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West Bromwich Building Society: Half-Year Results Presentation September 2018

Strategic Overview and Financial Reporting

Ashraf Piranie – Group Finance & Operations Director

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Strategic Overview

Purpose

To Support the financial wellbeing of our members by providing a safe and good return on the savings they entrust with us and promote home ownership through responsible lending

Primary Activities

- Savings and Investments
- Mortgages and Protection

Strategic Priorities

Security	Members	Efficiency
• We generate and maintain sufficient capital and liquidity to enable us to deliver our business plans. • We continue to exit our legacy positions whilst balancing speed with the economic cost. • We have a clear, transparent approach to risk management.	• We make decisions that are in the interests of our current and future membership as a whole. • We consider the impact of actions on customer outcomes, customer experience and other stakeholders.	• Delivery of member value underpins all components of our operating model. • Existing resources are leveraged to deliver acceptable returns. • We seek to exploit technology at every stage of the operating model to reduce the cost of service delivery.

Focus on the delivery of our core purpose:

- Mortgage, savings and investment products all aim to deliver security, simplicity and value;
- Significant progress with delivery of core strategy and continued exit from non-core activities;
- Business model:
  - **Retail** – Owner occupied residential lending supported by retail savings products delivered through branch, intermediary, internet and direct.
  - **Commercial (CRE)** – Non-core commercial real estate investment currently being managed down.
  - **Property** – Managed portfolio of residential properties held to generate rental income.

Background

The simple premise of delivering our core purpose:

- Following the financial crisis, West Bromwich Building Society (the "Society or "Group") pursued a strategy of 'back to basics' – seeking to exit of non-core CRE assets and focus on prime owner-occupied residential lending.

- As at 31 March 2008, the lending comprised only 36% for the purpose of home ownership, with the remainder being made up of 41% buy to let and 23% CRE loans. 10 years on and our 31 March 2018 annual results illustrate how a focus on the 'back to basics' principles have changed fundamentally the composition of the loan book, which is now over 56% for home ownership, 34% buy to let and just 10% CRE lending.

Buy to let decision & continued progress:

