribution of such Ordinary Shares, and (iv) aware, and each beneficial owner of the Ordinary Shares has been advised, that the sale of the Ordinary Shares to it is being made in reliance on Rule 144A or in reliance on another exemption from, or in a transaction not subject to, the registration requirements of the Securities Act;

(b) it understands that the Ordinary Shares are being offered and sold in the United States only in a transaction not involving any public offering within the meaning of the Securities Act and that the Ordinary Shares have not been and will not be registered under the Securities Act or with any securities regulatory authority of any State or other jurisdiction of the United States and may not be offered, sold, pledged or otherwise transferred except (i) to a person that it and any person acting on its behalf reasonably purchasing for its own account or for the account of a QIB in a transaction meeting the requirements of Rule 144A, or another exemption from, or in a transaction not subject to, the registration requirements of the Securities Act, (ii) in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S, (iii) pursuant to an exemption from registration under the Securities Act provided by Rule 144 thereunder (if available) or (iv) pursuant to an effective registration statement under the Securities Act, in each case in accordance with any applicable securities laws of any state of the United States. It further (A) understands that the Ordinary Shares may not be deposited into any unrestricted depositary receipt facility in respect of the Ordinary Shares established or maintained by a depositary bank, (B) acknowledges that the Ordinary Shares (whether in physical certificated form or in uncertificated form held in CREST) are "restricted securities" within the meaning of Rule 144(a)(3) under the Securities Act and that no representation is made as to the availability of the exemption provided by Rule 144 for resales of the Ordinary Shares and (C) understands that the Company may not recognise any offer, sale, resale, pledge or other transfer of the Ordinary Shares made other than in compliance with the above-stated restrictions;

(c) it understands that the Ordinary Shares (to the extent they are in certificated form), unless otherwise determined by the Company in accordance with applicable law, will bear a legend substantially to the following effect:

THE ORDINARY SHARES REPRESENTED HEREBY HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE US SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT") OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) TO A PERSON THAT THE SELLER AND ANY PERSON ACTING ON ITS BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER, (2) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR RULE 904 OF REGULATION S UNDER THE SECURITIES ACT, (3) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF AVAILABLE) OR (4) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT, IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES. NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT FOR RESALES OF THE SHARES. NOTWITHSTANDING ANYTHING TO THE CONTRARY IN THE FOREGOING, THE ORDINARY SHARES REPRESENTED HEREBY MAY NOT BE DEPOSITED INTO ANY UNRESTRICTED DEPOSITARY RECEIPT FACILITY IN RESPECT OF THE ORDINARY SHARES ESTABLISHED OR MAINTAINED BY A DEPOSITARY BANK. EACH HOLDER, BY ITS ACCEPTANCE OF ORDINARY SHARES, REPRESENTS THAT IT UNDERSTANDS AND AGREES TO THE FOREGOING RESTRICTIONS; and

(d) it represents that if, in the future, it offers, resells, pledges or otherwise transfers such Ordinary Shares while they remain "restricted securities" within the meaning of Rule 144, it shall notify such subsequent transferee of the restrictions set out above.

The Company, the Underwriters and their affiliates and others will rely on the truth and accuracy of the foregoing acknowledgements, representations and agreements.

Japan

The Ordinary Shares have not been and will not be registered under the Financial Instruments and Exchange Law as amended; the ("**FIEL**"). The Ordinary Shares may not be offered or sold directly or indirectly, in Japan or to, or for the benefit of, any resident in Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organised under the laws of Japan), or to others for reoffering or resale, directly or indirectly, in Japan or to, or for the benefit of, a resident of Japan except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the FIEL and any other applicable laws, regulations and ministerial guidelines of Japan.

Australia

This Prospectus (a) does not constitute a prospectus or a product disclosure statement under the Corporations Act 2001 of the Commonwealth of Australia ("**Corporations Act**"); (b) does not purport to include the information required of a prospectus under Part 6D.2 of the Corporations Act or a product disclosure statement under Part 7.9 of the Corporations Act; has not been, nor will it be, lodged as a disclosure document with the Australian Securities and Investments Commission ("**ASIC**"), the Australian Securities Exchange operated by ASX Limited or any other regulatory body or agency in Australia; and (c) may not be provided in Australia other than to select investors ("**Exempt Investors**") who are able to demonstrate that they (i) fall within one or more of the categories of investors under section 708 of the Corporations Act to whom an offer may be made without disclosure under Part 6D.2 of the Corporations Act and (ii) are "wholesale clients" for the purpose of section 761G of the Corporations Act.

The Ordinary Shares may not be directly or indirectly offered for subscription or purchased or sold, and no invitations to subscribe for, or buy, the Ordinary Shares may be issued, and no draft or definitive offering memorandum, advertisement or other offering material relating to any Ordinary Shares may be distributed, received or published in Australia, except where disclosure to investors is not required under Chapters 6D and 7 of the Corporations Act or is otherwise in compliance with all applicable Australian laws and regulations. By submitting an application for the Ordinary Shares, each purchaser or subscriber of Ordinary Shares represents and warrants to the Company, the Selling Shareholders, the Underwriters and their affiliates that such purchaser or subscriber is an Exempt Investor.

As any offer of Ordinary Shares under the Prospectus, any supplement or the accompanying prospectus or other document will be made without disclosure in Australia under Parts 6D.2 and 7.9 of the Corporations Act, the offer of those Ordinary Shares for resale in Australia within 12 months may, under the Corporations Act, require disclosure to investors if none of the exemptions in the Corporations Act applies to that resale. By applying for the Ordinary Shares each purchaser or subscriber of Ordinary Shares undertakes to the Company, the Selling Shareholders and the Underwriters that such purchaser or subscriber will not, for a period of 12 months from the date of issue or purchase of the Ordinary Shares, offer, transfer, assign or otherwise alienate those Ordinary Shares to investors in Australia except in circumstances where disclosure to investors is not required under the Corporations Act or where a compliant disclosure document is prepared and lodged with ASIC.

Canada

Any distribution of the Offer Shares in Canada will be made only in the provinces of Ontario and Quebec, by an investment dealer, an exempt market dealer or a restricted dealer, in each case, that is registered in accordance with applicable provincial securities laws, or by a person that is exempt from registration under such laws under the "international dealer registration exemption" in Section 8.18 of National Instrument 31-103, and for greater certainty, will be undertaken in accordance with applicable provincial securities laws so that the Company does not become subject to such laws as a "reporting issuer".

Guernsey

To the extent to which any promotion of the Ordinary Shares which are comprised in the Offer is deemed to take place in Guernsey, the Ordinary Shares are only being promoted in or from within the Bailiwick of Guernsey either (i) by persons licensed to do so under the Protection of Investors (Bailiwick of Guernsey) Law 1987 (as amended) or (ii) to persons licensed under the Protection of

Investors (Bailiwick of Guernsey) Law, 1987 (as amended), the Insurance Business (Bailiwick of Guernsey) Law, 2002 (as amended), the Banking Supervision (Bailiwick of Guernsey) Law, 1994 (as amended) or the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000 (as amended). Promotion is not being made in any other way.

Hong Kong

The Ordinary Shares have not been offered or sold and will not be offered or sold in Hong Kong, by means of any document, other than (a) to "professional investors" as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made under that Ordinance; or (b) in other circumstances which do not result in the document being a "prospectus" as defined in the Companies Ordinance (Cap. 32) of Hong Kong or which do not constitute an offer to the public within the meaning of that Ordinance; and no advertisement, invitation or document relating to the Ordinary Shares, which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong), other than with respect to Ordinary Shares which are or are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance has been or will be issued, whether in Hong Kong or elsewhere.

Isle of Man

The Company is not subject to any form of authorisation or approval in the Isle of Man. Investors in the Company are not protected by any statutory compensation arrangements in the event of the Company's failure and the Isle of Man Financial Supervision Commission does not vouch for the financial soundness of the Company or for the correctness of any statements made or opinions expressed with regard to it.

Jersey

The Prospectus constitutes a "financial service advertisement" under the Financial Services (Advertising) (Jersey) Order 2008. Consent under the Control of Borrowing (Jersey) Order 1958 has not been obtained for the circulation of the Prospectus. Accordingly, the offer that is the subject of the Prospectus, may only be made in Jersey where the offer is valid in the United Kingdom or Guernsey and is circulated in Jersey only to persons similar to those to whom, and in a manner similar to that in which, it is for the time being circulated in the United Kingdom or Guernsey as the case may be. The Directors may, but are not obliged to, apply for such consent in the future.

Singapore

The Prospectus has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, the Prospectus and any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the Ordinary Shares may not be circulated or distributed, nor may Ordinary Shares be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to persons in Singapore other than (i) to an institutional investor as defined under Section 275(2) and under Section 274 of the Securities and Futures Act, Chapter 289 of Singapore ("**SFA**"), (ii) to a relevant person as defined under Section 275(2) and under Section 275(1), or any person under Section 275(1A), and in accordance with the conditions specified in Section 275 of the SFA, or (iii) otherwise under, and in accordance with the conditions of, any other applicable provision of the SFA.

Where Ordinary Shares are subscribed or purchased under Section 275 of the SFA by a relevant person which is:

(A) a corporation (which is not an accredited investor (as defined in Section 4A of the SFA)) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or

(B) a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary of the trust is an individual who is an accredited investor, shares, debentures and units of shares and debentures of that corporation or the beneficiaries' rights and interest (howsoever described) in that trust shall not be transferred within six months after that corporation or that trust has acquired the Ordinary Shares under an offer made under Section 275 of the SFA except:

(1) to an institutional investor (for corporations, under Section 274 of the SFA) or to a relevant person defined in Section 275(2) of the SFA, or to any person under an offer that is made

on terms that such shares, debentures and units of shares and debentures of that corporation or such rights and interest in that trust are acquired at a consideration of not less than US$200,000 (or its equivalent in a foreign currency) for each transaction, whether such amount is to be paid for in cash or by exchange of securities or other assets, and further for corporations, in accordance with the conditions specified in Section 275 of the SFA;

(2) where no consideration is or will be given for the transfer; or

(3) where the transfer is by operation of law.

Switzerland

The Ordinary Shares may not be publicly offered in Switzerland and will not be listed on the SIX Swiss Exchange ("**SIX**") or on any other stock exchange or regulated trading facility in Switzerland. The Prospectus has been prepared without regard to the disclosure standards for issuance prospectuses under art. 652a or art. 1156 of the Swiss Code of Obligations or the disclosure standards for listing prospectuses under art. 27 ff. of the SIX Listing Rules or the listing rules of any other stock exchange or regulated trading facility in Switzerland. Neither the Prospectus nor any other offering or marketing material relating to the Ordinary Shares or the offering may be publicly distributed or otherwise made publicly available in Switzerland.

Neither the Prospectus nor any other offering or marketing material relating to the Offer, the Company or the Ordinary Shares have been or will be filed with or approved by any Swiss regulatory authority. In particular, the Prospectus will not be filed with, and the offer of Ordinary Shares will not be supervised by, the Swiss Financial Market Supervisory Authority ("**FINMA**"), and the offer of Ordinary Shares has not been and will not be authorised under the Swiss Federal Act on Collective Investment Schemes ("**CISA**"). The investor protection afforded to acquirers of interests in collective investment schemes under the CISA does not extend to acquirers of Ordinary Shares.

PART XXII
ADDITIONAL INFORMATION

1 Responsibility

The Company, the Directors, whose names and principal functions are set out in Part XI: *"Directors, Senior Management and Corporate Governance"* and the Prospective Non-executive Director, accept responsibility for the information contained in this Prospectus. To the best of the knowledge of the Company, the Directors and the Prospective Non-executive Director (each of whom has taken all reasonable care to ensure that such is the case), the information contained in this Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.

2 Incorporation

2.1 The Company was incorporated and registered in England and Wales on 31 January 2014 as a public company limited by shares under the Companies Act 2006 with the name TSB Banking Group plc and with the registered number 8871766.

2.2 The Company's registered office and principal place of business is at 20 Gresham Street, London EC2V 7JE (telephone number: +44 (0)20 700 39419).

3 Share capital

3.1 The share capital history of the Company is as follows:

3.1.1 On incorporation, the issued share capital of the Company was £50,000 represented by 50,000 shares of £1 each.

3.1.2 On 26 March 2014:

(a) in connection with the acquisition by the Company of TSB Bank described in more detail in *"Pre – IPO Reorganisation"* below, the TSB Board resolved, subject to the passing of the resolutions referred to in paragraph 3.1.3 below, to allot 50,000,000 Ordinary Shares to the Selling Shareholder; and

(b) in connection with the capitalisation of the Company, the TSB Board approved, subject to the passing of the resolution referred to in paragraph 3.1.3(b) below and the completion of the acquisition by the company of TSB Bank, the allotment of Ordinary Shares up to a maximum nominal amount of £10 million to the Selling Shareholder.

3.1.3 On 4 April 2014, by resolutions passed at a general meeting of the Company, it was resolved that:

(a) the Company's existing share capital be sub-divided into 5,000,000 ordinary shares of 1 pence each; and

(b) the TSB Board be generally and unconditionally authorised to exercise all of the powers of the Company to allot Ordinary Shares in the Company up to a maximum nominal amount of £10.5 million, pursuant to and in accordance with section 551 of the Companies Act, such authority to expire on 1 June 2014 unless renewed, varied or revoked by the Company prior to such date.

3.1.4 On 25 April 2014, and in consideration for the acquisition by the Company of TSB Bank, the Company allotted 50,000,000 Ordinary Shares to the Selling Shareholder.

3.1.5 On 19 May 2014, and in connection with the capitalisation of the Company, the Company allotted 445,000,000 Ordinary Shares to the Selling Shareholder for cash consideration of £200 million.

3.1.6 On 4 June 2014, by resolutions passed at a general meeting of the Company, it was resolved that, subject to and conditional upon Admission:

(a) the TSB Board be generally and unconditionally authorised, pursuant to section 551 of the Companies Act, to allot relevant securities: (i) following Admission, up to an amount equal to one third of the aggregate nominal value of the Ordinary Shares in issue immediately following Admission; and (ii) following Admission and in connection with a rights issue, up to an amount equal to a further one third of the aggregate nominal value of the Ordinary Shares in issue

immediately following Admission, such authority to replace all existing authorities and to expire at the end of the next annual general meeting of the Company or on 30 June 2015, whichever is the earlier (save that the Company would be able to make an offer or agreement which would or may require relevant securities to be allotted after such expiry);

(b) the TSB Board be empowered pursuant to sections 570 and 573 of the Companies Act to allot equity securities (as defined in the Companies Act) for cash, pursuant to the authority described in paragraph 3.1.6 above in substitution for any prior powers conferred on it, but without prejudice to the terms of such powers, as if section 561(1) of the Companies Act did not apply to any such allotment, such power being limited, following Admission, up to an amount equal to one-twentieth of the aggregate nominal value of the Ordinary Shares in issue immediately following Admission, such authority to expire at the end of the next annual general meeting of the Company or on 30 June 2015, whichever is the earlier (save that the Company would be able to make an offer or agreement which would or may require relevant securities to be allotted after such expiry); and

(c) the TSB Board be authorised to make market purchases of Ordinary Shares pursuant to section 701 of the Companies Act, subject to the following conditions:

(I) the maximum number of Ordinary Shares authorised to be purchased may not be more than the number equal to 10 per cent. of the Ordinary Shares in issue immediately following Admission;

(II) the minimum price which may be paid for an Ordinary Share is 1 pence, being the nominal value of an Ordinary Shares; and

(III) the maximum price which may be paid for an Ordinary Share shall be the higher of: (i) an amount equal to five per cent. above the average market value of an Ordinary Share for the five Business Days immediately preceding the day on which that Ordinary Share is contracted to be purchased; and (ii) an amount equal to the higher of the price of the last independent trade and the highest current independent bid on the trading venue where the purchase is carried out, in each case exclusive of expenses,

such power to apply until the date of the annual general meeting of the Company in 2015 (or, if earlier, 30 June 2015) but, in each case, so that the Company may enter into a contract to purchase Ordinary Shares which will or may be completed or executed wholly or partly after the power ends and the Company may purchase Ordinary Shares pursuant to any such contract as if the power had not ended.

3.2 The issued share capital of the Company as at the date of the publication of this Prospectus and immediately following Admission will be as follows:

	Nominal value	Number of shares issued	Aggregate nominal value
Ordinary Shares	One pence	500,000,000	£5,000,000

3.3 No new Ordinary Shares will be issued, allotted or offered in connection with the Offer or Admission.

3.4 Save as disclosed in this Prospectus:

3.4.1 no share or loan capital of the Company or any of its subsidiaries has within the period covered by the historical financial information set out in this Prospectus (other than intra-group issues by wholly owned subsidiaries or pursuant to the Offer) been issued or been agreed to be issued fully or partly paid, either for cash, or for a consideration other than cash and no such issue is now proposed;

3.4.2 no commissions, discounts, brokerages or other special terms have been granted by the Company or any of its subsidiaries within the period covered by the historical financial information set out in this Prospectus in connection with the issue or sale of any share or loan capital of any such company; and

3.4.3 no share or loan capital of the Company or any of its subsidiaries is under option or agreed, conditionally or unconditionally, to be put under option.

3.5 The Ordinary Shares are in registered form and, subject to the provisions of the CREST Regulations, the Directors may permit the holding of shares in any class of shares in uncertificated form and title to such shares may be transferred by means of a relevant system (as defined in the CREST Regulations). Where shares are held in certificated form, share certificates will be sent to the registered members by first class post.

3.6 When admitted to trading, the Ordinary Shares will be registered with the ISIN GB00BMQX2Q65 and SEDOL number BMQ X2Q6.

4 Pre-IPO Reorganisation

In connection with Admission, the TSB Bank Group undertook a corporate reorganisation that included the Company becoming the holding company of the TSB Bank Group. The Pre-IPO Reorganisation occurred between 21 January 2014 and 25 April 2014 and consisted of the following principal steps:

4.1 the buy-back, pursuant to a share purchase agreement dated 21 January 2014, and subsequent cancellation, of 1,349,999 preference shares in TSB Bank that were issued to TSB Intermediate Company 2 Limited;

4.2 the acquisition, pursuant to a share purchase agreement dated 14 March 2014, of the entire share capital of TSB Bank by the Selling Shareholder from TSB Intermediate Company 2 Limited for consideration of £360,027,000; and

4.3 the acquisition, pursuant to a share purchase agreement dated 25 April 2014, of the entire share capital of TSB Bank by the Company from the Selling Shareholder in exchange for the allotment to the Selling Shareholder of 50,000,000 ordinary shares in the Company.

5 Articles of Association

The Company's objects are not restricted by its Articles. Accordingly, pursuant to section 31 of the Companies Act 2006, the Company's objects are unrestricted.

The Articles of the Company adopted on 4 June, conditional upon Admission being effective, include provisions to the following effect.

5.1 Shares

Respective share rights of different classes of shares

5.1.1 Without prejudice to any rights attached to any existing shares, the Company may issue shares with such rights or restrictions as determined by either the Company by ordinary resolution or, if the Company passes a resolution to so authorise them, the directors. The Company may also issue shares which are, or are liable to be, redeemed at the option of the Company or the holder and the directors may determine the terms, conditions and manner of redemption of any such shares.

Voting rights

5.1.2 At a general meeting, subject to any special rights or restrictions attached to any class of shares:

(a) on a show of hands, every member present in person and every duly appointed proxy present shall have one vote;

(b) on a show of hands, a proxy has one vote for and one vote against the resolution, and one vote against the resolution if the proxy has been duly appointed by more than one member entitled to vote on the resolution and the proxy has been instructed:

(I) by one or more of those members to vote for the resolution and by one or more other of those members to vote against it; or

(II) by one or more of those members to vote either for or against the resolution and by one or more other of those members to use his discretion as to how to vote; and

(c) on a poll, every member present in person or by proxy has one vote for every share held by him or her.

5.1.3 A proxy shall not be entitled to vote on a show of hands or on a poll where the member appointing the proxy would not have been entitled to vote on the resolution had he been present in person.

Variation of rights

5.1.4 Whenever the share capital of the Company is divided into different classes of shares, the special rights attached to any class may be varied or abrogated either with the written consent of the holders of three-quarters in nominal value of the issued shares of the class (excluding shares held as treasury shares) or with the sanction of a special resolution passed at a separate meeting of the holders of the shares of the class (but not otherwise), and may be so varied or abrogated either while the Company is a going concern or during or in contemplation of a winding-up.

5.1.5 The special rights attached to any class of shares will not, unless otherwise expressly provided by the terms of issue, be deemed to be varied by (a) the creation or issue of further shares ranking, as regards participation in the profits or assets of the Company, in some or all respects equally with them but in no respect in priority to them, or (b) the purchase or redemption by the Company of any of its own shares.

