2017 ANNUAL GENERAL MEETING – FINANCE DIRECTOR'S PRESENTATION

Good afternoon Ladies and Gentlemen, and thank you Mike.

As Finance Director my focus is very clearly on safeguarding the strength and security of the Society, and on ensuring we can continue to provide value to our members through our products and services. This means ensuring we have a strong balance sheet and a core underlying profitability that allows us to price our products to deliver this value whatever market conditions we face.

The Board monitors how well we achieve this through a set of key measures, the main financial ones of which are shown on this slide – and don't worry about reading these, I'll be covering them all separately in a moment. These are looked at together with non-financial measures on a Group scorecard, which includes our trading performance together with the four strategic priorities. This helps us make sure that we balance how much we focus on different areas – for example, making sure we don't drive our financial performance at the expense of good service.

I'm glad to say that in 2016 we generally outperformed the Plan set at the start of the year, despite a number of trading and economic challenges. You can see the overall performance against our 2016 target where we set one and our prior year performance. In all areas with a target we either bettered them, or got very close.

Looking in more detail, our statutory profit which is the measure defined by regulation and easily compared across different businesses was £152m, which was above our target and, as planned, down on 2015. This decrease was driven by a reduction in our interest income offset by one off profits from the sale of non-core investments and properties. Our core operating profit which excludes these and other non-core items, and gives a clearer view of our underlying performance was on target and as anticipated down £57m on 2015.

The key driver in both of these profit numbers is our net interest income – that is the difference between the interest we earn on our mortgages and other assets and the interest we pay on savings balances and other funding. This margin fell in 2016 partly because mortgages written several years ago at relatively high rates rolled off onto lower current rates, meaning we earn less on these loans. The main reason, though, was that, as Mike has discussed, we increased the differential between our average savings rates and those of the market. At the year end the 0.38% differential was, I estimate, worth over £100m annually to our members.

I realise that people would like us to pay even higher rates on our savings products. But if we did so then we run the risk of attracting too much cash into the business, and cash that we wouldn't be able to sensibly and safely lend on as mortgages. Excess savings balances would have to be kept at the Bank of England earning minimal amounts and making a significant loss, which in turn would mean we would have to lower the rates we pay our savers and/or increase what we charge our

borrowers to make up the shortfall. As one of our key responsibilities is the financial security of the Society, we cannot sensibly do this. What we also don't want to do is constantly pay high initial rates on savings products so that, to balance the books, we later have to cut rates perhaps as low as 0.01% as some of our competitors do, in the hope that people will unwittingly leave the money there for some time. We aim to provide good long term value to all our members and although not always the best rates on the market members know that they will receive a sensible rate for as long as their money is with us. Clearly, this means that if a saver chooses to constantly move their money between best buy products then they could make more. Based on feedback, the majority of our members understand and appreciate our approach.

Turning to our key measures of balance sheet strength - our core capital and liquidity increased during the year, whilst our arrears measures improved further and remain below the industry average. We consider being strongly capitalised to be an essential factor if people are to trust us with their savings since this is the element that protects savers against unexpected events impacting on our business. Likewise, holding enough cash to meet our obligations in both "day to day" and stressed conditions means people can rely on us to meet our financial commitments as they fall due. Both of these areas are comfortably but sensibly above our regulatory and own calculations of what is required.

As Mike has outlined, a key focus for us is on our efficiency and our costs. We are aware of the need to improve our cost base and are focussed on addressing it. I am pleased that in 2016 we halted the year-on-year increases, but we must remain mindful to spend the money sensibly. This means focussing on those things that we either do because we are a regulated business, or are those that add value to our members in a way that they want to interact with us, for example by developing new products or digital channels. The recent changes we announced are largely driven by this. They will deliver improvements to our efficiency and focus us on future customer needs. We will continue to look for further areas where we can improve.

Turning to our business volumes we increased our level of lending in 2016 to £7.2bn and saw an inflow of £0.9bn in savings accounts after a broadly flat performance in 2015. These provided what I would describe as steady growth in 2016, underpinned in many areas by improvements in our products and services arising from our investments in recent years. As a result of this our savings balances ended the year at just over £29bn, and our mortgages balances just over £34bn.

Overall we believe our 2016 performance was steady and we are pleased, in particular, that we achieved this whilst increasing the direct, savings related benefit we delivered to our members.

Looking forward, we will remain financially focussed on a number of areas:

1. Ensuring that our capital position remains robust at a time when the regulators are making all financial institutions hold more capital;

2. Ensuring we have robust but efficient lending practices as well as sufficient provisions against our loan books so we can protect the Group as the UK faces economic uncertainties that may lead to more borrowers facing difficulties in the coming years;
3. Driving our efficiency to make sure we are only spending what we need to spend;
4. Given interest rates look likely to remain low for some time to come, focussing our support for members on our savings products whilst making sure that our mortgages remain competitive and attractive;
5. Lastly, making sure that the business is financially secure – making adequate profits, growing sensibly and remaining well capitalised.

Thank you for listening, and I'll hand over to Guy.