Transfer of shares

5.1.6 Transfers of certificated shares may be effected in writing or any other form acceptable to the directors, and signed by or on behalf of the transferor and, if any of the shares are not fully-paid shares, by or on behalf of the transferee. The transferor shall remain the holder of the shares concerned until the name of the transferee is entered in the Register in respect of those shares. Transfers of uncertificated shares shall be effected by means of a relevant system (i.e. CREST) unless the CREST Regulations provide otherwise.

5.1.7 The directors may decline to register any transfer of a certificated share, unless (a) the instrument of transfer is in respect of only one class of share, (b) the instrument of transfer is lodged at the transfer office, duly stamped if required, accompanied by the relevant share certificate(s) or other evidence reasonably required by the directors to show the transferor's right to make the transfer or, if the instrument of transfer is executed by some other person on the transferor's behalf, the authority of that person to do so, and (c) the certificated share is fully paid up.

5.1.8 The directors may refuse to register an allotment or transfer of shares in favour of more than four persons jointly.

Restrictions where notice not complied with

5.1.9 If any person appearing to be interested in shares (within the meaning of Part 22 of the Companies Act 2006) has been duly served with a notice under section 793 of the Companies Act 2006 (which confers upon public companies the power to require information as to interests in its voting shares) and is in default for a period of 14 days in supplying to the Company the information required by that notice:

(a) the holder of those shares shall not be entitled to attend or vote (in person or by proxy) at any shareholders' meeting, unless the directors otherwise determine; and

(b) the directors may in their absolute discretion, where those shares represent 0.25 per cent. or more of the issued shares of a relevant class, by notice to the holder direct that:

(I) any dividend or part of a dividend (including shares issued in lieu of a dividend) or other money which would otherwise be payable on the shares will be retained by the Company without any liability for interest; and/or

(II) (with various exceptions set out in the Articles) transfers of the shares will not be registered.

Forfeiture and lien

5.1.10 If a member fails to pay in full any sum which is due in respect of a share on or before the due date for payment, then, following notice by the directors requiring payment of

the unpaid amount with any accrued interest and any expenses incurred, such share may be forfeited by a resolution of the directors to that effect (including all dividends declared in respect of the forfeited share and not actually paid before the forfeiture).

5.1.11 A member whose shares have been forfeited will cease to be a member in respect of the shares, but will remain liable to pay the Company all monies which at the date of forfeiture were presently payable together with interest. The directors may in their absolute discretion enforce payment without any allowance for the value of the shares at the time of forfeiture or for any consideration received on their disposal, or waive payment in whole or part.

5.1.12 The Company shall have a lien on every share (not being a fully paid-up share) that is not fully paid for all monies called or payable at a fixed time in respect of such share. The Company's lien over a share takes priority over the rights of any third party and extends to any dividends or other sums payable by the Company in respect of that share. The directors may waive any lien which has arisen and may resolve that any share shall for some limited period be exempt from such a lien, either wholly or partially.

5.1.13 A share forfeited or surrendered shall become the property of the Company and may be sold, re-allotted or otherwise disposed of to any person (including the person who was, before such forfeiture or surrender, the holder of that share or entitled to it) on such terms and in such manner as the directors think fit.

5.2 General meetings

Annual general meeting

5.2.1 An annual general meeting shall be held in each period of six months beginning with the day following the Company's accounting reference date, at such place or places, date and time as may be decided by the directors.

Convening of general meetings

5.2.2 The directors may, whenever they think fit, call a general meeting. The directors are required to call a general meeting once the Company has received requests from its members to do so in accordance with the Companies Act 2006.

Notice of general meetings etc.

5.2.3 Notice of general meetings shall include all information required to be included by the Companies Act 2006 and shall be given to all members other than those members who are not entitled to receive such notices from the Company under the provisions of the Articles. The Company may determine that only those persons entered on the Register at the close of business on a day decided by the Company, such day being no more than 21 days before the day that notice of the meeting is sent, shall be entitled to receive such a notice.

5.2.4 For the purposes of determining which persons are entitled to attend or vote at a meeting, and how many votes such persons may cast, the Company must specify in the notice of the meeting a time, not more than 48 hours before the time fixed for the meeting, by which a person must be entered on the Register in order to have the right to attend or vote at the meeting. The directors may in their discretion resolve that, in calculating such period, no account shall be taken of any part of any day that is not a working day (within the meaning of section 1173 of the Companies Act 2006).

Quorum

5.2.5 No business other than the appointment of a chairman shall be transacted at any general meeting unless a quorum is present at the time when the meeting proceeds to business. Two members present in person or by proxy shall be a quorum.

Conditions of admission

5.2.6 The directors may require attendees to submit to searches or put in place such arrangements or restrictions as they think fit to ensure the safety and security of

attendees at a general meeting. Any member, proxy or other person who fails to comply with such arrangements or restrictions may be refused entry to, or removed from, the general meeting.

5.2.7 The directors may decide that a general meeting shall be held at two or more locations to facilitate the organisation and administration of such meeting. A member present in person or by proxy at the designated "satellite" meeting place may be counted in the quorum and may exercise all rights that they would have been able to exercise if they had been present at the principal meeting place. The directors may make and change from time to time such arrangements as they shall in their absolute discretion consider appropriate to:

(a) ensure that all members and proxies for members wishing to attend the meeting can do so;

(b) ensure that all persons attending the meeting are able to participate in the business of the meeting and to see and hear anyone else addressing the meeting;

(c) ensure the safety of persons attending the meeting and the orderly conduct of the meeting; and

(d) restrict the numbers of members and proxies at any one location to such number as can safely and conveniently be accommodated there.

5.3 Directors

General powers

5.3.1 The directors shall manage the business and affairs of the Company and may exercise all powers of the Company other than those that are required by the Companies Act 2006 or by the Articles to be exercised by the Company at the general meeting.

Number of directors

5.3.2 The directors shall not be less than two or more than fifteen in number save that the Company may, by ordinary resolution, from time to time vary the minimum number and/or maximum number of directors.

Share qualification

5.3.3 A director shall not be required to hold any shares of the Company by way of qualification. A director who is not a member of the Company shall nevertheless be entitled to attend and speak at general meetings.

Directors' fees

5.3.4 Directors' fees are determined by the directors from time to time except that they may not exceed £1,500,000 per annum in aggregate or such higher amount as may from time to time be determined by ordinary resolution of the shareholders.

5.3.5 Any director who holds any executive office (including the office of chairman or deputy chairman), or who serves on any committee of the directors, or who otherwise performs services which in the opinion of the directors are outside the scope of the ordinary duties of a director, may be paid extra remuneration by way of salary, commission or otherwise or may receive such other benefits as the directors may determine.

Executive directors

5.3.6 The directors may from time to time appoint one or more of their number to be the holder of any executive office and may confer upon any director holding an executive office any of the powers exercisable by them as directors upon such terms and conditions, and with such restrictions, as they think fit. They may from time to time revoke, withdraw, alter or vary all or any of such delegated powers.

Directors' retirement

5.3.7 Each director shall retire at the annual general meeting held in the third calendar year following the year in which he was elected or last re-elected by the Company. In

addition, each director (other than the Chairman and any director holding an executive office) shall also be required to retire at each annual general meeting following the ninth anniversary on the date on which he was elected by the Company. A director who retires at any annual general meeting shall be eligible for election or re-election unless the directors resolve otherwise not later than the date of the notice of such annual general meeting.

5.3.8 When a director retires at an annual general meeting in accordance with the Articles, the Company may, by ordinary resolution at the meeting, fill the office being vacated by re-electing the retiring director. In the absence of such a resolution, the retiring director shall nevertheless be deemed to have been re-elected, except in the cases identified by the Articles.

Removal of a director by resolution of the Company

5.3.9 The Company may, by ordinary resolution of which special notice is given, remove any director before the expiration of his period of office in accordance with the Companies Act 2006, and elect another person in place of a director so removed from office. Such removal may take place notwithstanding any provision of the Articles or of any agreement between the Company and such director, but is without prejudice to any claim the director may have for damages for breach of any such agreement.

Proceedings of the Board

5.3.10 Subject to the provisions of the Articles, the directors may meet for the despatch of business and adjourn and otherwise regulate its proceedings as they think fit.

5.3.11 The quorum necessary for the transaction of business of the directors may be fixed from time to time by the directors and unless so fixed at any other number shall be three. A meeting of the directors at which a quorum is present shall be competent to exercise all powers and discretions for the time being exercisable by the directors.

5.3.12 The directors may elect from their number a chairman and a deputy chairman (or two or more deputy chairmen) and decide the period for which each is to hold office.

5.3.13 Questions arising at any meeting of the directors shall be determined by a majority of votes. In the case of an equality of votes, the chairman of the meeting shall have a second or casting vote.

Directors' interests

5.3.14 For the purposes of section 175 of the Companies Act 2006, the directors shall have the power to authorise any matter which would or might otherwise constitute or give rise to a breach of the duty of a director to avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the Company.

5.3.15 Any such authorisation will be effective only if:

(a) the matter in question was proposed in writing for consideration at a meeting of the directors, in accordance with the Board's normal procedures or in such other manner as the directors may resolve;

(b) any requirement as to the quorum at the meeting at which the matter is considered is met without counting the director in question or any other interested director; and

(c) the matter was agreed to without such interested directors voting or would have been agreed to if their votes had not been counted.

5.3.16 The directors may extend any such authorisation to any actual or potential conflict of interest which may arise out of the matter so authorised and may (whether at the time of the giving of the authorisation or subsequently) make any such authorisation subject to any limits or conditions they expressly impose, but such authorisation is otherwise given to the fullest extent permitted. The directors may also terminate any such authorisation at any time.

Restrictions on quorum and voting

5.3.17 Except as provided below, a director may not vote in respect of any contract, arrangement or any other proposal in which he, or a person connected to him, is interested. Any vote of a director in respect of a matter where he is not entitled to vote shall be disregarded.

5.3.18 Subject to the provisions of the Companies Act 2006, a director is entitled to vote and be counted in the quorum in respect of any resolution concerning any contract, transaction or arrangement, or any other proposal (*inter alia*):

(a) in which he has an interest, of which he is not aware, or which cannot be reasonably be regarded as likely to give rise to a conflict of interest;

(b) in which he has an interest only by virtue of interests in the Company's shares, debentures or other securities or otherwise in or through the Company;

(c) which involves the giving of any security, guarantee or indemnity to the director or any other person in respect of obligations incurred by him and guaranteed by the Company (or vice versa);

(d) concerning an offer of securities by the Company or any of its subsidiary undertakings in which he is or may be entitled to participate as a holder of securities or as an underwriter or sub-underwriter;

(e) concerning any other body corporate, provided that he and any connected persons do not own or have a beneficial interest in 1 per cent. or more of any class of share capital of such body corporate, or of the voting rights available to the members of such body corporate;

(f) relating to an arrangement for the benefit of employees or former employees which does not award him any privilege or benefit not generally awarded to the employees or former employees to whom such arrangement relates;

(g) concerning the purchase or maintenance of insurance for any liability for the benefit of directors or for the benefit of persons who include directors;

(h) concerning the giving of indemnities in favour of the directors;

(i) concerning the funding of expenditure by any director or directors (i) on defending criminal, civil or regulatory proceedings or actions against him or them, (ii) in connection with an application to the court for relief, (iii) on defending him or them in any regulatory investigations, or (iv) incurred doing anything to enable him to avoid incurring such expenditure;

(j) in respect of which the director's interest, or the interest of directors generally, has been authorised by ordinary resolution.

Confidential information

5.3.19 If a director, otherwise than by virtue of his position as director, receives information in respect of which he owes a duty of confidentiality to a person other than the Company, he shall not be required to disclose such information to the Company or otherwise use or apply such confidential information for the purpose of or in connection with the performance of his duties as a director, provided that such an actual or potential conflict of interest arises from a permitted or authorised interest under the Articles. This is without prejudice to any equitable principle or rule of law which may excuse or release the director from disclosing the information in circumstances where disclosure may otherwise be required under the Articles.

Borrowing powers

5.3.20 The directors may exercise all the powers of the Company to borrow money, and to mortgage or charge its undertaking, property and uncalled capital, and to issue debentures and other securities, whether outright or as collateral security for any debt, guarantee, liability or obligation of the Company or of any third party.

Powers of the directors

5.3.21 The directors may delegate any of their powers or discretions, including those involving the payment of remuneration or the conferring of any other benefit to the directors, to such person or committee and in such manner as they think fit. Any such person or committee shall, unless the directors otherwise resolve, have the power to sub-delegate any of the powers or discretions delegated to them. The directors may make regulations in relation to the proceedings of committees or sub-committees.

5.3.22 The directors may appoint any person or fluctuating body of persons to be the attorney of the Company with such purposes and with such powers, authorities and discretions and for such periods and subject to such conditions as they may think fit.

5.3.23 Any director may at any time appoint any person (including another director) to be his alternate director and may at any time terminate such appointment.

Directors' liabilities

5.3.24 So far as may be permitted by the Companies Act 2006, every director, former director or Secretary of the Company or of an "Associated Company" (as defined in section 256 of the Companies Act 2006) of the Company may be indemnified by the Company out of its own funds against any liability incurred by him in connection with any negligence, default, breach of duty or breach of trust by him or any other liability incurred by him in the execution of his duties, the exercise of his powers or otherwise in connection with his duties, powers or offices.

5.3.25 The directors may also purchase and maintain insurance for or for the benefit of:

(a) any person who is or was a director or secretary of a "Relevant Company" (as defined in the Articles); or

(b) any person who is or was at any time a trustee of any pension fund or employees' share scheme in which employees of any Relevant Company are interested,

including insurance against any liability (including all related costs, charges, losses and expenses) incurred by or attaching to him in relation to his duties, powers or offices in relation to any Relevant Company, or any such pension fund or employees' share scheme.

5.3.26 So far as may be permitted by the Companies Act 2006, the Company may provide a "Relevant Officer" (as defined in the Articles) with defence costs in relation to any criminal or civil proceedings in connection with any negligence, default, breach of duty or breach of trust by him in relation to the Company or an Associated Company of the Company, or in relation to an application for relief under section 205(5) of the Companies Act 2006. The Company may do anything to enable such Relevant Officer to avoid incurring such expenditure.

5.4 Dividends

5.4.1 The Company may, by ordinary resolution, declare final dividends to be paid to its shareholders. However, no dividend shall be declared unless it has been recommended by the directors and does not exceed the amount recommended by the directors.

5.4.2 If the directors believe that the profits of the Company justify such payment, they may pay fixed dividends on any class of share carrying a fixed dividend expressed to be payable on fixed dates. They may also pay interim dividends on shares of any class in amounts and on dates and periods as they think fit. Provided the directors act in good faith, they shall not incur any liability to the holders of any shares for any loss they may suffer by the payment of dividends on any other class of shares having rights ranking equally with or behind those shares.

5.4.3 Unless the share rights otherwise provide, all dividends shall be declared and paid according to the amounts paid up on the shares on which the dividend is paid, and apportioned and paid pro rata according to the amounts paid on the shares during any portion or portions of the period in respect of which the dividend is paid.

5.4.4 Any unclaimed dividends may be invested or otherwise applied for the benefit of the Company until they are claimed. Any dividend unclaimed for 12 years from the date on which it was declared or became due for payment shall be forfeited and shall revert to the Company.

5.4.5 The directors may, if authorised by ordinary resolution, offer to ordinary shareholders the right to elect to receive, in lieu of a dividend, an allotment of new ordinary shares credited as fully paid.

5.5 Failure to supply an address

A shareholder who has no registered address within the United Kingdom and has not supplied to the Company an address within the United Kingdom for the service of notices will not be entitled to receive notices from the Company.

5.6 Disclosure of shareholding ownership

The Disclosure and Transparency Rules require a member to notify the Company if the voting rights held by such member (including by way of certain financial instruments) reach, exceed or fall below 3 per cent. and each 1 per cent. threshold thereafter up to 100 per cent. Under the Disclosure and Transparency Rules, certain voting rights in the Company may be disregarded.

5.7 Changes in capital

The provisions of the Articles governing the conditions under which the Company may alter its share capital are no more stringent than the conditions imposed by the Companies Act 2006.

6 Directors and Senior Management of the Company

The Directors, the Prospective Non-executive Director and members of the Senior Management and their functions within the Company and brief biographies are set out in Part XI: "Directors, Senior Management and Corporate Governance".

The companies and partnerships of which the Directors, the Prospective Non-executive Director and members of the Senior Management are, or have been, within the past five years, members of the administrative, management or supervisory bodies or partners (excluding the Company and its subsidiaries and also excluding the subsidiaries of the companies listed below) are as follows:

Name	Current directorships/partnerships	Former directorships/partnerships
Will Samuel	Chairman, Howden Joinery Group plc Chairman, Ecclesiastical Insurance Group plc Chairman, Ecclesiastical Insurance Office plc	Trustee and Honorary Treasurer, International Alert Deputy Chairman, Inchcape plc Director, Edinburgh Investment Trust plc
Paul Pester	Advisory Board Member, the Financial Services Forum	Director, Micro Focus International

Name	Current directorships/partnerships	Former directorships/partnerships
Darren Pope	None	Director, Cheltenham & Gloucester plc Director, C&G Financial Services Ltd Director, C&G Homes Limited Director, C&G Property Holdings Ltd Director, Lloyds TSB Homeloans Ltd Director, Barnwood Mortgages Ltd Director, Central Mortgage Finance Ltd Director, Bavarian Mortgages No. 5 Ltd Director, Birmingham Midshires Asset Management Ltd Director, Birmingham Midshires Land Development Ltd Director, Birmingham Midshires Mortgage Services Ltd Director, Birmingham Midshires Mortgage Services No. 1 Ltd Director, Halifax Mortgage Services Ltd Director, HL Group (Holdings) Ltd Director, Western Trust & Savings Holdings Ltd Director, Sussex County Homes Limited
Norval Bryson	Director and Deputy Chairman, Scottish Widows Group Limited Deputy Chairman, St Columba's Hospice Trustee, Church of Scotland Investors Trust	None
Mark Fisher[1]	None	Director, Scottish Widows Group Limited Director, Matisse Court Limited
Godfrey Robson	None	Director, Frontline Consultants Limited Director, Caledonia Youth
Sandra Dawson	Director, Winton Capital Group Limited Director, DRS plc Director and Trustee, Institute for Government Chairman of Executive Committee and Trustee, Social Science Research Council USA Member, UK-India Round Table	Director, Barclays Bank plc Director and Trustee, Oxfam Director, Financial Services Authority Member, Prime Minister's Council on Science and Technology
Philip Augar	Non-Executive Member, Public Interest Committee, KPMG Director, Philip Augar and Associates Inc.	Director, Philip Augar and Associates Limited
Alexandra Kinney Pritchard	Director, MBNA Ltd Director, CPA Audit Corporate Services Limited Director, Gradient Finance Ltd	Director, Skipton Building Society Director, Financial Services Compensation Scheme Limited Director, Permanent TSB plc.

[1] Mark Fisher has been appointed to the TSB Board conditional upon, and from the date of, receipt of PRA approvals.

Name	Current directorships/partnerships	Former directorships/partnerships
Stuart Sinclair	Director, Prudential Health Holdings Limited Director, Prudential Protect Limited Director, Provident Financial plc Director, Swinton Group Limited Director, QBE Insurance (Europe) Limited	Director, The One Place Capital Limited Director, TH&SB Holdings Limited Director, The Savings Bank Limited Director, Liverpool Victoria Friendly Society Ltd Chairman, Platinum Bank (Kiev) Director, Universalna Insurance (Kiev)
Polly Williams	Chairman, National Counties Building Society Director, Counties Home Loan Management Limited Director, Worldspreads Limited (in special administration) Director, Scotiabank Ireland Limited Director, Daiwa Capital Markets Europe Limited	Director, Execution Holdings Limited Director, Hampshire Trust plc Director, APS Financial Limited
Neeta Atkar	None	None
Susan Crichton	Director, Hospice of St Francis (Berkhamsted) Limited Director, Hospice of St Francis Trading Limited	General Counsel, Post Office Limited Director, Postal Heritage Collection Trust Director, Postal Heritage Trust Director, Post Office Management Services Limited
Ian Firth	None	Director, SWIP Global Liquidity Fund plc
Nigel Gilbert	Member, Incorporated Society of British Advertisers (ISBA) Council	None
Rosemary Hilary	Director, Shelter	None
Rachel Lock	None	None
Peter Navin	Director, Bank of Scotland Foundation	Director, Lloyds TSB Financial Consultants Ltd
Helen Rose	None	Director, Lloyds Bank Pension Trust (No. 1) Limited Director, Lloyds Bank Pension Trust (No. 2) Limited

Save as set out above, none of the Directors, the Prospective Non-executive Director, the Senior Management or the Company Secretary has any business interests, or performs any activities, outside the TSB Group which are significant with respect to the TSB Group.

6.1 There are no family relationships between any Directors, between any members of the Senior Management, between any Directors and any members of Senior Management or between the Prospective Non-executive Director and any Directors or any members of Senior Management.

6.2 Save as set out at 6.3 below, as at the date of this Prospectus, none of the Directors, the Prospective Non-executive Director or members of the Senior Management has, at any time within the last five years:

6.2.1 had any prior convictions in relation to fraudulent offences;

6.2.2 been declared bankrupt or been the subject of any individual voluntary arrangement;

6.2.3 been associated with any bankruptcies, receiverships or liquidations when acting in the capacity of a member of the administrative, management or supervisory body or of a senior manager;

6.2.4 been subject to any official public incrimination and/or sanction by any statutory or regulatory authority (including designated professional bodies);

6.2.5 been disqualified by a court from acting in the management or conduct of the affairs of any issuer;

6.2.6 been disqualified by a court from acting as a member of the administrative, management or supervisory bodies of any issuer;

6.2.7 been a partner or senior manager in a partnership which, while he was a partner or within 12 months of his ceasing to be a partner, was put into compulsory liquidation or administration or which entered into any partnership voluntary arrangement;

6.2.8 owned any assets which have been subject to a receivership or been a partner in a partnership subject to a receivership where he was a partner at the time or within the 12 months preceding such event; or

6.2.9 been an executive director or senior manager of a company which has been placed in receivership, compulsory liquidation, creditors' voluntary liquidation or administration or which entered into any company voluntary arrangement or any composition or arrangement with its creditors generally or any class of creditors, at any time during which he was an executive director or senior manager of that company or within 12 months of his ceasing to be an executive director or senior manager.

6.3 Polly Williams is a director of Worldspreads Limited, a UK based online financial markets trading businesses which provided spread-betting services relating to foreign exchange, futures and options. On 18 March 2012, KPMG were appointed by the High Court special administrators of Worldspreads Ltd. Worldspreads Ltd is a wholly owned subsidiary of Worldspreads plc, a holding company incorporated in Dublin, Ireland which has been in liquidation since May 2012, pending resolution of the administration of the Worldspreads Ltd. Polly Williams is also a director of Worldspreads plc.

7 Service Agreements, benefits and remuneration

7.1 Remuneration approach

TSB's remuneration approach reflects TSB's core values and supports its business strategy. It is based on the following principles:

- encouraging employee share ownership – enabling a real sense of partnership in TSB;
- transparent and fair reward – to facilitate the recruitment, retention and motivation of competent and qualified employees who share the TSB Board's vision for TSB, its customers and its shareholders;
- reward directly linked to the achievement of sustainable performance – carefully balancing performance in terms of profitability, customer treatment, risk, conduct and compliance, with the application of malus (performance adjustment) and claw back as appropriate; and
- ensuring a balanced view of reward – looking at all elements of the package and ensuring that the balance between fixed and variable elements is aligned to and will help embed TSB's core values.

In line with this approach, regulatory requirements and guidance, and reflecting the business and values of TSB, TSB will reduce the proportion of variable pay elements over fixed pay elements for the Executive Directors from Admission.

TSB intends that the structure and quantum of ongoing remuneration for the Executive Directors and all other employees will be in line with a 1:1 cap on variable to fixed remuneration set out in the PRA Handbook.

A review of remuneration structure more widely is under way, led by the Remuneration Committee, including an assessment of the extent to which TSB might continue to move away from sales-linked reward towards rewarding sustainable performance over the longer term. TSB's current intention is to have new arrangements in place for all employees in 2015. In implementing the new strategy, TSB will seek to ensure that no employee's overall reward is materially reduced and that the overall cost to TSB will not be materially impacted.

In light of the TSB Board's desire to encourage employee share ownership, it is intended that all employees who are employed by TSB on the date of Admission will receive an award of Ordinary Shares with a value of £100. These awards will be structured under the TSB Share Incentive Plan (for further information, see *"Employee Share Plans – SIP"* below) and will normally be held for at least three years. In order to encourage retention, it is envisaged that the long-term ownership of those Ordinary Shares will, under normal circumstances be required to ensure eligibility for performance-related awards. It is intended that new joiners employed by TSB after the date of Admission will receive an award of Ordinary Shares with a value of £100 using an alternative share plan which will also have a minimum holding period of three years.

The Remuneration Committee has reviewed the remuneration arrangements applicable to the Company's "Remuneration Code staff" (as defined in the Remuneration Code issued by the PRA), which includes the Executive Directors, and is of the opinion that they are in compliance with the Remuneration Code.

7.2 Executive Director Remuneration Summary

Salary

Base salaries will typically be reviewed annually. Actual salaries take into account the experience, scope and nature of the role, overall remuneration opportunity and practices at peer companies of equivalent size and complexity. The pay and conditions of the wider workforce will also be considered when considering Executive Director remuneration.

TSB Award

The Executive Directors are eligible to participate in the TSB Award, an annual award based on meeting profit, customer treatment, individual conduct, risk and compliance gateways and the achievement of pre-determined annual corporate and customer treatment performance conditions. The target award level will not exceed 10 per cent. of salary, with the maximum award level not exceeding 15 per cent. of salary. For Executive Directors a proportion of any awards made may, in line with the PRA's Remuneration Code, be made in the form of awards of Ordinary Shares which will be subject to a retention period of at least six months.

Sustainable Performance Award

The Executive Directors are eligible to participate in the Company's discretionary incentive plan, the Sustainable Performance Award (see *"Employee Share Plans – Sustainable Performance Award"* below). The maximum award level for any participant in respect of any financial year will be 100 per cent. of salary subject always to the 1:1 cap on fixed to variable remuneration, as prescribed by the PRA and the EU, highlighted above. It is envisaged that the on-target level will be 62.5 per cent. Sustainable Performance Awards will normally vest in five equal tranches on the first five anniversaries of the grant date and will be subject to any retention requirements, as set out in the PRA Remuneration Code. The vesting of each component part of any outstanding Sustainable Performance Awards will be conditional on the Remuneration Committee being satisfied that the Company and the participant have achieved satisfactory levels of performance up until the point of vesting. A summary of the plan and its intended operation is set out under *"Employee Share Plans – Sustainable Performance Award"* below. Fixed pay for these purposes includes salary and any relevant contractual benefits (including pension contributions and car allowances).

Pensions and benefits

Details of the proposed retirement benefits and benefits in kind applicable to the Executive Directors are set out under *"General Terms"* below.

Share ownership guidelines

Paul Pester and Darren Pope will be subject to Ordinary Shareholding requirements of 200 per cent. of salary and 150 per cent. of salary respectively. Ordinary Shareholding values will be based on historical investment value (or value on vesting if arising from incentive plans). Ordinary Shares vesting (after the payment of tax) under incentive arrangements would normally have to be held until these requirements have been met.

Other TSB share plans

The Executive Directors are also eligible to participate in the TSB Save As You Earn Plan and TSB Share Incentive Plan. Summaries of these plans and their intended operation are set out under *"Employee Share Plans"* below.

Legacy Lloyds Banking Group share awards

Paul Pester, Darren Pope and other members of management who hold subsisting share awards under the Lloyds Banking Group Long Term Incentive Plan 2006 will be eligible to receive substitution awards over Ordinary Shares to compensate them for Lloyds Banking Group awards that may lapse on a time pro-rated basis on or after the point at which the Company ceases to be a subsidiary of Lloyds Banking Group plc due to the participants becoming "good leavers" under the plan. Any substitution awards will be of a broadly equivalent value to the portion of Lloyds Banking Group awards they are replacing and it is intended will be made as soon as practicable after the Company ceases to be a subsidiary of Lloyds Banking Group plc. Further details are set out under *"Employee Share Plans – Lloyds Banking Group share plans – Legacy"* below.

7.3 Executive Directors

The current employment and remuneration arrangements for the Executive Directors are summarised below.

Executive Directors' remuneration and service agreements

On 9 June 2014, the Executive Directors entered into service agreements with the Company which are effective upon Admission. These service agreements are terminable by the Executive Director with no less than six months' prior notice or by the Company with no less than twelve months' prior notice. From Admission, Paul Pester and Darren Pope are entitled to receive an annual salary of £700,000 and £450,000 respectively. Fixed annual reward, comprising base salary, pension and other benefits, will total £877,500 for Paul Pester and £567,500 for Darren Pope. Variable reward will be £507,500 for on-target performance and a maximum of

£805,000 for Paul Pester, and £326,250 for on-target performance and a maximum of £517,500 for Darren Pope. This gives a total on-target amount of £1,385,000 and maximum total amount of £1,682,500 for Paul Pester and a total on-target amount of £893,750 and maximum total amount of £1,085,000 for Darren Pope.

General terms

Executive Directors are entitled to employer contributions to the TSB Pension Scheme of 20 per cent. of salary. If the Executive Director opts out of the TSB Pension Scheme the employer will pay the Executive Director an amount equal to 20 per cent. of annual salary as a non-pensionable cash supplement. They will also receive benefits in kind including private health cover, life assurance cover, health screening and participation in the Company's flexible benefits scheme of a value equivalent to four per cent. of salary.

The Executive Directors will be entitled to be reimbursed for all reasonable expenses incurred in the course of their duties. They will be provided with a car allowance of £9,500 per annum. They will also be entitled to 30 days paid holiday per annum (in addition to public and bank holidays in England and Wales).

Termination provisions

The Company can elect to terminate an Executive Director's employment by making a payment in lieu of notice equivalent to up to 12 months' base salary. Any payments in lieu of notice may be paid in instalments and be subject to mitigation. Alternatively, the Company may put the Executive Director on garden leave during their notice period.

The employment of each Executive Director will be terminable with immediate effect without notice in certain circumstances, including where the Executive Director commits any material or continued breach of their service agreement; is guilty of a serious breach of the regulatory regime affecting the TSB Group or any TSB Group policy, or of any material misconduct or material neglect in the discharge of their duties; has a bankruptcy order made against them; is convicted of any criminal offence; brings themselves or the Company into disrepute; is prohibited by law from acting as a director; is disqualified from any relevant professional or regulatory body or ceases to be a FSMA-approved person.

The service agreements of the Executive Directors also contain post-termination restrictions. These include restrictions on competition with the TSB Group for six months and restrictions on the solicitation of employees or customers of the TSB Group for a period of twelve months.

7.4 Non-Executive Directors letters of appointment

Each of the Non-Executive Directors and the Prospective Non-executive Director has been appointed by a letter of appointment (in the case of the Prospective Non-executive Director, conditional upon, and from the date of, receipt of PRA approvals). The key terms of these letters of appointment are set out below.

Name	Date of initial appointment	Committee Chairmanships/ Other Board Positions	Fee per annum (£)
Will Samuel	07/03/2014	Board Chairman Chair Nomination Committee	£325,000
Norval Bryson	31/01/2014	Board Fee Attendee Risk Committee Attendee Remuneration Committee Total	£ 60,000 £ 10,000 £ 10,000 £ 80,000
Mark Fisher[1]		Board Fee	£ 60,000
Godfrey Robson	31/01/2014	Board Fee Attendee Audit Committee Total	£ 60,000 £ 10,000 £ 70,000
Sandra Dawson	16/05/2014	Board Fee Member Nomination Committee Chair Remuneration Committee Senior Independent Director Total	£ 60,000 £ 5,000 £ 25,000 £ 20,000 £110,000
Philip Augar	16/05/2014	Board Fee Member Nomination Committee Member Risk Committee Member Remuneration Committee Total	£ 60,000 £ 5,000 £ 10,000 £ 10,000 £ 85,000
Alexandra Kinney Pritchard	16/05/2014	Board Fee Member Audit Committee Chair Risk Committee Total	£ 60,000 £ 10,000 £ 25,000 £ 95,000
Stuart Sinclair	16/05/2014	Board Fee Member Nomination Committee Member Audit Committee Member Risk Committee Total	£ 60,000 £ 5,000 £ 10,000 £ 10,000 £ 85,000
Polly Williams	16/05/2014	Board Fee Chair Audit Committee Member Remuneration Committee Member Risk Committee Total	£ 60,000 £ 25,000 £ 10,000 £ 10,000 £105,000

In addition, each Non-Executive Director is entitled to be reimbursed for all reasonable expenses properly incurred in the performance of his or her duties. The Non-Executive Directors do not participate in any of the Company's share plans.

The Non-Executive Directors are, subject to shareholder approval, appointed for an initial period of three years (one year for Norval Bryson and Godfrey Robson) and will stand for re-election at each Annual General Meeting of the Company. Thereafter, the TSB Board may

[1] Mark Fisher has been appointed to the TSB Board conditional upon, and from the date of, receipt of PRA approvals.

invite them to serve for an additional period of three years again subject to re-election at each Annual General Meeting of the Company.

Appointment is terminable by each Non-Executive Director on one month's notice. The Non-Executive Directors' continuation of appointment is subject to satisfactory performance and each Non-Executive Director is expected to devote sufficient time to meet the expectations and requirements connected with their appointments. Non-Executive Directors are not entitled to any compensation or pay in lieu of notice if they are not re-appointed.

7.5 Directors' and Senior Management's remuneration for the financial year ended 31 December 2013

The amounts of remuneration paid (including salary and other emoluments), benefits in kind granted to each of the Executive Directors for services in all capacities by the Lloyds Banking Group and the value of all their long-term incentives that vested in respect of 2013 are set out in the table below:

Executive Director	Basic salary and fees	Lloyds Banking Group Bonus[3]	Taxable benefits	Pension contributions (or cash in lieu)	Lloyds Banking Group Long-Term Incentive	Total
Paul Pester	£453,750[1]	£370,500	£25,700	£90,750	Nil	£940,700
Darren Pope . . .	£279,413[2]	£199,500	£19,706	£55,883	Nil	£554,502

1 Paul Pester's salary was increased by Lloyds Banking Group with effect from 1 October 2013 from £405,000 to £600,000.

2 Darren Pope's salary was increased by Lloyds Banking Group with effect from 1 October 2013 from £247,550 to £375,000.

3 The Lloyds Banking Group bonus referred to above includes the cash and deferred element of the awards.

The figures above represent actual salary, pension and benefits received, bonus awarded and LTIP awards vested in respect of 2013.

The aggregate remuneration paid (including salary and other benefits) to the Senior Management for 2013, including the value of all their long-term incentives that vested, was £2,023,536 of which £1,124,399 comprised salaries, £206,520 retirement benefits or cash in lieu of pension, £601,950 annual variable remuneration, nil long-term incentives and £90,667 taxable benefits, including car allowance and flexible benefits.

Lloyds Banking Group determined that the Executive Directors would be eligible to receive a Verde completion award following Admission, subject to the individual's satisfactory performance up to Admission, the achievement of key corporate milestones (achieving brand and separation, the publication of the Prospectus and Admission) and the individual's continued employment on the payment date. The maximum payments that may be made by Lloyds Banking Group to Paul Pester and Darren Pope are £405,000 and £247,550 respectively. Any payments will be made as soon as reasonably practicable after the first anniversary of Admission. These payments are subject to meeting certain targets and remain subject to performance adjustment at the discretion of the remuneration committee of Lloyds Banking Group if warranted.

8 Interests of the Directors and Senior Management

8.1 As at the date of this Prospectus and as is expected to be the position immediately following Admission (apart from the award of £100 of Ordinary Shares as described under "*Service Agreements, benefits and remuneration—Remuneration approach*" above), neither the Directors nor the Senior Management, and none of their respective immediate families, have any interests in the share capital of the Company which:

8.1.1 are required to be notified to the Company pursuant to Chapter 3 of the Disclosure and Transparency Rules;

8.1.2 are interests of a connected person (within the meaning of Schedule 11B to FSMA) which would be required to be disclosed under 8.1.1 above and the existence of which is known to or could with reasonable diligence be ascertained by that Director or Senior Manager, as at the date of this Prospectus; or

8.1.3 would have been required to be disclosed by paragraph 8.1.1 or 8.1.2 above if the relevant member of the Senior Management had been a PDMR of the Company.

8.2 Certain of the Directors have indicated to the Company that they intend to make applications in the Intermediaries Offer. The number of Ordinary Shares to be held by each Director following the Offer will be published in the Pricing Statement. The Directors will not receive any priority allocation or benefit from any terms more favourable than those applicable to all investors in the Intermediaries Offer.

9 Interests of significant Shareholders

9.1 Insofar as it is known to the Company as at the date of this Prospectus, the Selling Shareholder will, on Admission, be directly or indirectly interested (within the meaning of the Companies Act) in 3 per cent. or more of the Company's issued share capital (being the threshold for notification of interests that will apply to Shareholders as of Admission pursuant to Chapter 5 of the Disclosure and Transparency Rules). On the basis that the Offer Size is set at the Expected Offer Size and the Over-allotment Option is not exercised, the Selling Shareholder's expected interests both immediately prior to and immediately following Admission are set out in the following table.

Selling Shareholder	Interests in Ordinary Shares immediately prior to Admission		Ordinary Shares to be sold pursuant to the Offer		Interests in Ordinary Shares immediately following Admission	
	No.	% of total issued	No.	% of total issued	No.	% of total issued
Lloyds Bank	500,000,000	100	125,000,000	25	375,000,000	75

On the basis that the Offer Size is set at the Expected Offer Size and the Over-allotment Option is exercised in full, the Selling Shareholder's expected interests both immediately prior to and immediately following Admission are set out in the following table

Selling Shareholder	Interests in Ordinary Shares immediately prior to Admission		Ordinary Shares to be sold pursuant to the Offer		Ordinary Shares to be sold pursuant to the Over-allotment Option		Interests in Ordinary Shares immediately following Admission	
	No.	% of total issued	No.	% of total issued	No.	% of total issued	No.	% of total issued
Lloyds Bank	500,000,000	100	125,000,000	25	12,500,000	2.5	362,500,000	72.5

9.2 Save as disclosed in this paragraph 9, the Directors are not aware of any holdings of voting rights (within the meaning of Chapter 5 of the Disclosure and Transparency Rules) which will represent 3 per cent. or more of the total voting rights in respect of the issued share capital of the Company following Admission.

9.3 The Selling Shareholder is the only person known to the Company who directly or indirectly could exercise or does exercise control over the Company and holds the proportions of voting capital set out in paragraph 9.1 above.

9.4 There are no differences between the voting rights enjoyed by the Selling Shareholder described in paragraph 9.1 above and those enjoyed by any other holder of Ordinary Shares in the Company.

9.5 For a description of the measures in place to ensure that the control exercised over the Company by the Selling Shareholder is not abused, please see *"Material Contracts – Relationship Agreement"* below.

9.6 Except as set out in paragraph 9.7 below, the Company and the Directors are not aware of any arrangements, the operation of which may at a subsequent date result in a change of control of the Company.

9.7 As part of the State Aid Restructuring Plan, Lloyds Banking Group has a legal obligation to divest its entire interest in TSB by 31 December 2015, which may be extended to 30 June 2016 or 31 December 2016 (depending on the proportion of Lloyds Banking Group's interest in TSB that has already been divested) in the event of Disorderly Markets.

10 Employee share plans

10.1 Lloyds Banking Group share plans

Legacy

Employees, including the Executive Directors, currently hold subsisting awards that were granted by Lloyds Banking Group under the Lloyds Banking Group Long Term Incentive Plan 2006 (the "**2006 Plan**"). These awards were granted in 2012 (the "**2012 Awards**"), 2013 (the "**2013 Awards**") and 2014 (the "**2014 Awards**" and together with the 2012 and 2013 Awards, the "**Lloyds Banking Group Awards**"). A summary of the number of Lloyds Banking Group plc shares currently under award for each Executive Director is as follows:

	Performance period	Number of Lloyds Banking Group plc shares under award	
		Paul Pester	Darren Pope
2012 Awards	1 January 2012 – 31 December 2014	873,196	711,636
2013 Awards	1 January 2013 – 31 December 2015	698,417	502,231
2014 Awards	1 January 2014 – 31 December 2016	760,668	475,417

From the date that the Company ceases to be a subsidiary of Lloyds Banking Group plc, the Lloyds Banking Group Awards will be treated as set out below.

General Treatment

Employees who hold Lloyds Banking Group Awards will become "good leavers" under the 2006 Plan from the date the Company ceases to be a subsidiary of Lloyds Banking Group plc. This will mean that their Lloyds Banking Group Awards will continue to vest on their original vesting dates, subject to (i) a pro-rata reduction in the number of Lloyds Banking Group plc shares to reflect the period of time which has elapsed between the date they became "good leavers" and the end of the respective performance periods and (ii) the achievement of their original performance conditions subject to the discretion of the Lloyds Banking Group Remuneration Committee. Until the Lloyds Banking Group Awards vest they will remain subject to the application of malus (performance adjustment) by the Lloyds Banking Group Remuneration Committee in accordance with the 2006 Plan.

To reflect the impact that the pro-rating referred to above will have on employees' Lloyds Banking Group Awards, it is the current intention of the TSB Remuneration Committee that employees will, as soon as practicable after the Company ceases to be a subsidiary of Lloyds Banking Group plc, be granted substitution awards ("**Substitution Awards**") under the TSB 2014 Share Plan (the principal terms of which are summarised under *"2014 Share Plan"* below). The intention is that the Ordinary Shares subject to these Substitution Awards will be of a value which will reflect the pro-rated reduction referred to above (before the application of performance conditions). The Substitution Awards will vest on the same original vesting dates as the Lloyds Banking Group Awards that they replaced.

Any Substitution Awards granted in respect of 2012 Awards will remain subject to the same performance conditions as applied to the 2012 Awards. Any Substitution Awards granted in respect of 2013 and 2014 Awards will be subject to the achievement of a balanced scorecard of TSB specific performance measures intended to include cost control, customer treatment, risk weighted assets, capital ratio and achievement of key strategic milestones.

The intention is that the estimated expected value of the Lloyds Banking Group Awards when the Company ceases to be a subsidiary of Lloyds Banking Group plc (subject to the time pro-rating referred to above) when added to the estimated expected value of the Substitution Awards, will be broadly equivalent to the estimated expected value of the Lloyds Banking Group Awards they replaced.

Legacy Lloyds Banking Group deferred bonus

Employees are currently also interested in shares awarded in 2012, 2013 and 2014 in respect of deferred Lloyds Banking Group bonuses. These awards will continue to vest on their original vesting dates, subject to the application of malus (performance adjustment) by the Lloyds Banking Group Remuneration Committee. At the date of Admission, Paul Pester and Darren Pope have total interests over 516,267 and 256,954 shares in respect of Lloyds Banking Group deferred bonuses respectively, plus £108,100 and £70,350 respectively in respect of the financial year 2013 that will be converted into Lloyds Banking Group plc shares in June 2014.

10.2 TSB share plans

Conditional on Admission, on 6 June 2014 the TSB Board adopted the following plans:

10.2.1 the TSB 2014 Share Plan;

10.2.2 the TSB Sustainable Performance Award (the "**Sustainable Performance Award**" and together with the TSB 2014 Share Plan, the "**Executive Plans**");

10.2.3 the TSB Save As You Earn Plan (the "**SAYE**"); and

10.2.4 the TSB Share Incentive Plan (the "**SIP**" and together with the Executive Plans and the SAYE, the "**Plans**").

10.3 Terms common to the TSB Plans

Overall plan limits

In any ten year period, not more than 10 per cent. of the issued Ordinary Share capital may be issued under the Plans and all other employees' share plans operated by the Company. This limit does not include awards which have lapsed but will include awards satisfied with treasury Ordinary Shares as if they were newly issued Ordinary Shares so long as required by the ABI.

Source of shares

Awards under the Plans may be granted over newly issued Ordinary Shares, Ordinary Shares held in treasury or Ordinary Shares purchased in the market.

Amendments

The TSB Board (or, in the case of the Executive Plans, the Remuneration Committee) can amend the Plans in any way. However, shareholder approval will be required to amend certain provisions to the advantage of participants. These provisions relate to eligibility, individual and plan limits, the basis for determining a participant's entitlement to, and the terms of, the Ordinary Shares or cash comprised in awards, the adjustment of awards on any variation in the Company's share capital and the amendment powers.

Minor amendments can however be made without shareholder approval to benefit the administration of the Plans, to take account of a change in legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment.

Further sub-plans

The TSB Board (or, in the case of the Executive Plans, the Remuneration Committee) may also, without shareholder approval, establish further plans based on the Plans (i) to facilitate the all employee £100 free share award referred to above, and/or (ii) which have been modified to take account of overseas securities laws, exchange controls or tax legislation. Ordinary Shares made available under such further plans will be treated as counting against any limits on participation in the Plans.

General

Any Ordinary Shares issued pursuant to the Plans will rank equally with Ordinary Shares of the same class in issue on the date of allotment except in respect of rights arising by reference to a prior record date. Awards will not form part of pensionable earnings.

10.4 Terms common to the TSB Executive Plans

Executive plan limits

In any ten year period, not more than 5 per cent. of the issued Ordinary Share capital of the Company may be issued under awards granted under the Executive Plans and any other discretionary employees' share plans adopted by the Company. This limit does not include awards which have lapsed but will include awards satisfied with treasury Ordinary Shares as if they were newly issued Ordinary Shares so long as required by the ABI.

Timing of awards

Awards may only be granted within the six-week period following Admission, the announcement of the Company's results for any period, or on any day on which the Remuneration Committee determines that exceptional circumstances exist, unless the grant of awards is restricted, in which case awards will be granted within six weeks of the day on which a restriction on the grant of awards is lifted. No awards may be granted more than ten years after Admission.

Claw back

The Remuneration Committee may within six years of the grant of an award decide to reduce the cash amount or number of Ordinary Shares to which an award relates or impose further conditions or require the participant to make a payment in respect of an award where there is a material misstatement of financial results or in other circumstances prescribed by the PRA Remuneration Code.

Dividend equivalents

The Remuneration Committee may determine that the number of Ordinary Shares to which a participant's award relates will increase to take account of some or all of the dividends paid on Ordinary Shares that vest under an award from the grant date until the date of vesting, on such terms as it determines. Alternatively, the Remuneration Committee may provide additional cash or Ordinary Shares to participants based on the value of some or all of the dividends paid on vested Ordinary Shares to which his award relates. In these circumstances, the Remuneration Committee has the discretion to determine the basis on which this additional amount will be calculated, which may assume the reinvestment of the relevant dividends into Ordinary Shares.

Leaving the TSB Group

Except as set out below, if a participant ceases to hold office with or be employed by the TSB Group by reason of ill-health, injury, disability, the sale of the entity that employs them out of the TSB Group or for any other reason at the Remuneration Committee's discretion (except where a participant is summarily dismissed), unvested awards will usually continue until the normal vesting date, unless the Remuneration Committee determines that the award will vest earlier. If an individual dies holding unvested awards, awards will normally vest as soon as practicable following the individual's death.

The Remuneration Committee will decide the extent to which an unvested award vests in these circumstances, taking account of the extent to which the relevant performance conditions have been satisfied up to the point of vesting. Unless the Remuneration Committee in its discretion determines otherwise, the period that has elapsed from the date on which the award was granted until the date on which the participant ceases to hold office or employment with the TSB Group will also be taken into account.

Where awards vest in these circumstances, awards structured as options will normally be exercisable for a period of up to twelve months after vesting. If a participant ceases to be an officer or employee of the TSB Group for one of these "good leaver" reasons whilst holding vested options, they will normally have twelve months from their cessation of office or employment to exercise those options.

If a participant ceases to hold office or employment with the TSB Group in any other circumstances the award (whether vested or not vested) will lapse on the date on which the participant ceases to hold office or employment.

Awards granted to Remuneration Code staff in respect of the share-based element of their TSB Awards will not be subject to the "leaver" provisions set out above.

Takeovers and reorganisations

In the event of a change of control of the Company, awards will vest. The extent to which awards vest will be determined by the Remuneration Committee in its discretion, taking into account the extent to which any relevant performance conditions have been satisfied and, unless the Remuneration Committee determines otherwise, the period of time that has elapsed from the grant date of the award. Options will then be exercisable for a period of one month.

Alternatively, the Remuneration Committee may permit, or in the case of an internal reorganisation if the Remuneration Committee so determines require, awards to be exchanged for equivalent awards which relate to shares in a different company.

If other corporate events occur such as a demerger, delisting, special dividend or other event which, in the opinion of the Remuneration Committee may affect the current or future value of Ordinary Shares, the Remuneration Committee may determine that awards will vest. Awards will vest taking into account the satisfaction of any relevant performance condition and, unless the Remuneration Committee determines otherwise, pro-rating to reflect the period of time from the grant date to the date of the relevant event. Options will then be exercisable for a period of one month.

General

In the event of a variation of the Company's share capital or a demerger, delisting, special dividend, rights issue or other event, which may, in the Remuneration Committee's opinion, affect the current or future value of Ordinary Shares, the number of Ordinary Shares subject to an award and/or any option price and/or any performance condition attached to the awards may be adjusted.

Awards are not transferable (other than on death). No payment will be required for the grant of an award.

At any time before the point at which an award has vested, or, in the case of an option, has been exercised, the Remuneration Committee may decide to pay a participant a cash amount equal to the value of the Ordinary Shares he or she would otherwise have received.

10.5 2014 Share Plan

Introduction

It is the current intention of the TSB Remuneration Committee that the 2014 Share Plan will be used to make the Substitution Awards referred to under *"Lloyds Banking Group share plans – Legacy"* above, and that subsequently the 2014 Share Plan will only be used to make share-based awards to Remuneration Code staff in respect of their TSB Awards (as required by the Remuneration Code) and in exceptional circumstances, such as on recruitment.

Eligibility

Employees of the Company and designated subsidiaries are eligible to participate in the 2014 Share Plan.

Grant of awards

The Remuneration Committee will decide who will participate in the 2014 Share Plan and how many Ordinary Shares they may receive. Under the 2014 Share Plan, participants are granted an option over Ordinary Shares subject to them remaining in employment and subject to such other conditions, such as the satisfaction of such performance conditions as the Remuneration Committee may determine. The Remuneration Committee will determine the option price (if any) payable for the Ordinary Shares on the exercise of the option.

Exercise of options

Options will normally only become exercisable after a period set by the Remuneration Committee on grant to the extent any condition is met. The participant may exercise the option for a period of up to ten years from the grant date or such shorter period determined by the Remuneration Committee, after which time it will lapse.

10.6 Sustainable Performance Award

Introduction

The Sustainable Performance Award is a discretionary executive plan delivering awards in a mixture of cash and awards over Ordinary Shares.

Eligibility

Selected employees of the Company or of its subsidiaries will be eligible to participate in the Sustainable Performance Award at the discretion of the Remuneration Committee.

Grant of awards

The Remuneration Committee shall only consider granting Sustainable Performance Awards in circumstances where it considers that the costs of those awards, when aggregated with the costs of the TSB Award, SAYE and SIP would not negatively impact on its aim to encourage sustainable growth. The size of Sustainable Performance Awards made to individuals will be determined by performance against pre-determined key corporate performance measures as well as the performance of the relevant individual. In any event the Sustainable Performance Awards would not exceed the 100 per cent. of salary individual limit referred to above. In addition, the Remuneration Committee must be comfortable that the resulting grant size is, in their view, appropriate to reflect the underlying sustainable performance and risk profile of TSB. Sustainable Performance Awards will be granted in a mixture of allocations of Ordinary Shares ("**Share Allocations**") and rights to receive a pre-determined amount of cash.

Share Allocations may be made in the form of a conditional right to acquire Ordinary Shares at no cost to the participant; an option over Ordinary Shares or a right to receive a cash amount which relates to the value of a certain number of notional Ordinary Shares.

Vesting of awards

Unless the Remuneration Committee determines otherwise, Sustainable Performance Awards will normally vest in five equal tranches on the first five anniversaries of the grant date (and will be subject to any retention requirements). Options will then normally be exercisable from vesting (or such later date when any applicable retention requirements have lifted) for a period of ten years from the grant date or such shorter period determined by the Remuneration Committee, after which time it will lapse.

The vesting of any outstanding Sustainable Performance Awards will be conditional on the Remuneration Committee being satisfied that the Company and the participant have achieved satisfactory levels of performance up until the point of vesting. In making this determination, the Remuneration Committee will consider, without limitation, the following factors: the Company's achievement of threshold financial targets relating to the Company's profitability and capital ratios, the Company's risk profile, any significant compliance failures, and the individual's continued employment and sustained satisfactory performance including his or her continued appropriate conduct, adherence to compliance requirements and attitude to risk.

10.7 SAYE

Introduction

The SAYE is an "all-employee" share option plan, registered with HMRC, under which participants save a monthly amount to acquire Ordinary Shares.

Invitations

When the SAYE is operated, invitations must be sent to any employee or full-time Director that satisfies the following conditions:

- they are employed by the Company or any participating subsidiary of the Company; and
- they have been continuously employed by the Company or a participating subsidiary of the Company for a minimum period (up to five years).

In addition, the TSB Board may send invitations to any other employee of the Company or any participating subsidiary of the Company who does not meet those criteria.

Invitations will normally be made within 42 days of an announcement of results or Admission. No options may be granted more than ten years after Admission. It is intended to issue invitations on or shortly after Admission.

Savings contract

The principle of the SAYE is that an employee is granted an option to acquire Ordinary Shares at a fixed option price (see below). The employee must enter into a savings contract and save at least £5 but not more than £500 per month (or such other sum as may be allowed by the relevant legislation from time to time). Ordinary Shares can only be bought with the amount saved plus any bonus paid under the savings contract.

Option price

The option price must not be less than 80 per cent. of the market value of the shares on the date specified in the invitation.

Exercise of options

Options are normally exercisable within six months after the third or fifth anniversary of the start of the savings contract. Options may however, be exercised early in certain circumstances. These include an employee leaving because of injury, disability, retirement, death, redundancy or the individual's employing company being sold out of the TSB Group. On cessation of employment for other reasons, options will normally lapse.

Change of control, merger or other reorganisation

Options may generally be exercised early on a takeover, scheme of arrangement, merger or other reorganisation. Alternatively, option holders may be allowed or required to exchange their options for options over shares in the acquiring company.

Variation in share capital

Options may be adjusted following any variation in the share capital of the Company.

10.8 SIP

Introduction

The SIP, which will be registered with HMRC, offers three ways to provide Ordinary Shares to employees based in the UK on a tax-favoured basis: free, partnership and matching shares. The SIP contains all three elements, and the TSB Board has the power to decide which, if any, of them should be implemented. The SIP operates in conjunction with a trust, which will hold shares on behalf of employees. It is intended to issue invitations for partnership shares on or shortly after Admission.

Eligibility

All employees of the Company and any subsidiaries designated by the TSB Board as participating companies must be eligible to join the SIP, if they have worked for the Company or a participating company for a qualifying period determined by the TSB Board which may not exceed 18 months.

Free shares

The SIP provides for the award of Ordinary Shares worth up to a maximum set by the legislation (currently £3,600) to each eligible employee each year. The Ordinary Shares must generally be offered on similar terms, but the award may be subject to performance targets. "Similar terms" means that the terms may only be varied by reference to remuneration, length of service or hours worked.

Free Ordinary Shares must be held in trust for a period of between three and five years at the discretion of the Company and will be free of income tax if held in trust for five years. If a participant leaves employment with the TSB Group, his or her Ordinary Shares cease to be subject to the SIP and may be forfeited.

Partnership shares

The SIP provides for employees to be offered the opportunity to purchase Ordinary Shares out of contributions from pre-tax salary of up to the maximum set by the legislation (currently £1,800, or 10 per cent. of salary if less). Employees can stop saving at any stage. The employees' contributions may be used to buy partnership shares immediately or accumulated for up to 12 months before they are used to buy Ordinary Shares.

Where they are accumulated the price at which they are acquired may be, at the TSB Board's discretion, the price at the beginning of the accumulation period, the price at the end of the accumulation period or the lower of the two.

Partnership shares can be withdrawn from the SIP by the participant at any time, but there will be an income tax liability if the shares are withdrawn before five years.

Matching shares

The SIP provides that where employees buy partnership shares, they may be awarded additional free matching shares by the Company on a matching basis, up to a current maximum of two matching shares for each partnership share. Matching shares will be free of income tax if held in trust for five years. If a participant leaves employment with the TSB Group or a participant withdraws their corresponding partnership shares, their shares cease to be subject to the SIP and may be forfeited.

Dividends

The SIP provides that the TSB Board may permit any dividends paid on the free, partnership or matching shares to be re-invested in the purchase of additional shares, which must be held in the plan for a period of three years.

Voting rights

Participants may direct the trustees of the SIP how to exercise the voting rights attributable to the shares held on their behalf. The trustees of the SIP will not exercise the voting rights unless they receive the participants' instructions.

11 Pensions

TSB operates a defined contribution pension scheme for its employees, the TSB Pension Scheme.

All employees were automatically included in the TSB Pension Scheme on joining TSB. As at 1 April 2014, approximately 8,600 employees participated in the TSB Pension Scheme. Employer contributions to the TSB Pension Scheme are a percentage of basic salary between 8 per cent. and 13 per cent. based on the level of employee contributions (although there are a small number for whom the minimum contribution is 6 per cent.). Insured life assurance benefits are also provided under the TSB Pension Scheme.

Executives and senior executives are respectively entitled to employer contributions to the TSB Pension Scheme of 15 per cent. and 20 per cent. of salary. If the executive or senior executive opts out of the TSB Pension Scheme (following automatic enrolment), the employer will pay the executive or senior executive an amount equal to 15 per cent. or 20 per cent. of annual salary as appropriate as a non-pensionable cash supplement.

In the year ended 31 December 2014, TSB expects to pay £16 million employer contributions to the TSB Pension Scheme in accordance with the rates specified by the rules of the scheme.

The assets of the TSB Pension Scheme are held in a separately administered trust that is managed independently of TSB by the scheme's Trustee.

12 Underwriting arrangements

On 9 June 2014, the Parent, the Selling Shareholder, the Company, the Directors, the Prospective Non-executive Director, and the Underwriters entered into the Underwriting Agreement. Pursuant to the Underwriting Agreement:

12.1 the Selling Shareholder has agreed, subject to certain conditions, to sell the Offer Shares in the Offer at the Offer Price;

12.2 the Underwriters have agreed, subject to certain conditions, to procure:

12.2.1 purchasers for the Institutional Offer Shares or, failing which, to purchase such Institutional Offer Shares themselves in their agreed proportions; and

12.2.2 purchasers for any Intermediaries Offer Shares which an Intermediary fails to make payment for in accordance with the terms of the Intermediaries Offer or, failing which, to purchase such Intermediaries Offer Shares themselves in their agreed proportions,

in each case, at the Offer Price;

12.3 the Selling Shareholder has agreed that the Underwriters may deduct from the proceeds of the Offer a commission of 1.75 per cent. of the product of the Offer Price and the number of Offer Shares together with any applicable VAT. In addition, the Selling Shareholder has agreed that the Stabilising Manager (on behalf of itself and the other Underwriters) may deduct a commission of 1.75 per cent. of the product of the Offer Price and the number of Over-allotment Shares (if any) acquired pursuant to the Over-allotment Option, together with any applicable VAT.

In addition, the Selling Shareholder has also agreed, in its absolute discretion, to pay a discretionary commission to some or all of the Underwriters of up to 0.85 per cent. of the product of (a) the Offer Price, and (b) the number of Institutional Offer Shares plus the number of Intermediaries Offer Shares which an Intermediary fails to make payment for in accordance with the terms of the Intermediaries Offer plus the maximum number of Over-allotment Shares, together with any applicable VAT;

12.4 the obligations of the Underwriters to procure (a) purchasers for the Institutional Offer Shares or, failing which, to purchase such Institutional Offer Shares themselves in their agreed proportions, and (b) purchasers for any Intermediaries Offer Shares which an Intermediary fails to make payment for in accordance with the terms of the Intermediaries Offer or, failing which, to purchase such Intermediaries Offer Shares themselves in their agreed proportions, in each case on the terms of the Underwriting Agreement, will be subject to certain conditions and termination rights that are customary for an agreement of this nature and the Parent and the Selling Shareholder not having terminated the Underwriting Agreement prior to the Offer Price having been determined. These conditions and termination rights include, amongst other things, the absence of any breach of representation, warranty or undertaking under the Underwriting Agreement, the delivery of customary comfort packages, the absence of a material adverse change in relation to the Company and or any member of the TSB Group and the market, approval of various offering documents having been received and Admission occurring by no later than 25 June 2014 (or such later date as the Parent, the Company and the Joint Global Co-ordinators (on behalf of themselves and the other Underwriters) may agree). In addition, the obligations of the Underwriters are conditional upon the Relationship Agreement, the Separation Agreement, the TSA, the LTSA and the Tax Separation Deed having been entered into and becoming unconditional. If the conditions are not satisfied or waived (if capable of being waived) or any termination right is exercised, the Offer will lapse, the Company will not seek Admission and any monies received in the respect of the Offer will be returned to applicants without interest;

12.5 the Stabilising Manager has been granted the Over-allotment Option by the Selling Shareholder pursuant to which it may purchase, or procure purchasers for, such number of Ordinary Shares as equals up to 10 per cent. of the number of Offer Shares at the Offer Price for the purposes of covering short positions arising from over-allocations, if any, made in connection with the Offer. Save as required by law or regulation, neither the Stabilising Manager, nor any of its agents, intends to disclose the extent of any over-allotments or stabilising transactions under the Offer. The Over-allotment Option may be exercised, in whole or in part, at any time during the period from the commencement of conditional dealings in Ordinary Shares on the London Stock Exchange to the 30th calendar day thereafter. Settlement of any purchase of Over-allotment Shares will take place shortly after such the number of Over-allotment Shares to be purchased by the Stabilising Manager has been determined (or, if acquired on Admission, at Admission). If any Over-allotment Shares are acquired pursuant to the Over-allotment Option, the Stabilising Manager will be committed to pay to the Selling Shareholder, or procure that payment is made to it of, an amount equal to the Offer Price multiplied by the number of Over-allotment Shares purchased from the Selling Shareholder, less commissions (together with any applicable VAT) and expenses;

12.6 the Selling Shareholder and the Company have each agreed to pay or cause to be paid certain costs, charges, fees and expenses of or arising in connection with, or incidental to, the Offer including: (i) any United Kingdom stamp duty chargeable on (a) a transfer on the initial sale of Offer Shares to investors pursuant to the Offer and/or (b) a transfer on an initial sale of Over-allotment Shares to investors pursuant to the Over-allotment Option and/or (ii) any United

Kingdom stamp duty reserve tax chargeable on (a) an agreement to transfer Offer Shares on the initial sale of Offer Shares to investors pursuant to the Offer and/or (b) an agreement to transfer Over-allotment Shares on an initial sale of Over-allotment Shares to investors pursuant to the Over-allotment Option (in each case, at a rate of 0.5 per cent.); however, neither the Selling Shareholder nor the Company will assume any liability to investors in relation to any element of any United Kingdom stamp duty or stamp duty reserve tax chargeable on a transfer of Offer Shares or Over-allotment Shares to a clearance service or to a depositary receipt issuer or to any agent or nominee thereof (currently imposed at a rate of 1.5 per cent.);

12.7 each of the Company, the Directors, the Prospective Non-executive Director and, on a limited basis, the Parent and the Selling Shareholder have given customary representations, warranties and undertakings to the Underwriters. Each of the Company, and on a limited basis, the Parent and the Selling Shareholder have given certain indemnities to the Underwriters in a form that is typical for an agreement of this nature (the liabilities of the Directors, the Prospective Non-executive Director, the Parent and the Selling Shareholder under the Underwriting Agreement being limited as to time and amount);

12.8 the parties to the Underwriting Agreement have given certain covenants to each other regarding compliance with laws and regulations affecting the making of the Offer in relevant jurisdictions;

12.9 the Company has entered into certain lock-up arrangements pursuant to which it has agreed that, subject to certain exceptions, during the period of 365 days from the date of Admission, it will not, without the prior written consent of the Joint Global Co-ordinators (on behalf of themselves and the other Underwriters), directly or indirectly, offer, issue, lend, mortgage, assign, charge, pledge, sell or contract to sell or issue or issue or sell options in respect of any Ordinary Shares (or any interest therein or in respect thereof) or any other securities exchangeable for or convertible into, or substantially similar to, Ordinary Shares or enter into any transaction with the same economic effect as, or agree to do, any of the foregoing;

12.10 each of the Directors and the Prospective Non-executive Director has entered into certain lock-up arrangements pursuant to which he or she has agreed that, subject to certain exceptions, during the period of 365 days from the date of Admission he or she will not, without the prior written consent of the Joint Global Co-ordinators (on behalf of themselves and the other Underwriters), directly or indirectly, offer, allot, issue, lend, mortgage, assign, charge, pledge, sell or contract to sell or issue, issue or sell options in respect of or otherwise dispose of, directly or indirectly, or announce an offering or issue of, any Ordinary Shares (or any interest therein or in respect thereof) or any other securities exchangeable for or convertible into, or substantially similar to, Ordinary Shares or enter into any transaction with the same economic effect as, or agree to do, any of the foregoing;

12.11 the Selling Shareholder has entered into certain lock-up arrangements pursuant to which it has agreed that, subject to certain exceptions, during the period of 90 days from the date of Admission, it will not, without the prior written consent of the Joint Bookrunners (on behalf of themselves and the other Underwriters), directly or indirectly, offer, issue, lend, mortgage, assign, charge, pledge, sell or contract to sell or issue, issue options in respect of, or otherwise dispose of, directly or indirectly, or announce an offering or issue of, any Ordinary Shares (or any interest therein or in respect thereof) or any other securities exchangeable for or convertible into, or substantially similar to, Ordinary Shares or enter into any transaction with the same economic effect as, or agree to do, any of the foregoing, other than pursuant to the Offer; and

12.12 the Company has appointed the Joint Sponsors to act as Joint Sponsors for the purposes of the Company's application for Admission.

In connection with settlement and stabilisation, J.P. Morgan Cazenove, as Stabilising Manager, will enter into a stock lending agreement with the Selling Shareholder. Pursuant to this agreement, J.P. Morgan Cazenove will be able to borrow up to a maximum of 10 per cent. of the total number of Offer Shares for the purposes, amongst other things, of allowing J.P. Morgan Cazenove to settle, on Admission, over-allotments, if any, made in connection with the Offer. If J.P. Morgan Cazenove borrows any Ordinary Shares pursuant to the stock lending agreement, it will be required to return equivalent securities to the Selling Shareholder by a date to be specified in the stock lending agreement.

13 Subsidiaries, investments and principal establishments

The Company is the holding company and TSB Bank is the principal operating company of the TSB Group. The TSB Group comprises the Company, TSB Bank and its two wholly-owned subsidiaries, TSB Scotland Nominees Limited and TSB Scotland (Investment) Nominees Limited, which are both nominee companies.

14 Material contracts

The following contracts (not being contracts entered into in the ordinary course of business) have been entered into by the Company or another member of the TSB Group on, or within the two years immediately preceding, the date of this Prospectus and are or may be material.

14.1 Business Transfer Agreement

TSB Bank, Lloyds Bank and Cheltenham & Gloucester plc entered into the Business Transfer Agreement on 13 March 2013. Pursuant to the Business Transfer Agreement, Lloyds Bank agreed to transfer certain assets and liabilities forming part of its banking business to TSB Bank, such transfer to be effected by means of a banking business transfer scheme pursuant to Part VII of FSMA (the "**Scheme**"). Under the terms of the Business Transfer Agreement, the parties agreed that certain historical liabilities in relation to breaches of law and regulation would be excluded from the business transferred to TSB Bank by the Scheme. These excluded liabilities therefore remained with Lloyds Bank and did not transfer to TSB Bank pursuant to the Scheme. To the extent that TSB Bank suffers loss in relation to such excluded liabilities it may claim such loss from Lloyds Bank to the extent covered by the Conduct Indemnity (for further information, see "*Separation Agreement*" below.) In consideration for the transfer, TSB Bank agreed to pay to Lloyds Bank an amount in cash equal to the book value of the transferring assets and liabilities (such amount to be left outstanding on the inter-company loan account).

14.2 Underwriting Agreement

The Underwriting Agreement is described in paragraph 12 above.

14.3 Relationship Agreement

14.3.1 On 9 June 2014, the Company and the Parent entered into the Relationship Agreement which will, conditional only on Admission, regulate (in part) the degree of control that the Parent and its associates may exercise over the management and business of the Company. The principal purpose of the Relationship Agreement is to ensure that the Company is capable at all times of carrying on its business independently of the Parent and its associates. The Relationship Agreement will take effect on Admission and will continue until the earlier of (i) the Ordinary Shares ceasing to be admitted to listing on the Official List and (ii) the Parent, together with its associates, ceasing to own or control (directly or indirectly) 20 per cent. or more of the voting share capital of the Company.

14.3.2 For the purposes of the Relationship Agreement, "associates" of the Parent excludes any person, company or entity within Lloyds Banking Group, and any other person, company or entity that would otherwise be deemed to be an associate of the Parent, to the extent and for as long as such person, company or entity is:

(i) acting in the ordinary course of business engaged in asset, investment, wealth or fund management activities for clients on a discretionary or non-discretionary basis; or

(ii) acting for and on behalf of any Lloyds Banking Group pension, insurance or investment fund as part of such fund's general investment or portfolio strategy,

including, for the avoidance of doubt, those operating within the Scottish Widows and/or Halifax Share Dealing businesses of the Lloyds Banking Group (each such person an "**Excluded Lloyds Person**"). The Parent has undertaken that it will not, and will procure that none of its associates will, act in concert with any Excluded

Lloyds Person in respect of any matter restricted by the Relationship Agreement or otherwise take any action through or by influencing any Excluded Lloyds Person that is intended to obviate or frustrate the terms of the Relationship Agreement.

14.3.3 Under the Relationship Agreement, the Parent has undertaken that, subject to certain limited exceptions, it will, and will procure that its associates will, among other things:

(i) not take any action or omit to take any action which inhibits any member of the TSB Group from carrying on its business independently;

(ii) conduct all transactions and arrangements with any member of the TSB Group at arm's length and on normal commercial terms;

(iii) not take any action (or omit to take any action) to prejudice the Company's status as a premium listed company or which would have the effect of preventing the Company from complying with its obligations under the Listing Rules;

(iv) not exercise any of its voting rights in a manner which is in breach of any competition or anti-trust legislation or regulation applicable to it; and

(v) not exercise any of its voting or other rights to propose or procure the proposal of a shareholder resolution which is intended or appears to be intended to circumvent the proper application of the Listing Rules.

14.3.4 The Parent has also undertaken that, subject to certain exceptions, if it or its associates intends to vote against the Board's recommendation in respect of any resolution at a general meeting of the Company, it will give the Board notice of such intention not less than five Business Days prior to the scheduled date of the relevant general meeting, and if it fails to give such notice when required to do so, it shall only be entitled:

(i) not to vote at all on the relevant resolution; or

(ii) to exercise all of the voting rights attached to their Ordinary Shares:

(a) in accordance with the Board's recommendation on the relevant resolution to all shareholders; or

(b) for and against the relevant resolution in the same proportions as the voting rights attached to Ordinary Shares held by all other shareholders are so exercised.

14.3.5 The Parent has also undertaken that, subject to certain exceptions, it will not exercise its voting rights in order to:

(i) requisition, or support a requisition for, a general meeting of the Company;

(ii) put forward a resolution, an item on the agenda, or an amendment to a resolution or an agenda item, at the Annual General Meeting of the Company; or

(iii) require the Company to circulate a written statement to shareholders.

14.3.6 The Relationship Agreement provides that for as long as the Parent (together with its associates) holds at least 20 per cent. of the voting share capital of the Company, it will be entitled to appoint one Non-Executive Director to the Board, which Non-Executive Director may not be an employee or a director of any Lloyds Banking Group company but may be a non-executive director of an associate of the Parent.

14.3.7 The Company has undertaken to the Parent to use reasonable endeavours to provided such assistance to the Parent as the Parent may reasonably request in connection with the Parent's obligation to divest its interest in the TSB Group, and the Parent has agreed to reimburse the TSB Group for any out-of-pocket costs and expenses reasonably incurred by the TSB Group in the course of providing such assistance.

14.4 Separation Agreement

The Company, TSB Bank and Lloyds Bank entered into the Separation Agreement on 9 June 2014. The Separation Agreement governs the separation of the TSB Bank Group from Lloyds

Banking Group and certain aspects of the relationship between the TSB Group and Lloyds Banking Group following Admission, including (amongst other things) the allocation of certain pre-Admission liabilities, including liability for breach of law and regulation and of customer terms and conditions.

Under the terms of the Separation Agreement, Lloyds Bank has agreed, subject to certain limitations, to provide each member of the TSB Group with a range of indemnity protection in respect of historical, pre-Admission issues (including issues in relation to the period between 9 September 2013, when TSB launched as a stand-alone bank, and Admission). This protection includes a broad and, save in certain limited respects, uncapped indemnity in respect of losses arising from pre-Admission acts or omissions that constitute breaches of law and regulation relating to customer agreements or the relevant security interest securing liability under such agreements (the "**Conduct Indemnity**"). The Conduct Indemnity provides TSB with economic protection against a wide range of types of losses resulting from historical conduct issues, including the costs of handling and settling customer claims and managing regulatory actions and investigations, the payment of regulatory or court-imposed fines and penalties, the costs of any required customer redress, the costs of implementing required changes to systems and procedures and, subject to certain conditions and limitations, the costs of remedial marketing activity.

In certain limited cases, such as in relation to costs and expenses of marketing activities designed to address the reputational impact on TSB of the relevant historical conduct issues and in relation to losses arising out of customers closing their PCAs with TSB as a result of historical conduct issues, specific limitations have been agreed on the amounts that can be recovered by TSB under the Conduct Indemnity. Separately, TSB is only able to recover "credit losses" (being losses resulting from the failure of a counterparty to pay an amount owing, the inadequacy of the value of any customer secured property or any failure of TSB to enforce its rights to recover amounts from customers) from Lloyds Bank in limited circumstances, including when TSB has otherwise exhausted the legal rights available to it in order to recover such amounts.

The Conduct Indemnity also provides the TSB Group with a limited period of continued protection for actions or omissions between Admission and 31 December 2014. Losses that arise as a result of such actions or omissions constituting breaches of law or regulation are covered by the Conduct Indemnity, where such actions and omissions are taken in continued reliance on systems and procedures inherited from and shared with Lloyds Banking Group.

Lloyds Bank and TSB have also agreed a protocol for the handing of complaints and claims (including customer complaints and the management of regulatory actions and investigations). Under the terms of this protocol, TSB will have initial responsibility for the handling of all such complaints and claims (other than those relating to PPI, for which Lloyds Bank will have responsibility), subject to:

(i) certain agreed requirements (and specified applicable standards) as to the manner in which TSB handles the relevant claims; and

(ii) rights exercisable, in certain circumstances, by each of Lloyds Bank and TSB in relation to certain material claims or categories of claims to require that the responsibility for the handling of such claims is transferred to Lloyds Bank.

The Separation Agreement also includes indemnities in respect of:

(a) losses arising from persistent or systemic pre-Admission breaches of or failures to comply with terms and conditions applicable to customer agreements or systems failures resulting in inaccuracies in the calculation, identification or communication of amounts owed by or to customers; and

(b) certain liabilities arising in relation to certain employment-related litigation and in relation to Lloyds Banking Group pension schemes.

Lloyds Bank has also provided certain representations and warranties to TSB in respect of the TSB business, including as to the enforceability of customer agreements, customer arrears, the sufficiency of services and assets required to operate the TSB business, intellectual property and litigation.

Lloyds Bank has also undertaken to procure that, subject to certain limited exceptions, Lloyds Banking Group will not conduct directed and targeted marketing to persons who were customers of the TSB Group customers as at 9 September 2013 for the purposes of marketing loan, credit card, mortgage, PCA, savings accounts or home insurance products for a period beginning at the date of the Separation Agreement and ending on the date that is two years from the date on which Lloyds Banking Group companies cease to hold any shares in the Company. In addition, Lloyds Bank has agreed to procure that for a period of two years from Admission, subject to certain limited exceptions, no Lloyds Bank, Halifax or Bank of Scotland branches will be opened in the United Kingdom within a 0.2 mile radius in towns and cities and otherwise within a one mile radius of a TSB branch.

Lloyds Bank has also agreed that it will not solicit certain TSB Bank employees or conduct recruitment initiatives directed at TSB Bank employees for a period of two years from the date of Admission. TSB Bank provides a reciprocal commitment not to solicit certain Lloyds Banking Group employees.

Lloyds Bank has agreed to procure that no new products will be originated by Lloyds Banking Group under the C&G brand following Admission. TSB has agreed that Lloyds Banking Group may use the C&G brand in connection with products or services originated by Lloyds Banking Group prior to Admission until the date such products mature. In addition, TSB has agreed that it will not use the C&G brand until the last date on which any savings products originated by Lloyds Banking Group under the C&G brand mature.

14.5 Tax Separation Deed

The Company, TSB Bank and Lloyds Bank entered into a Tax Separation Deed on 9 June 2014 which will be effective as of Admission. The Tax Separation Deed regulates certain aspects of the mechanics of the separation of the members of the TSB Group from any tax groups to which they are party with other Lloyds Banking Group companies and governs co-operation between the TSB Group companies and Lloyds Banking Group companies in respect of tax matters. Furthermore, it contains: (i) indemnities and warranties from Lloyds Bank intended to protect the Company and TSB Bank against unanticipated taxes payable by the TSB Group arising in respect of historical pre-Admission transactions (including in particular the pre-Admission banking business transfers to TSB Bank pursuant to Part VII of FSMA, and the Pre-IPO Reorganisation); (ii) reciprocal indemnities from Lloyds Bank and the Company relating to secondary tax liabilities; and (iii) an adjustment mechanism relating to the deferred tax asset contained in the consolidated audited accounts of the TSB Bank Group for the year ended 31 December 2013. The adjustment mechanism in the Tax Separation Deed is designed, amongst other things to compensate TSB (in certain circumstances) should it transpire that the deferred tax asset is not available to be used by the TSB Group in full. The mechanism provides that should it transpire that the deferred tax asset is overstated, (in certain circumstances) a compensatory payment shall be made by Lloyds Bank to the Company. It also provides that should it transpire that the deferred tax asset is understated (in certain circumstances) a compensatory payment shall be made by the Company to Lloyds Bank.

14.6 Transitional Services Agreement

Overview of services

TSB Bank and Lloyds Bank entered into the TSA on 9 June 2014. Under the TSA, which will commence upon Admission, Lloyds Bank provides certain IT and operational services to TSB, on a transitional basis, for a term of up to the end of 31 December 2016. Some of the TSA services are planned to be exited and migrated either to TSB or an alternative service provider; a number of the services (including the IT services) will continue to be provided by Lloyds Bank to TSB on and from 1 January 2017 under the Long Term Services Agreement.

The TSA services that are currently planned to be exited under the TSA by 31 December 2016 include Cash Provisions, Risk Operations, Treasury Operations, Colleague Benefits (flexible), Travel Money, ATM Reconciliations and Maintenance, EUCs Support, NPA Reconciliations,

Credit/Debit Card Disputes and Chargebacks, Business Continuity Management, Operational Risk Systems, Cash in Transit and Accounts Payable and Invoice & Expense Processing.

The TSA services that are currently planned to be provided by Lloyds Bank to TSB under the Long Term Services Agreement include IT Services, Business Services (bulk printing and scanning and indexing mail), Card Processing, e-Payment Processing, Clearing (Cheques and Drafts), Finance Operations, Global Transaction Compliance (of payments and customers), Mortgages System Configuration, TMS workflow configuration process, BIT configuration support, Treasury Finance support, Group Reference Data Management, BPM Data Feed Support, Code Authenticator, Specialist Investigations support and Treasury Market Operations Support. In addition, the TSA services that are currently planned to be provided by Lloyds Bank to TSB under the LTSA as extended transitional services are storage and retrieval of customer records and retention and retrieval of retail mortgage deeds.

In addition to the TSA services, for a limited period following Admission (which is expected to be no more than three months), Lloyds Bank will continue to provide to TSB certain additional operational services (namely, loans processing, digital services and internal mail/courier services), in the same manner and charged for in the same way as in the six-month period immediately prior to Admission.

Overview of terms

Lloyds Bank is required to provide the TSA services in accordance with certain agreed service levels, with service credits payable for certain service level failures. Lloyds Bank is bound by a range of qualitative service commitments including to provide the services with reasonable care and skill and in accordance with applicable laws. Regular reports will be provided by Lloyds Bank to TSB Bank to enable ongoing monitoring of service performance. A defined incident management process will be followed by Lloyds Bank in managing service-related incidents and outages.

TSB Bank pays a core service charge monthly in arrears that includes an agreed baseline of service volumes set by reference to the balances and assumed customer behaviours in TSB's agreed 2014 to 2017 business plan. The core service charge is inclusive of any applicable VAT and will be adjusted annually to reflect inflation. Additional payments are payable for increases in service volumes over and above those set by reference to TSB's agreed 2014 to 2017 business plan (except for the IT services during the term of the TSA) based on agreed unit charges and cost drivers. A proportion of certain third party charges for telephony, card processing and other consumables will be charged to TSB Bank on a pass-through basis, with no mark-up, as will any increase in Royal Mail rates for inputs used by Lloyds Bank in providing the services. The core service charge will be reduced on a pro-rata basis where a service provision ends before the planned exit date. In addition to the core service charge, service changes or projects that TSB initiates will be charged for on the basis of an agreed rate card.

TSB will have the right to initiate, at its own cost, projects or changes to the services to support TSB's own competitive strategy, for example, changes to product pricing and other non-price product features and the launch of new products. TSB Bank has agreed that during the TSA period its ability to initiate certain defined service changes that would require significant reengineering of the underlying IT and operations infrastructure (for example, a change to TSB's banking licence structure, overseas expansion by TSB or material changes to the corporate core functionality, process or systems) should be restricted; however, these restrictions do not apply if TSB requires such a service change in order to meet any changes in applicable laws or regulations or if TSB can reasonably demonstrate that such changes are necessary for TSB to continue to operate its business in the same manner (in all material respects) should the Scottish people vote for independence in the upcoming referendum.

Subject to certain conventional exceptions (for example in the case of fraud or intellectual property rights claims) where the parties' liability is uncapped, each party's liability to the other party under the TSA is capped annually at a level which approximates to the annual fees under the LTSA (summarised under "*Long Term Services Agreement*") below. Each party's liability is also subject to an additional aggregate cap. Lloyds Bank's aggregate cap is refreshed at the beginning of the sixth year after the effective date of the TSA (i.e. during the term of the

LTSA). For TSB Bank, the aggregate cap is not refreshed at the beginning of the sixth year and is subject to a requirement that amounts paid out to Lloyds Bank under the TSA or LTSA should not lead to TSB's Tier 1 or Tier 2 capital falling below 0.5 per cent. above the applicable regulatory thresholds.

There is flexibility for TSB Bank to terminate the TSA (or services thereunder) for convenience (upon prior notice) before its expiry date subject to minimum notice requirements. TSB Bank may also terminate the TSA for cause, including for Lloyds Bank's material breach or insolvency, persistent poor performance, or where TSB Bank or Lloyds Bank is acquired by another FCA regulated bank. Lloyds Bank may only terminate the TSA if required to do so by a regulatory authority or by law, or for non-payment of material charges by TSB Bank.

The TSA contains provisions designed to support the exit of services in a termination scenario. The TSA identifies at a high level the respective responsibilities of each of Lloyds Bank and TSB Bank in relation to exit, and provides a mechanism for the parties to define and agree their respective obligations in detailed technical and commercial exit plans during the 12-month period following Admission. Due to the criticality of the IT services, Lloyds Bank and TSB Bank have defined in advance some specific exit options for TSB, namely: (i) the creation of a cloned and carved-out set of IT systems which would be transferred to a third party provider to operate on TSB's behalf (the "carve-out option"); (ii) the migration of TSB's data to the IT systems of a third party service provider; or (iii) the migration of TSB's data to the IT systems of another financial institution with whom TSB enters into a merger or acquisition. If TSB Bank were to choose the carve-out option, Lloyds Bank would assume the cost of creating and transferring the clone, subject to a £50 million contribution from TSB. If TSB chose to exit the IT services via one of the migration options, Lloyds Bank has agreed to make a £450 million contribution to TSB's costs of undertaking the migration, and TSB may elect to spend some or all of the £450 million obtaining exit assistance services from Lloyds Bank. With the exception of the carve-out option, Lloyds Bank has agreed to support the exit of the services (including both IT and non-IT services) on a time and materials at cost basis.

Lloyds Bank is committed under the TSA to providing services to TSB until they have been successfully exited to successor service providers, to incentivise the timely completion of exit, a charges ratchet mechanism applies for any service provision beyond the agreed expiry of each service.

Lloyds Bank is required to maintain reasonable technical and organisation controls to guard against unauthorised/unlawful access to TSB's data by Lloyds Bank personnel, including systems-level measures where appropriate. Lloyds Bank undertakes that it has and will continue to have in place up-to-date business continuity and disaster recovery plans. Lloyds Bank agrees to test the business continuity plans and provide TSB Bank with written results of the testing and details of the steps taken to remedy any shortcomings or failures identified.

14.7 Long Term Services Agreement

Overview of services

TSB Bank and Lloyds Bank entered into the LTSA (the "**LTSA**") on 9 June 2014. Under the LTSA, which will commence upon Admission, Lloyds Bank provides certain IT and operational services on and from 1 January 2017 to TSB for a term of up to seven and a half years.

The IT services to be provided by Lloyds Bank under the LTSA comprise the following:

- Distribution Services: ATM's IT Service, Community Bank IT Service, Digital Banking IT Service, Telephone Banking IT Service, Customer Value Management IT Service and Business Performance Management IT Service;
- Hub Services: Retail Operations IT Service, Credit Operations IT Service, Payments IT Service and Markets Trading IT Service;
- Manufacturing Services: Data Warehouse IT Service and Commercial Banking IT Service;
- Corporate Core Services: Risk IT Service, Security and Fraud IT Service, Finance IT Service, Markets Finance IT Service, Corporate Treasury IT Service, Corporate Affairs IT Service, Human Resources IT Service, Property Management IT Service and Sourcing IT Service;
- Support Services ("reactive support" provided in response to a particular issue, incident or event): IT Service Desk, IT Incident management, IT Problem Management and IT Service Continuity;

- Support Services ("proactive support" provided on an on-going basis): IT Back-up and Recovery, IT Service Relationship Management and IT Performance and Capacity Planning;
- Support Services ("consumer services" which are available, if approved upon request): IT Request Management (Order IT) and Collaboration Services;
- Support Services ("IT Change" which relates to the on-going management and implementation of IT Changes): IT Change Management; and
- Support Services (Security, which relate to the IT security services operated by Lloyds Bank): Security Identity and Access Management, IT Security Solutions Management, IT Security Monitoring and Oversight and IT Threat and Vulnerability Management.

Operational services to be provided by Lloyds Bank under the LTSA comprise Business Services (bulk printing and scanning and indexing mail), Cards Processing, e-Payment Processing during Transition, Clearing (Cheques and Drafts), Finance Operations, Global Transaction Compliance (for payments and customers), Code Authenticator, Specialist Investigations Support, Mortgages System Configuration, TMS Workflow Process Configuration, BIT Configuration Support, Treasury Finance Support, Group Reference Data Management, BPM Data Feed Support and Treasury Market Operations Support.

Overview of terms

Lloyds Bank is required to provide the LTSA services in accordance with certain agreed service levels, with service credits payable for certain service level failures. Lloyds Bank is bound by a range of qualitative service commitments, including to provide the services with reasonable care and skill and in accordance with applicable laws. Regular reports will be provided by Lloyds Bank to TSB Bank to enable ongoing monitoring of service performance. A defined incident management process will be followed by Lloyds Bank in managing service-related incidents and outages.

TSB Bank pays a core service charge monthly in arrears that includes an agreed baseline of service volumes, The core service charge is inclusive of any applicable VAT and will be adjusted annually to reflect inflation. Additional payments are payable for increases in service volumes based on agreed unit charges and cost drivers. Certain third party charges for telephony, card processing and other consumables will be charged to TSB Bank on a pass-through basis, with no mark-up, as will any increase in Royal Mail rates for inputs used by Lloyds Bank in providing the services. The core service charge will be reduced on a pro-rata basis where a service provision ends before the planned exit date. In addition to the core service charge, service changes or projects that TSB initiates will be on the basis of an agreed rate card.

TSB will have the right to initiate, at its own cost, projects or changes to the services to support TSB's own competitive strategy, for example, changes to product pricing and other non-price product features and the launch of new products.

Subject to certain conventional exceptions (for example, in the case of fraud or intellectual property rights claims) where the parties' liability is uncapped, each party's liability to the other party under the LTSA is capped annually at a level which approximates to the annual fees under the LTSA. Each party's liability is also subject to an additional aggregate cap. Lloyds Bank's aggregate cap is refreshed at the beginning of the sixth year after the effective date of the TSA. For TSB Bank, the aggregate cap is not refreshed at the beginning of the sixth year and is subject to a requirement that amounts paid out to Lloyds Bank under the TSA or LTSA should not lead to TSB's Tier 1 or Tier 2 capital falling below 0.5 per cent. above the applicable regulatory thresholds.

There is flexibility for TSB Bank to terminate the LTSA (or services thereunder) prior to its expiry date subject to minimum notice requirements. TSB Bank may also terminate the LTSA for convenience (upon prior notice) or cause, including for Lloyds Bank's material breach or insolvency, persistent poor performance, or where TSB Bank or Lloyds Bank is acquired by another FCA regulated bank. Lloyds Bank may only terminate the LTSA if required to do so by a regulatory authority or law, or for non-payment of material charges by TSB Bank.

The LTSA contains provisions designed to support the exit of services in a termination scenario. As exit is anticipated to take at least three years (and potentially longer) to complete, the exit

phase is therefore planned to commence no later than three years before the end of the LTSA term, or earlier if either party exercises its termination rights (as outlined above). The LTSA outlines at a high level the respective responsibilities of each of TSB Bank and Lloyds Bank in relation to exit and provides a mechanism for the parties to continue to define and agree their respective obligations in detailed technical and commercial exit plans during the 12 months following Admission. Due to the criticality of the IT services, Lloyds Bank and TSB Bank have defined in advance some specific exit options for TSB, namely: (i) the creation of a cloned and carved-out set of IT systems which would be transferred to a third party provider to operate on TSB's behalf (the "carve-out option"); (ii) the migration of TSB's data to the IT systems of a third party service provider; or (iii) the migration of TSB's data to the IT systems of another financial institution with whom TSB enters into a merger or acquisition. If TSB Bank were to choose the carve-out option, Lloyds Bank would assume the cost of creating and transferring the clone, subject to a £50 million contribution from TSB. If TSB chose to exit the IT services via one of the migration options, Lloyds Bank has agreed to make a £450 million contribution to TSB's costs of undertaking the migration, and TSB may elect to spend some or all of the £450 million obtaining exit assistance services from Lloyds Bank. With the exception of the carve-out option, Lloyds Bank has agreed to support the exit of the services (including both IT services and non-IT services) on a time and materials at cost basis.

As Lloyds Bank is committed under the LTSA to providing services to TSB until they have successfully exited to successor service providers, to incentivise the timely completion of exit, a charges ratchet mechanism applies for any service provision beyond the agreed expiry date of each service. The carve-out option for exiting the IT services is dependent in part on each of Lloyds Bank and TSB entering into a separate agreement with the successor operator for build services (in the case of Lloyds Bank's agreement) and for run-state services (in the case of TSB's agreement). Accordingly, an additional pricing adjustment mechanism applies to disincentivise delay by either party in concluding its agreement with the successor operators by one and a half years before the end of the LTSA term.

Lloyds Bank is required to maintain reasonable technical and organisational controls to guard against unauthorised/unlawful access to TSB's data by Lloyds Bank's personnel including systems-level measures where appropriate. Lloyds Bank undertakes that it has and will continue to have in place up-to-date business continuity and disaster recovery plans. Lloyds Bank agrees to test the business continuity plans and provide TSB Bank the written results of the testing and details of the steps taken to remedy any shortcomings or failings identified.

14.8 Mortgage Intermediary Platform Build Agreement

The Company, TSB Bank and Lloyds Bank entered into the Mortgage Intermediary Platform Build Agreement on 9 June 2014, under which Lloyds Bank has agreed to complete the build of a mortgage intermediary platform, which Lloyds Bank will use to provide certain IT services to TSB under the TSA and the LTSA.

Lloyds Bank has undertaken to complete the build of the mortgage intermediary platform in accordance with the design agreed between the parties, and perform certain testing and TSB business readiness activities, by 9 January 2015 (the "**Delivery Date**"). Lloyds Bank has agreed to pay TSB Bank liquidated damages of specified amounts (being not less than £5 million) in the event of a failure to complete the build in accordance with the agreed terms and/or to perform the associated testing and TSB business readiness activities by the date falling two months following the Delivery Date (such liquidated damages increasing on a ratchet basis for further delays beyond such date), except to the extent such failure is caused by specified factors, including TSB's failure to complete certain actions and deliverables on which the obligations of Lloyds Bank are dependent.

Lloyds Bank will also reimburse TSB for certain costs associated with the setting up of its mortgage intermediaries business, including TSB's internal costs associated with the platform build, recruitment costs and training costs.

14.9 Tier 2 Subscription Agreement

The Company and Lloyds Bank have entered into the Tier 2 Subscription Agreement relating to the subscription of the Tier 2 Securities which settled on 1 May 2014.

Pursuant to the Tier 2 Subscription Agreement, Lloyds Bank subscribed for the Tier 2 Securities at an issue price of 99.493 per cent. of their principal amount. Interest on the Tier 2 Securities is payable: (i) semi-annually in arrear in respect of interest periods commencing prior to 6 May 2021, at a fixed rate of interest at 5.750 per cent. per annum; and (ii) quarterly in arrear in respect of interest periods commencing on or following such date, at a rate of interest per annum determined on the relevant interest period commencement date to be equal to three-month LIBOR plus a margin equal to the initial credit spread of 343 basis points. Further, the Company provided certain customary representations and warranties to Lloyds Bank. The Company further undertook to prepare a prospectus in respect of the listing of the Tier 2 Securities and to procure that the Tier 2 Securities be admitted to listing on the Official List of the UK Listing Authority and to trading on the regulated market of the London Stock Exchange as soon as reasonably practicable and in any event by the later of: (i) the date that is six calendar months following Admission; and (ii) 31 December 2014.

The Tier 2 Securities will mature on the interest payment date falling on or nearest to 6 May 2026 and are also callable in whole but not in part at the option of the Company on 6 May 2021 or any interest payment date thereafter at their principal amount together with accrued but unpaid interest, subject to certain conditions. If certain events relating to the taxation treatment or regulatory capital classification of the Tier 2 Securities occur, the Company will also have an option to redeem the Tier 2 Securities at their principal amount together with accrued interest or an option to substitute or vary the terms of the Tier 2 Securities, in each case subject to certain conditions.

14.10 Mortgage Enhancement Agreements

14.10.1 Mortgage Sale Agreement

On 4 March 2014, TSB Bank and Bank of Scotland entered into the Mortgage Sale Agreement in relation to the equitable assignment (which took effect from 28 February 2014) of the Additional Mortgages from Bank of Scotland to TSB Bank.

Pursuant to the Mortgage Sale Agreement, TSB Bank purchased Bank of Scotland's equitable interest in the Additional Mortgages for a consideration of approximately £3.4 billion (such sum being equal to the fair value of the Additional Mortgages at the time of transfer). Under the terms of the Mortgage Sale Agreement, legal title in the Additional Mortgages has remained and will remain with Bank of Scotland unless a perfection event occurs (namely an insolvency event in relation to Bank of Scotland or specified material breach by Bank of Scotland of its obligations under the Mortgage Sale Agreement or following termination of the appointment of Bank of Scotland as servicer under the Mortgage Servicing Agreement at the option of the Purchaser). Unless and until any such perfection event occurs, the Additional Mortgage customers remain customers of Bank of Scotland.

Under the Mortgage Sale Agreement, Bank of Scotland has provided certain representations and warranties to TSB Bank as to the Additional Mortgages as at the date of the agreement, including as to the enforceability of the Additional Mortgages, the absence of arrears in relation to the Additional Mortgages in the 12 months preceding the transfer and the properties securing the Additional Mortgages being located in England and Wales (the "**Portfolio Warranties**").

In case of a breach of certain fundamental Portfolio Warranties, TSB Bank has the right to require Bank of Scotland to repurchase the Additional Mortgages to which the breach of warranty relates. In case of a breach of any other Portfolio Warranties, Bank of Scotland has agreed to indemnify TSB Bank in respect of specified losses resulting from such breach. Any such indemnity or obligation is subject to the terms of the Mortgage Sale Agreement, including in respect of any limitations.

Further and to the extent that TSB Bank does not have a claim against Bank of Scotland for a breach of one of the Portfolio Warranties contained in the Mortgage Sale Agreement, subject to certain limitations, Bank of Scotland has given TSB Bank additional protection in the Mortgage Sale Agreement, including an indemnity relating to the accuracy of certain data provided to TSB Bank by Bank of Scotland and an indemnity providing protection against certain losses arising from pre-transfer acts

or omissions constituting breaches of applicable laws and regulations on terms that are similar to those of the Conduct Indemnity (for further information on the Conduct Indemnity, see "*Separation Agreement*" above), and subject to the same limitations as apply to other indemnities provided by Bank of Scotland in the Mortgage Sale Agreement.

Under the Mortgage Sale Agreement, Bank of Scotland has agreed with TSB Bank that, prior to the occurrence of a perfection event, Bank of Scotland may grant advances of further money ("**Further Advances**") to borrowers under existing Additional Mortgages upon request from the borrower. Bank of Scotland has agreed to repurchase any Additional Mortgages that are the subject of Further Advances at their fair value.

Under the Mortgage Sale Agreement, Bank of Scotland and TSB Bank have agreed that prior to the occurrence of a perfection event (as described above), Bank of Scotland may grant requests by borrowers under existing Additional Mortgages to vary certain financial terms or conditions of such Additional Mortgages (a "**Product Switch**"). To the extent a Product Switch necessitates the payment by the lender to the borrower or any third party, then the responsibility for such payment rests solely with Bank of Scotland. Additional Mortgages that are the subject of a Product Switch are not required (subject to remote exceptions) to be repurchased by Bank of Scotland.

Under the terms of the Mortgage Sale Agreement, TSB Bank is entitled to require Bank of Scotland to repurchase the equitable interest in the Additional Mortgages at any time at fair value.

Bank of Scotland may require, by way of the Call Option, TSB Bank to sell its equitable interest in the Additional Mortgages back to Bank of Scotland at fair value provided that:

- the Deemed Profit Trigger has been met (that is, TSB Bank has made a Deemed Profit of at least £230 million on the Additional Mortgages); and
- either:
  - (i) the 2017 Deemed Profit Trigger has been met (that is, TSB Bank has made a Deemed Profit of at least £30 million on the Additional Mortgages in 2017); or
  - (ii) the Call Option is exercised on or after 31 December 2017.

The Call Option cannot be exercised in circumstances where the effect on TSB Bank of the repurchase by Bank of Scotland at fair value would result in the Deemed Profit falling below the Deemed Profit Trigger or (where applicable) the Deemed Profit in 2017 falling below the 2017 Deemed Profit Trigger.

For further information on Deemed Profit and the Deemed Profit Calculation, see Part X: "*Information on the TSB Group – Mortgage Enhancement Structure and related funding arrangements*".

14.10.2 Mortgage Servicing Agreement

On 4 March 2014, TSB Bank and Bank of Scotland entered into the Mortgage Servicing Agreement in relation to the servicing of the Additional Mortgages.

Pursuant to the Mortgage Servicing Agreement, Bank of Scotland agreed to service the Additional Mortgages, including all aspects of the customer relationship, in return for the payment by TSB Bank, monthly in arrears, of a servicing fee equivalent to 0.12 per cent. per annum of the outstanding balance of the Additional Mortgages (subject to a minimum monthly fee of £175,000 from 1 July 2018).

Under the arrangements, Bank of Scotland will retain control over the determination of interest rates, fees and other charges in relation to the Additional Mortgages and the ability to offer new products to the Additional Mortgage customers. Bank of Scotland has undertaken to TSB Bank to apply the same policies relating to the

originating, underwriting, administration, arrears and enforcement of the Additional Mortgages as it does to loans and the security for such loans which are beneficially owned solely by Bank of Scotland.

Bank of Scotland has also undertaken in the Mortgage Servicing Agreement to provide TSB Bank with specified data and reports required by TSB Bank in order to meet its legal and regulatory obligations in relation to the Additional Mortgages. An 'External Assurance Agent' will also be appointed as required to monitor the underlying systems and controls used to produce the data and reports provided by Bank of Scotland to TSB Bank under the agreement.

Further, subject to certain limitations, Bank of Scotland has given TSB Bank certain indemnity protection in the Mortgage Servicing Agreement including an indemnity relating Bank of Scotland's ongoing role in administering and servicing the Additional Mortgages.

Upon the occurrence of certain termination events (broadly an insolvency event in relation to Bank of Scotland or specified material breaches by Bank of Scotland of its obligations under the Mortgage Servicing Agreement), TSB Bank has the right pursuant to the Mortgage Servicing Agreement to terminate the appointment of Bank of Scotland as servicer and appoint, subject to certain conditions, a replacement servicer of the Additional Mortgages.

14.11 RMBS Funding Facility Agreements

On 20 May 2014, TSB Bank and a special purpose vehicle established by TSB Bank ("**TSB RMBS SPV**") and others entered into the RMBS Mortgage Sale Agreement, and the same parties, together with Lloyds Bank and others entered into the Variable Funding Note Issuance Deed ("**VFNID**") and other ancillary documents in relation to the RMBS Funding Facility.

Under the terms of the VFNID, senior funding is raised by TSB RMBS SPV through a combination of drawings on a variable funding note ("**VFN**") issued by TSB RMBS SPV to Lloyds Bank (the "**Lloyds VFN**") and TSB Bank (the "**TSB VFN**"). Subject to certain conditions (including the non-occurrence of specified "term out" events), up until 17 December 2018, TSB RMBS SPV has the option to repay and redraw the Lloyds VFN (in whole or in part).

14.11.1 Pricing of Lloyds VFN

The Lloyds VFN is drawn at a rate of interest equivalent to three-month LIBOR plus 0.6 per cent. until 17 December 2018, when there is a step up in interest costs to three-month LIBOR plus 1.2 per cent. During the commitment period, a commitment fee on undrawn amounts under the Lloyds VFN equivalent to 0.3 per cent. of such undrawn amount is also payable. In certain limited circumstances (related to specified defaults or breaches of obligations by TSB under the terms of the RMBS Funding Facility Agreements), the overall costs to TSB of the RMBS Funding Facility may increase.

14.11.2 Warranty and indemnity protection

Under the terms of the RMBS Mortgage Sale Agreement, TSB Bank has given in favour of TSB RMBS SPV customary warranties relating to the TSB Bank mortgages transferred to TSB RMBS SPV. In addition, TSB Bank has given TSB RMBS SPV and other parties customary indemnities under the terms of various documents relating to the RMBS Funding Facility.

14.11.3 Mandatory repayment events in relation to the Lloyds VFN

The VFNID provides for the mandatory repayment of the Lloyds VFN on the occurrence of limited specific events, which aim to ensure the funding provided under the Lloyds VFN is not greater than the aggregate principal amount outstanding of the Additional Mortgages that continue to be held by TSB Bank pursuant to the Mortgage Enhancement Structure (so that, for example, where TSB Bank sells its

beneficial interest in the Additional Mortgages upon exercise of the Call Option under the Mortgage Enhancement Structure, the funding under the Lloyds VFN would be required to be repaid in full).

14.11.4 Term Out of Lloyds VFN

Pursuant to the VFNID, Lloyds Bank's commitment to advance further monies to TSB RMBS SPV under the Lloyds VFN will terminate (and any funding provided by Lloyds Bank will start to amortise) on the earlier to occur of certain dates or events, including:

- 17 December 2018;
- the occurrence of certain triggers or other events, including (among others) insolvency of TSB, instances of illegality, increased cost events and certain breaches by TSB Bank of the RMBS Funding Facility Agreements;
- failure by TSB RMBS SPV to repay the Lloyds VFN upon a mandatory repayment event (as described above); and
- the occurrence of an event of default, including breaches by TSB RMBS SPV of the RMBS Funding Facility Agreements, non-payment of principal or interest or any commitment fee and insolvency events in relation to TSB RMBS SPV.

On the occurrence of certain events, payments to TSB Bank under the TSB VFN may be subordinated.

14.11.5 Drawstop

In addition, temporary drawstops may arise in relation to the Lloyds VFN on the occurrence of certain events and circumstances related to the performance of the RMBS Mortgages.

14.12 General Insurance Distribution Agreement

On 9 June 2014, LBIS and TSB Bank entered into a general insurance distribution agreement (the "**GIDA**"). Pursuant to the GIDA, and with effect from 12 May 2013, LBIS agreed to administer a home insurance product ("**Lloyds Home Solutions Insurance**") underwritten by LBGI and entered into prior to 12 May 2013 with customers who were TSB customers as at 12 May 2013. Under the GIDA, LBIS and TSB Bank have also agreed that TSB Bank shall promote and sell to TSB banking customers on or after 12 May 2013 the same insurance product via the TSB branches, in this case TSB-branded ("**TSB Home Solutions Insurance**") underwritten by LBGI and mediated and administered by LBIS.

Under the GIDA, LBIS has agreed, subject to certain limitations, to indemnify TSB Bank in respect of pre-Admission mis-selling liabilities relating to the Lloyds Home Solutions Insurance or TSB Home Solutions Insurance, mis-selling liabilities relating to the Lloyds Home Solutions Insurance and mis-selling liabilities that relate to the activities of LBIS under the GIDA. TSB Bank has agreed, subject to certain limitations, to indemnify LBIS in respect of any other post-Admission mis-selling liabilities relating to the TSB Home Solutions Insurance.

Pursuant to the GIDA, LBIS has agreed to pay TSB Bank a commission in relation to new sales and renewals of TSB Home Solutions Insurance and a commission in relation to renewals of 'legacy' Lloyds Home Solutions Insurance. LBIS has also agreed to pay to TSB Bank a percentage of the income it earns on Lloyds Home Solutions Insurance and TSB Home Solutions Insurance.

The GIDA contains mutual provisions in relation to the use of customer data for the purposes of the agreement. LBIS and TSB Bank have each also agreed to certain restrictions in relation to direct and targeted marketing of TSB Home Solutions Insurance and Lloyds Home Solutions Insurance customers respectively.

The Distribution Agreement shall terminate automatically on 30 April 2019 unless terminated earlier in accordance with its terms. Each party has the right to terminate the GIDA in relation to TSB Home Solutions Insurance customers (but not Lloyds Home Solutions Insurance customers) on not less than 12 months notice in writing, such notice to expire no earlier than midnight on 30 April 2016.

15 Related party transactions and other arrangements

15.1 Save:

15.1.1 as described in the TSB Bank Group's historical financial information for the three years ended 31 December 2013, 2012 and 2011 set out in Note 19 to Part XVI: *"Historical Financial Information"*;

15.1.2 as described in the unaudited pro forma financial information set out in Part XVIII: *"Unaudited Pro forma Financial Information"*;

15.1.3 for the Relationship Agreement, the Separation Agreement, the Tax Separation Deed, the TSA, the LTSA, the Tier 2 Subscription Agreement, the Mortgage Enhancement Agreements, the RMBS Funding Facility Agreements, the Mortgage Intermediary Platform Build Agreement, the Co-servicing Agreement and the General Insurance Distribution Agreement; and

15.1.4 as described at paragraph 15.2 below,

there were no related party transactions entered into by the Company or any member of the TSB Group during the financial years ended 31 December 2013, 2012 and 2011 and during the period up to the date of this Prospectus.

15.2 In January 2009, the UK Government through HM Treasury became a related party of the Parent, the TSB Group's ultimate parent company, following its subscription for ordinary shares issued by the Parent under a placing and open offer. As at 6 June 2014 (being the latest practicable date prior to the publication of this Prospectus), HM Treasury held a 24.9 per cent. interest in the Parent's ordinary share capital and consequently HM Treasury is a related party of the TSB Group.

From 1 January 2011, in accordance with IAS 24, UK Government controlled entities became related parties of the TSB Group. The TSB Group regards the Bank of England and entities controlled by the UK Government, including The Royal Bank of Scotland Group plc and UK Asset Resolution Limited, as related parties. There were no significant transactions between the TSB Group and the UK Government or UK Government-controlled entities (including UK Government-controlled banks) during the period from 31 December 2013 to the date of publication of this Prospectus that were not made in the ordinary course of business or that were unusual in their nature or conditions. During the ordinary course of business, the TSB Group may from time to time access market-wide facilities provided by central banks.

16 Litigation

There are no Governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the TSB Group is aware) during the 12 months preceding the date of this Prospectus which may have, or have had, a significant effect on the Company's or the TSB Group's financial position or profitability.

17 Working capital

In the opinion of the Company the working capital available to the TSB Group is sufficient for the TSB Group's present requirements, that is for at least the next 12 months following the date of this Prospectus.

18 No significant change

Save for:

(i) in relation to the share capital and equity capitalisation of the Company: (a) the incorporation of the Company on 31 January with subscriber share capital of £50,000, being 50,000 ordinary shares of £1 each; (b) the subdivision of each £1 ordinary share in the Company into 100 1p Ordinary Shares on 4 April 2014; (c) the acquisition by the Company of the entire share capital of TSB Bank from Lloyds Bank on 25 April 2014 for consideration of a further 50,000,000 Ordinary Shares of 1p each; and (d) the issue on 19 May 2014 of 445 million Ordinary Shares in the Company of 1p each to Lloyds Bank for cash consideration of £200 million (and subsequent issue by TSB Bank to the Company of 445 million Ordinary Shares of 1p each for cash consideration of £200 million);

(ii) the settlement on 1 May 2014 of Tier 2 Securities by Lloyds Bank for net proceeds of £383 million (and subsequent issue of a similar instrument by TSB Bank to the Company for net proceeds of £383 million); and

(iii) in relation to the funding of the Mortgage Enhancement, the entry by TSB Bank into the £2,500 million RMBS Funding Facility on 20 May 2014 (pursuant to which £10 million was drawn down on 20 May 2014 and a further £240 million drawn down on 2 June 2014) and repayment by TSB Bank on 2 June 2014 of the unsecured funding facility of £1,535 million that had been put in place on 4 March 2014,

there has been no significant change in the financial or trading position of the TSB Group since 31 March 2014, the date to which the last interim financial information was prepared.

19 Consents

PricewaterhouseCoopers LLP is a member firm of the Institute of Chartered Accountants in England and Wales and has given and has not withdrawn its written consent to the inclusion of the reports in Part XVI: *"Historical Financial Information"* and Part XVIII: *"Unaudited Pro forma Financial Information"*, in the form and context in which they appear, and has authorised the contents of its reports for the purposes of Rule 5.5.3R(2)(f) of the Prospectus Rules. A written consent under the Prospectus Rules is different from a consent filed with the SEC under Section 7 of the Securities Act. As the Ordinary Shares have not been, and will not be, registered under the US Securities Act, PricewaterhouseCoopers LLP has not filed a consent under Section 7 of the Securities Act.

20 General

20.1 The Selling Shareholder will bear approximately £33.2 million of fees and expenses in connection with the Offer and Admission, including commissions payable (excluding any discretionary commissions), other estimated fees and expenses in connection with the Offer and Admission (excluding fees and expenses in relation to the transfer of any Bonus Shares pursuant to the Bonus Share Scheme) and amounts in respect of VAT and United Kingdom stamp duty and SDRT (assuming the Offer Size is set at the Expected Offer Size, no exercise of the Over-allotment Option and that the Offer Price is set at the mid-point of the Offer Price Range).

20.2 The financial information contained in this Prospectus does not amount to statutory accounts within the meaning of section 434(3) of the Companies Act. Full audited accounts have been delivered to the Registrar of Companies for the Company for the three accounting periods ended 31 December 2013.

20.3 The Intermediaries authorised as at the date of this Prospectus to use this Prospectus in connection with the Intermediaries Offer are: ADM Investor Services International Limited, AJ Bell Securities Limited, All IPO plc, Alliance Trust Savings Limited, Arnold Stansby & Co. Ltd, Barclays Bank plc, Barratt & Cooke, Beaufort Asset Clearing Services Ltd, Blankstone Sington Limited, Brewin Dolphin Ltd, Brown Shipley & Co Ltd, Canaccord Genuity Wealth (International) Ltd, Cave & Sons Ltd., Charles Stanley & Co Ltd, Cornhill Capital Limited, Dowgate Capital Stockbrokers Ltd, Edwards Securities Limited, EFG Harris Allday, Equiniti Financial Services Limited, Fiske Plc, FXCM Securities Ltd, GHC Capital Markets Ltd, Halifax Share Dealing Limited, Hargreave Hale Limited, Hargreaves Lansdown Asset Management Limited, Havelock Hunter Stockbrokers Ltd, Hedley and Company Stockbrokers Limited, iDealing.com Ltd, Interactive Investor Trading Ltd, Investec Wealth & Investment Limited, J.M. Finn & Co. Ltd, James Brearley & Sons Ltd, James Sharp & Co LLP, Jarvis Investment Management Ltd, Killik & Co LLP, M D Barnard & Co Limited, Midas Investment Management Ltd, Old Park Lane Capital Plc, Paul E. Schweder Miller & Co., Pilling & Company (Manchester) Limited, Quilter Cheviot Investment Management Limited, Rathbone Investment Management Limited, Redmayne-Bentley LLP, Reyker Securities Plc, Rowan Dartington & Co Ltd, Sanlam Private Investments UK, Smith & Williamson Investment Services Limited, Spiers & Jeffrey Ltd, SVS Securities Plc, The Share Centre Ltd, Thomas Grant & Company Ltd, TD Direct Investing (Europe) Limited, W H Ireland Nominees Limited and Walker Crips Stockbrokers Limited.

20.4 Any new information with respect to financial intermediaries unknown at the time of approval of this Prospectus, including whether an Intermediary ceases to participate in the Intermediaries Offer, will be available online at tsbshareoffer.equiniti.com.

21 Takeover regulation

The City Code on Takeovers and Mergers (the "**City Code**") is issued and administered by The Panel on Takeovers and Mergers (the "**Takeover Panel**"). The Company is subject to the City Code and therefore its shareholders are entitled to the protections afforded by the City Code.

Under Rule 9 of the City Code, when: (i) a person acquires an interest in shares which (when taken together with shares he and persons acting in concert with him are interested) carry 30 per cent. or more of the voting rights of a company subject to the City Code; or (ii) any person who, together with persons acting in concert with him, is interested in shares which in the aggregate carry not less than 30 per cent. of the voting rights of a company, but does not hold shares carrying more than 50 per cent. of the voting rights of a company subject to the City Code, and such person, or any persons acting in concert with him, acquires an interest in any other shares which increases the percentage of the shares carrying voting rights in which he is interested, then, in either case, that person, together with the person acting in concert with him, is normally required to extend offers in cash, at the highest price paid by him (or any persons acting in concert with him) for shares in the company within the preceding 12 months, to the holders of any class of equity share capital, whether voting or non-voting, and also to the holders of any other class of transferable securities carrying voting rights.

Following Admission, the Selling Shareholder will hold 75 per cent. of the issued Ordinary Share capital of the Company, assuming the Offer Size is set at the Expected Offer Size and the Over-allotment Option is not exercised, and 72.5 per cent., assuming the Offer Size is set at the Expected Offer Size and the Over-allotment Option is exercised in full. Investors should be aware that any person who acquires 30 per cent. or more of the voting rights attached to the issued share capital of the Selling Shareholder may, pursuant to Note 8 to Rule 9.1 of the City Code, be required by the Takeover Panel to make an offer for the shares in the Company not owned or controlled by the Selling Shareholder at that time.

22 Documents available for inspection

Copies of the following documents are available for inspection during usual business hours on any weekday (Saturdays, Sundays and public holidays excepted) for the life of this Prospectus at the offices of Linklaters LLP, One Silk Street, London EC2Y 8HQ and at the Company's Registered Office at 20 Gresham Street, London, EC2V 7JE, United Kingdom:

22.1 the memorandum and articles of association of the Company;

22.2 the historical financial information for the TSB Bank Group in respect of the three financial years ended 31 December 2013, 2012 and 2011;

22.3 service agreements of all of the Executive Directors and letters of appointment of the Chairman, all of the Non-Executive Directors and the Prospective Non-executive director;

22.4 new share scheme rules to be adopted by the Company on Admission;

22.5 the consent letter referred to in *"Consents"* above;

22.6 the reports from PricewaterhouseCoopers LLP which are set out in Part XVI: *"Historical Financial Information"* and Part XVIII: *"Unaudited Pro forma Financial Information"*; and

22.7 this Prospectus.

Dated: 9 June 2014

PART XXIII
DEFINITIONS AND INDUSTRY TERMS

Definitions

The following definitions apply throughout this Prospectus unless the context requires otherwise:

ABI	the Association of British Insurers
Act or **Companies Act**	the Companies Act 2006, as such act may be amended, modified or re-enacted from time to time
Additional Mortgages	the portfolio of residential mortgages transferred by Bank of Scotland to TSB Bank pursuant to the Mortgage Sale Agreement as more fully described in Part X: "*Information on the TSB Group – Mortgage Enhancement Structure and related funding arrangements*"
Additional Tier 1 Capital	deeply subordinated perpetual instruments issued in accordance with the requirements of CRD IV
Admission	the admission of the Ordinary Shares to the premium listing segment of the Official List and to trading on the London Stock Exchange's main market for listed securities becoming effective in accordance with, respectively, the Listing Rules and the Admission and Disclosure Standards published by the London Stock Exchange
APE	Annual Premium Earned, the amount of total premiums collected by an insurance business over a year that have been earned based on the ratio of the time passed on the policies to their effective life
Approved Person	an individual who has been approved by the FCA and/or the PRA to perform one or more controlled functions on behalf of an authorised firm
APR	Annual Percentage Rate, the annualised rate of interest paid by a borrower to a lender
AQR	Asset Quality Rating, an evaluation assessing the credit risk associated with a particular asset
Articles	the articles of association of the Company to be adopted upon Admission
ATM	Automated Teller Machine
Audit Committee	the audit committee of the Board
Auditors	PricewaterhouseCoopers LLP
AVA	Added Value Accounts, also known as "packaged accounts", PCAs that provide additional products packaged with the PCA in return for a fixed monthly/annual charge
Bank of Scotland	Bank of Scotland plc
Banking Act	the UK Banking Act 2009, as may be amended, modified or re-enacted from time to time
Banking Reform Act	the UK Financial Services (Banking Reform) Act 2013
Banking Reform Bill	The draft Financial Services (Banking Reform) Bill published by the UK Government in October 2012
Base Rate	the Bank of England's base rate, the interest rate that the Bank of England charges banks for secured overnight lending
Basel III	a package of capital and liquidity requirements published by the Basel Committee intended to establish minimum liquidity standards for credit institutions

Basel Committee	The Basel Committee on Banking Supervision
BCA	Business Current Account
BCOBS	the FCA's Banking: Conduct of Business Sourcebook
BIPRU	the PRA's Prudential sourcebook for Banks, Building Societies and Investment Firms
BIS	the department for Business, Innovation and Skills
Board Committees	the Audit, Remuneration, Nomination and Risk Committees of the Board and any other Committees of the Board from time to time
Board or **TSB Board**	the board of directors of the Company
Bonus Share Distribution Agent	Equiniti Limited
Bonus Shares	Ordinary Shares transferred or to be transferred to qualifying investors under the terms of the Bonus Share Scheme
Bonus Share Scheme	the scheme provided under the terms of the Intermediaries Offer for the transfer of Bonus Shares to qualifying investors on the terms set out in this document
Bonus Share Record Date	the date falling 12 months after Admission
BTL	Buy-to-let mortgages, mortgages provided to customers who intend to rent out the purchased property
Business Day	any day other than a Saturday or Sunday on which banks are generally open for the transaction of business in London, other than solely for the purposes of trading and settlement in Euro
Business Transfer Agreement	the business transfer agreement entered into on 13 March 2013 between Lloyds Bank and TSB Bank and Cheltenham & Gloucester plc relating to the transfer of part of the business of Lloyds Bank to TSB Bank
C&G Period	has the meaning given in Part II: "*Risk Factors – the TSB Franchise business is subject to risks relating to the cost and availability of liquidity and funding*"
CAGR	Compound Annual Growth Rate
Capital Requirements Directive or **CRD**	the Banking Consolidation Directive (2006/28/EC) and the recast Capital Adequacy Directive (2006/49/EC)
Capital Requirements Regulation	the UK Capital Requirements Regulations 2006, implementing in part the Capital Requirements Directive
CCA	Consumer Credit Act 1974
CDS	Credit Default Swap
CEO	the chief executive officer of the Company, Paul Pester
CET1	common equity tier 1 capital, calculated by TSB on the basis set out in the notes to Part XVIII: "*Unaudited Pro forma Financial Information*"
Chairman	the chairman of the Company, Will Samuel
CHAPS	Clearing House Automated Payments System
CIR	Cost-to-Income Ratio, the ratio of operating costs (excluding impairments) to income
Citigroup	Citigroup Global Markets Limited
City Code	the UK City Code on Takeovers and Mergers (as amended from time to time)
CMA	the UK Competition and Markets Authority
CML	Council of Mortgage Lenders
COBS	the FCA's Conduct of Business Sourcebook

Common Equity Tier 1 Capital Ratio	a ratio of CET1 to RWAs, calculated by TSB on the basis set out in the notes to Part XVIII: "*Unaudited Pro forma Financial Information*"
Company	TSB Banking Group plc
Company Secretary	Susan Crichton, the company secretary of the Company
CONC	the FCA's Consumer Credit Sourcebook
Conduct Indemnity	has the meaning given in paragraph 14.4 of Part XXII: "*Additional Information – Material Contracts – Separation Agreement*"
Co-Servicing Agreement	the agreement in relation to certain limited co-servicing by the branches of each of Lloyds Bank and TSB Bank for the other bank's customers until 26 July 2014, entered into between Lloyds Bank and TSB Bank dated 9 June 2014
CRD II	Directive 2009/111/EC
CRD III	Directive 2010/76/EU
CRD IV	the legislative package implementing the Basel III proposals, consisting of: (i) Directive 2013/36/EU on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms; and (ii) Regulation (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms of the European Parliament and of the European Council of 26 June 2013
CREST	the UK-based system for the paperless settlement of trades in listed securities, of which Euroclear UK & Ireland Limited is the operator
CREST Regulations	the Uncertified Securities Regulations 2001 (512001/3755)
Delivery Date	in relation to the Mortgage Intermediary Platform Build Agreement, 9 January 2015
Directors	the directors of the Company whose names are set out in Part XI: *"Directors, Senior Management and Corporate Governance"* and including, from the time and date on which PRA approvals are received, the Prospective Non-executive Director
Disclosure and Transparency Rules	the disclosure rules and transparency rules produced by the FCA and forming part of the handbook of the FCA as, from time to time, amended
Disorderly Markets	in relation to an extension of the deadline for Lloyds Banking Group's full divestment of its interest in TSB, a scenario in which, in the judgment of Lloyds Banking Group's sponsoring banks and as indicated by certain market metrics in the prior six month period relating to: (i) the total number of IPOs in the main market of the London Stock Exchange, and (ii) the performance of the share price of the banks listed on the main market of the London Stock Exchange relative to the FTSE 100, the UK capital markets are in such condition that a full divestment by 31 December 2015 would not be achievable in an orderly fashion
DWF	the Bank of England's Discount Window Facility, a bilateral on-demand facility that allows participants to borrow highly liquid assets in return for less liquid collateral
EA 2002	the UK Enterprise Act 2002, as may be amended, modified or re-enacted from time to time
EC Treaty	the Treaty establishing the European Community (signed in Rome on 25 March 1957), as amended by the Treaty on European Union (signed in Maastricht on 7 February 1992), the Treaty of Amsterdam (signed in Amsterdam on 2 October 1997) and the Treaty of Nice (signed in Nice on 26 February 2001)
ECJ	the European Court of Justice

EEA or **European Economic Area**	the EU, Iceland, Norway and Liechtenstein
EEA State	any state in the EEA
EMU	the European Monetary Union
EU	the European Union
Euro, euro or **€**	the lawful currency of the Member States of the EU that adopt the single currency in accordance with the EC Treaty
European Commission	the Commission of the European Union
European Union or **EU**	the European Union first established by the treaty made at Maastricht on 7 February 1992
Eurozone	those Member States of the European Union which have adopted the euro
Exchange Act	the United States Securities Exchange Act of 1934, as amended
Executive Directors	the executive directors of the Company
Executive Plan	the TSB Executive Plan as described in Part XXII: "*Additional Information – Employee share plans*"
Expected Offer Size	125,000,000 Ordinary Shares, representing 25 per cent. of the issued Ordinary Share capital of the Company at Admission
FCA	the UK Financial Conduct Authority (or any predecessor authority or authorities carrying out banking and/or insurance regulatory functions in the UK prior to the date hereof, including the Financial Services Authority)
FCA Handbook	the handbook of rules and guidance issued by the FCA from time to time
Financial Adviser	Deloitte LLP
FLS or **Funding for Lending**	the Funding for Lending Scheme launched by the Bank of England and HM Treasury on 13 July 2012
FOS or **Ombudsman**	the Financial Ombudsman Service
FPC	the Financial Policy Committee
FSA 2012	the Financial Services Act 2012, as amended
FSCS	the Financial Services Compensation Scheme, a UK compensation fund set up under FSMA to provide compensation to customers of authorised financial services firms if a firm is unable, or likely to be unable, to pay claims against it
FSMA	the Financial Services and Markets Act 2000, as amended
FTE	full-time employee
FTP	Funds Transfer Pricing, a method used to individually measure how much each source of funding is contributing to overall profitability
GDP	Gross Domestic Product
General Insurance Distribution Agreement or **GIDA**	the agreement dated 9 June 2014 between LBIS and TSB Bank in relation to the distribution of general insurance products as more fully described in Part XXII: "*Additional Information – Material Contracts – General Insurance Distribution Agreement*"
GENPRU	the PRA's General Prudential sourcebook
GI	General Insurance

Government or **UK Government**	the Government of the United Kingdom
Help to Buy	UK Government-backed initiative to help individuals purchase a home through mortgage guarantees, equity loans and share ownership
HFI	the historical financial information set out in Part XVI: *"Historical Financial Information"*
HMRC	HM Revenue & Customs
HMT or **HM Treasury**	the Commissioners of her Majesty's Treasury
HPI	House Price Index
HVR	Homeowner Variable Rate
IAS	International Accounting Standards
IASB	the International Accounting Standards Board
ICAAP	Individual Capital Adequacy Assessment Process
ICB	the Independent Commission on Banking
ICG	Individual Capital Guidance
IFRIC	the International Accounting Standards Interpretation Committee
IFRS-EU or **IFRS**	the International Financial Reporting Standards, as adopted by the European Union
ILAA	Individual Liquidity Adequacy Assessment
ILAS	Individual Liquidity Adequacy Standards, the liquidity rules contained in BIPRU chapter 12
ILG	Individual Liquidity Guidance
Indexed LTV Ratio	Indexed loan-to-value ratio. Where this refers to individual loans, this measures the outstanding balance of an existing mortgage divided by the indexed value of the property on which the mortgage is secured. Where this refers to existing mortgage lending in aggregate, this measures the sum of the outstanding balances of the existing mortgage loans divided by the sum of the total indexed property values on which the mortgages are secured. The indexed property value(s) at completion are adjusted using the HPI at the time of reporting, on a regional level
Institutional Offer	the offer of Ordinary Shares to certain institutional investors, including QIBs in the United States, described in Part XXI: "*The Offer*"
Institutional Offer Shares	the Offer Shares sold pursuant to the Institutional Offer
Interim Financials	has the meaning given in Part XII: "*Selected Financial and Other Information – Interim Financial Information*"
Intermediaries	the entities listed in paragraph 20.3 of Part XXII: "*Additional Information*" of this Prospectus, together with any other intermediary financial institution (if any) that is appointed by the Selling Shareholder in connection with the Intermediaries Offer after the date of this Prospectus, and "**Intermediary**" shall mean any one of them
Intermediaries Booklet	the booklet entitled "TSB Banking Group plc Share Offer: Information for Intermediaries" and containing, among other things, the Intermediaries Terms and Conditions
Intermediaries Offer	the offer of Ordinary Shares to Intermediaries located in the United Kingdom, the Channel Islands and the Isle of Man described in Part XXI: "*The Offer*"

Intermediaries Offer Co-ordinator	J.P. Morgan Cazenove
Intermediaries Offer Shares	the Offer Shares sold pursuant to the Intermediaries Offer
Intermediaries Terms and Conditions	the terms and conditions agreed between the Parent, the Selling Shareholder and the Intermediaries in relation to the Intermediaries Offer and contained in the Intermediaries Booklet
Investec	Investec Bank plc
IPO	Initial Public Offering
IRB or **Advanced**	the Internal Ratings Based approach to calculating a bank's risk weightings for credit risk. Under the IRB approach, capital requirements are based on a bank's own estimates of certain parameters together with other parameters set out in the Banking Consolidation Directive
IRS	the U.S. Internal Revenue Service
ISA	Individual Savings Account, a type of savings product that is exempt from United Kingdom tax
ISIN	International Security Identification Number
J.P. Morgan Cazenove	J.P. Morgan Securities plc (which conducts its UK investment banking services as J.P. Morgan Cazenove)
Joint Bookrunners	Citigroup, J.P. Morgan Cazenove and UBS
Joint Global Co-ordinators	Citigroup and J.P. Morgan Cazenove
Joint Lead Managers	Investec, Numis, RBC and UBS
Joint Sponsors	Citigroup and J.P. Morgan Cazenove
LBGI	Lloyds Bank General Insurance Limited
LBIS	Lloyds Bank Insurance Services Limited
LCR	Liquidity Coverage Ratio, calculated by TSB on the basis set out in the notes to Part XVIII: "*Unaudited Pro forma Financial Information*"
LDR	Loan-to-Deposit Ratio, the ratio of total bank loans to deposits
Leverage Ratio	a ratio of Tier 1 Capital to total exposures, calculated by TSB on the basis set out in the notes to Part XVIII: "*Unaudited Pro forma Financial Information*"
LIBOR	London Interbank Offered Rates
Liquidity Coverage Ratio	a ratio of highly liquid assets to net cash over a 30 day period. TSB Calculates its Liquidity Coverage Ratio in the manner set out in the notes to part XVIII: "*Unaudited Pro forma Financial Information*"
Listing Rules	the listing rules produced by the FCA relating to admission to the Official List made under section 73A(2) of FSMA
Lloyds TSB	Lloyds TSB Bank plc
Lloyds Bank	Lloyds Bank plc (formerly Lloyds TSB Bank plc)
Lloyds Banking Group	the Parent and its consolidated subsidiaries and subsidiary undertakings from time to time but excluding, from Admission, the members of the TSB Group
London Stock Exchange	the London Stock Exchange plc or its successor(s)
Long Term Services Agreement or **LTSA**	the agreement in relation to the provision of long term services by Lloyds Bank to the TSB Group entered into between Lloyds Bank and TSB Bank dated 9 June 2014

LTSBS	Lloyds TSB Scotland plc
LTV	loan-to-value
LTV Ratio	Loan-to-Value Ratio. Where this refers to individual loans, this measures the size of a mortgage at origination divided by the value of the property at completion on which the loan is secured. Where this refers to new business mortgage lending in aggregate, this measures the sum of the total value of new mortgage loans at origination divided by the sum of the total property values at completion on which the mortgages are secured
Management Basis	TSB Bank Group's audited Income Statement data for the three years ended 31 December 2013, 2012 and 2011 and the unaudited Income Statement data for the three months ended 31 March 2014, are presented in this Prospectus on a management basis, which the TSB Board believes better reflects the underlying performance of the business by highlighting certain transactions and underlying trends. Certain differences exist between the Management Basis and the income statement in the Historical Financial Information included in Part XVI of this Prospectus. These differences resulted in changes to certain line items for the year ended 31 December 2013 and the three months ended 31 March 2014, as set out in the reconciliation presented in Part XII: "*Selected Financial and Other Information*". There were no changes to the line items in the years ended 31 December 2012 or 2011 as a result of the differences between the Management Basis and the HFI
Maximum Offer Size	175,000,000 Ordinary Shares, representing 35 per cent. of the issued Ordinary Share capital of the Company at Admission
MCOB	the FCA's Mortgages and Home Finance: Conduct of Business sourcebook
Member States	member states of the EU
MFI	Monetary Financial Institutions
MMR	the FCA's Mortgage Market Review
Mortgage Enhancement Agreements	the Mortgage Sale Agreement and the Mortgage Servicing Agreement
Mortgage Enhancement or **Mortgage Enhancement Structure**	the transfer by Bank of Scotland to TSB Bank of its equitable interest in the Additional Mortgages, as more particularly described in Part IX: "*Introduction to TSB – Evolution of the TSB business: 2013 OFT recommendations*"
Mortgage Enhancement Variable Rate	the variable interest rate applicable to a portion of the Additional Mortgages
Mortgage Intermediary Platform Build Agreement	the agreement dated 9 June 2014 between the Company, TSB Bank and Lloyds Bank in relation to the build of a mortgage intermediary platform as more fully described in Part XXII: "*Additional Information – Material Contracts – Mortgage Intermediary Platform Build Agreement*"
Mortgage Sale Agreement	the agreement dated 4 March 2014 between TSB Bank and Bank of Scotland in relation to the transfer of the Mortgage Enhancement as more fully described in Part XXII: "*Additional Information – Material Contracts – Mortgage Enhancement Agreements*"
Mortgage Servicing Agreement	the agreement dated 4 March 2014 between TSB Bank and Bank of Scotland in relation to the ongoing servicing of the Mortgage Enhancement as more fully described in Part XXII: "*Additional Information – Material Contracts – Mortgage Enhancement Agreements*"
NII	Net Interest Income

NIM	Net Interest Margin
Nomination Committee	the nomination committee of the Board
Non-Executive Directors	the non-executive Directors of the Company including, from the time and date on which PRA approvals are received, the Prospective Non-executive Director
NSFR	Net Stable Funding Ratio, a ratio used to calculate the proportion of long-term assets which are funded by long term, stable deposits
Numis	Numis Securities Limited
Offer	the Institutional Offer and the Intermediaries Offer
Offer Period	the period during which the Offer is open
Offer Price	the price at which each Offer Share is to be sold in the Offer
Offer Price Range	220 pence to 290 pence
Offer Shares	Ordinary Shares in the capital of the Company to be sold in the Offer by the Selling Shareholder (excluding, for the avoidance of doubt, the Over-allotment Shares)
Offer Size	the number of Ordinary Shares to be sold in the Offer (excluding, for the avoidance of doubt, the Over-allotment Shares and the Bonus Shares)
Official List	the Official List of the FCA
OFT	the Office of Fair Trading
Ordinary Shares	ordinary shares of one pence each in the capital of the Company
Over-allotment Option	the option expected to be granted to J.P. Morgan Cazenove by the Selling Shareholder to purchase, or procure purchasers for, a number of Ordinary Shares representing up to 10 per cent. of the Offer Shares as more particularly described in Part XXI: "*The Offer*"
Over-allotment Shares	the Ordinary Shares that are the subject of the Over-allotment Option
Parent	Lloyds Banking Group plc
Payments Council	the UK Payments Council, which has responsibility for ensuring that payments services work in the UK
PCA	Personal Current Account
PDMR	a person discharging managerial responsibilities (as defined in the FSMA)
Pensions Regulator	the regulator of work-based pension schemes in the UK
Perimeter	the perimeter of the divesting business
PPI	Payment Protection Insurance
PRA	the UK Prudential Regulation Authority
PRA Handbook	the handbook of rules and guidance issued by the PRA from time to time
Pre-IPO Reorganisation	means the corporate reorganisation of the TSB Bank Group that occurred between 21 January 2014 and 25 April 2014, further details of which are set out in paragraph 4 of Part XXII: "*Additional Information*" of this document
Pricing Statement	the statement containing the Offer Price, Offer Size and certain other information expected to be published on 20 June 2014
Profit Objective	has the meaning given in Part I: "*Summary information – D1 Key information on the key risks that are specific to the Company or its industry*"

Prospective Non-executive Director	Mark Fisher, who has been appointed to the TSB Board conditional upon, and from the date of receipt of, PRA approvals
Prospectus Directive	EU Prospectus Directive (2003/71/EC) (and amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in the Relevant Member State and includes any relevant implementing measure in the Relevant Member State, and the expression "**2010 PD Amending Directive**" means Directive 2010/73/EU)
Prospectus Directive Regulation	EU Prospectus Directive Regulation (No. 2004/809/EC)
Prospectus Rules	the rules for the purposes of Part VI of FSMA in relation to offers of securities to the public and the admission of securities to trading on a regulated market
qualified institutional buyers or **QIBs**	has the meaning given by Rule 144A under the Securities Act
Qualified Investors	persons who are "qualified investors" within the meaning of Article 2(1)(e) of the Prospectus Directive
RBC	RBC Europe Limited
Recovery and Resolution Directive or **RRD**	the proposed directive providing for the establishment of an EU-wide framework for the recovery and resolution of credit institutions and investment firms
Register	the Share register of the Company as amended from time to time
Registrar	Equiniti Limited
Regulation S	Regulation S under the Securities Act
Regulatory Information Service	one of the regulatory information services authorised by the UK Listing Authority to receive, process and disseminate regulatory information in respect of listed companies
Relationship Agreement	the relationship agreement between the Company and the Parent entered into on 9 June 2014
Relevant Member State	an EEA State which has implemented the Prospectus Directive
Relevant Regulator	has the meaning given in Part XIX: *"Supervision and Regulation"*
Remuneration Code	the FCAs remuneration code as set out in Senior Management Arrangements, Systems and Controls of the FCA Handbook
Remuneration Committee	the remuneration committee of the Board
Reporting Accountants	PricewaterhouseCoopers LLP
Risk Committee	the risk committee of the Board
RMBS	retail mortgage backed security:
RMBS Funding Facility	the securitisation structure by which TSB part-funds the Additional Mortgages, as more particularly described in Part IX: "*Introduction to TSB – Evolution of the TSB business: 2013 OFT recommendations*"
RMBS Funding Facility Agreements	the RMBS Mortgage Sale Agreement and the VFNID
RMBS Mortgage Sale Agreement	the agreement between TSB Bank, TSB RMBS SPV and others in relation to the transfer of TSB Bank residential mortgages to TSB RMBS SPV in connection with the RMBS Funding Facility dated 20 May 2014 as described in Part XXII: "*Additional Information – Material Contracts – RMBS Funding Facility Agreements*"
RPI	Retail Price Index
Rule 144A	Rule 144A under the Securities Act
RWA	Risk-Weighted Assets
SDRT	United Kingdom stamp duty reserve tax
Securities Act	United States Securities Act of 1933, as amended
SEDOL	Stock Exchange Daily Official List
Selling Shareholder	Lloyds Bank, being the shareholder who sells existing shares in the Offer

Senior Independent Director	Sandra Dawson, the senior independent director of the Company
Senior Management	members of the Company's management team, details of whom are set out in Part XI: "*Directors, Senior Management and Corporate Governance*" and "**Senior Manager**" means any one of them
Separation Agreement	the separation agreement entered into between the Company, TSB Bank and Lloyds Bank dated 9 June 2014
Shareholders or **shareholders**	the holders of Ordinary Shares in the capital of the Company
Sharesave Plan or **TSB Sharesave Plan**	the TSB Sharesave Plan as described in Part XXII: "*Additional Information – Employee share plans*"
SIFI	Systemically Important Financial Institution
SIP or **TSB Share Incentive Plan**	the TSB share incentive plan as described in Part XXII: "*Additional Information – Employee share plans*"
SIPP	self-invested personal pension
Skilled Person	has the meaning given in Part IX: "*Introduction to TSB – Evolution of the TSB business: 2013 OFT Recommendations*"
SME	Small and Medium Sized Enterprises
SMS	Short Message Service
SRR	Special Resolution Regime
Stabilising Manager	J.P. Morgan Cazenove
SVR	Standard Variable Rate
SYSC	the FCA's Senior Management Systems and Controls Handbook
Takeover Panel or **Panel**	the Panel on Takeovers and Mergers
Tax Separation Deed	the tax separation deed between the Company, TSB Bank and Lloyds Bank dated 9 June 2014, as more fully described in Part XXII: "*Additional Information – Material Contracts – Tax Separation Deed*"
Tier 1 Capital	tier 1 capital, comprising CET1 and Additional Tier 1 Capital
Tier 2 Capital	tier 2 capital, calculated by TSB on the basis set out in the notes to Part XVIII: "*Unaudited Pro forma Financial Information*"
Tier 2 Securities	the Company's £385 million (in issue amount) Callable Fixed/ Floating Subordinated Notes due 2026, settled by Lloyds Bank on 1 May 2014 for net proceeds of £383 million
Tier 2 Subscription Agreement	The subscription agreement between Lloyds Bank and the Company entered into in relation to the Tier 2 Securities
Total Capital	total capital, comprising CET1, Additional Tier 1 Capital and Tier 2 Capital
Total Capital Ratio	a ratio of Total Capital to RWAs, calculated by TSB on the basis set out in the notes to Part XVIII: "*Unaudited Pro forma Financial Information*"
Track Record Period	the years ended 31 December 2013, 2012 and 2011
Transitional Services Agreement or **TSA**	the agreement in relation to the provision of transitional services by Lloyds Bank to TSB entered into between Lloyds Bank and TSB Bank dated 9 June 2014
TSB or **TSB Group**	the Company and its subsidiaries from time to time
TSB Bank	TSB Bank plc
TSB Bank Board	the board of directors of TSB Bank plc

TSB Bank Group	TSB Bank plc and its consolidated subsidiaries and subsidiary undertakings from time to time
TSB Board	the board of TSB Banking Group plc
TSB Franchise	TSB's business excluding the Mortgage Enhancement, i.e. the retail banking business carried out in the UK under the TSB brand.
TSB Pension Scheme	TSB's defined contribution pension scheme as described in Part XXII: "*Additional Information – Pensions*"
UBS	UBS Limited
UK Corporate Governance Code	the UK Corporate Governance Code published by the Financial Reporting Council and dated September 2012, as amended from time to time
UK Listing Authority	the FCA in its capacity as the competent authority for the purposes of Part VI of FSMA
Underwriters	Citigroup, J.P. Morgan Cazenove, UBS, Investec, Numis and RBC
Underwriting Agreement	the underwriting agreement expected to be entered into between the Company, the Directors, the Prospective Non-executive Director, the Parent, the Selling Shareholder and the Underwriters described in Part XXII: "*Additional Information – Underwriting arrangements*"
Underwriting Syndicate	collectively, the Underwriters
United Kingdom or **UK**	the United Kingdom of Great Britain and Northern Ireland
United States or **U.S.**	the United States of America, its territories and possessions, any State of the United States of America, and the District of Columbia
VAT	within the EU, such taxation as may be levied in accordance with (but subject to derogations from) the Directive 2006/112/EEC and, outside the EU, any taxation levied by reference to added value or sales
VFN	variable funding note
VFNID	the Variable Funding Note Issuance Deed between TSB Bank, TSB RMBS SPV, Lloyds Bank and others in relation to the issue of VFN in connection with the RMBS Funding Facility dated 20 May 2014 as described in Part XXII: "*Additional Information – Material Contracts – RMBS Funding Facility Agreements*"

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