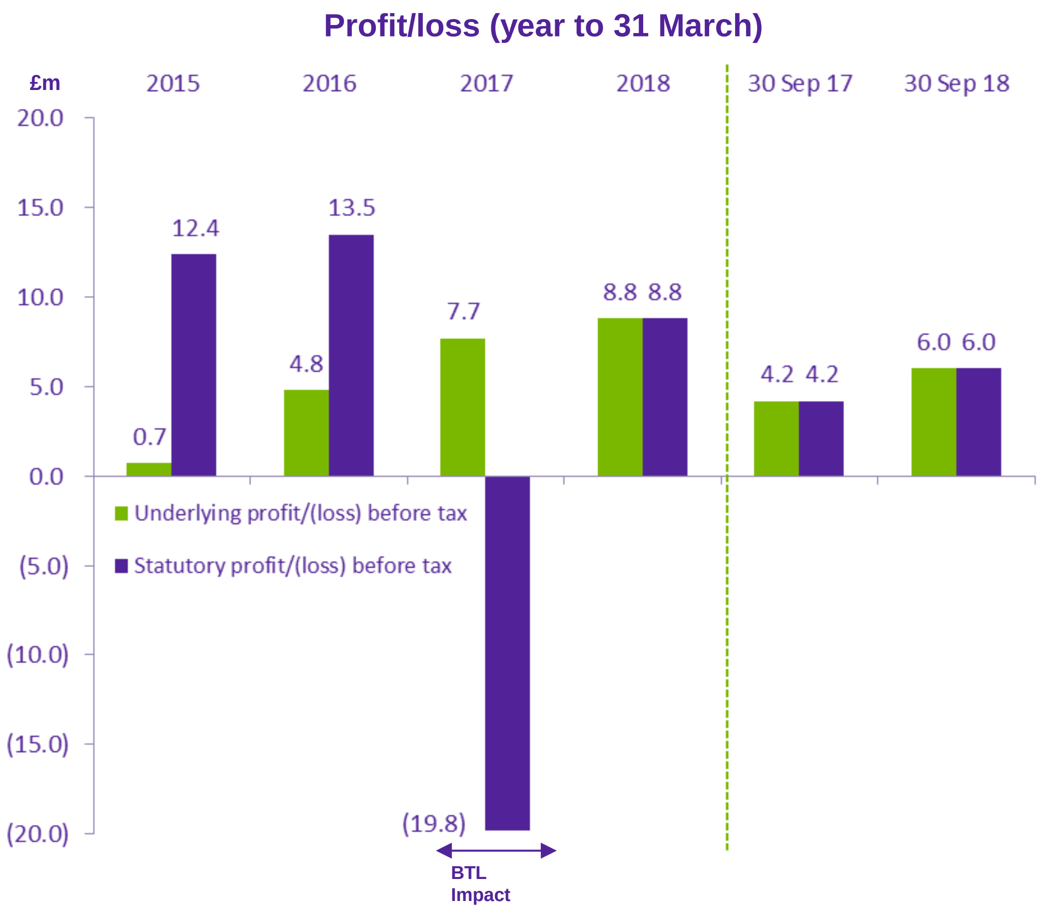
- In 2013 the Board took the decision to increase the interest rate paid by landlord investors in accordance with the product terms and conditions, the vast majority of whom were not members of the Society. This decision was taken to address the unfair position of members given the low returns being suffered by the Society's saving members, and the relatively high SVR being paid by borrowers. The action was taken on the basis of clear and unambiguous legal advice. Both the full and half year 2016/17 loss before tax reflect the Court of Appeal's decision to overturn a previous High Court ruling with a one-off cost of £27.5m incurred by the Society. The Society duly met its obligations and ceased to charge the additional interest and reimburse affected borrowers for what had previously been levied.

- The 2017/18 financial year results showed a return to a statutory profit of £8.8m (2016/17: statutory loss of £19.8m) with the dramatic swing in profitability a result of the adjustment required in financial year 2016/17 for the £27.5m of one-off costs relating to the reimbursement of the interest charged on the buy to let mortgages mentioned above. Pleasingly our 2018/19 half-year results have continued to build on the impressive progress already made with statutory profit before tax of £6.0m - a year on year increase of 43% (30 September 2017: £4.2m).

Modernised capital structure:

- In January 2017 the Society received a challenge from a new minority shareholder of the Society's issued capital as to the eligibility of the Profit Participating Deferred Shares (PPDS) as Common Equity Tier 1 (CET 1) capital. Consequently, the Society announced a Liability Management Exercise (LME), which introduced two new capital instruments, Core Capital Deferred Shares (CCDS) and Subordinated Tier 2 Notes. This restructuring was completed in April 2018 , just after the financial year end, and resulted in an increase in member reserves of circa £52m with no material change in the Society's CET 1 or total capital ratios. The execution of this transaction, the results of which are reflected in the half-year figures, represents a significant milestone for the Society in modernising its capital structure.

Half-year performance highlights



A strong half-year performance to 30 September 2018:

- Profit before tax of £6.0m for the six months to 30 September 2018, a year on year increase of 43% (30 September 2017: £4.2m).
- £466m advanced for new mortgage lending (30 September 2017: £478m). The Society maintained traction in a highly competitive retail market.
- An uplift in the net interest margin to 1.02% (30 September 2017: 0.98%).
- Management expenses reduced to £24.9m (30 September 2017: £25.8m). Group management expenses ratio reduced from 0.89% to 0.88%, compared with the same period in 2017.
- CET 1 capital ratio increased to 15.2% (30 September 2017: 14.8%).
- An increased level of provision coverage from 8.6% at 31 March 2018 on an IAS 39 basis to 16.7% at 30 September 2018 on an IFRS 9 basis (see p15), on adoption of IFRS9.

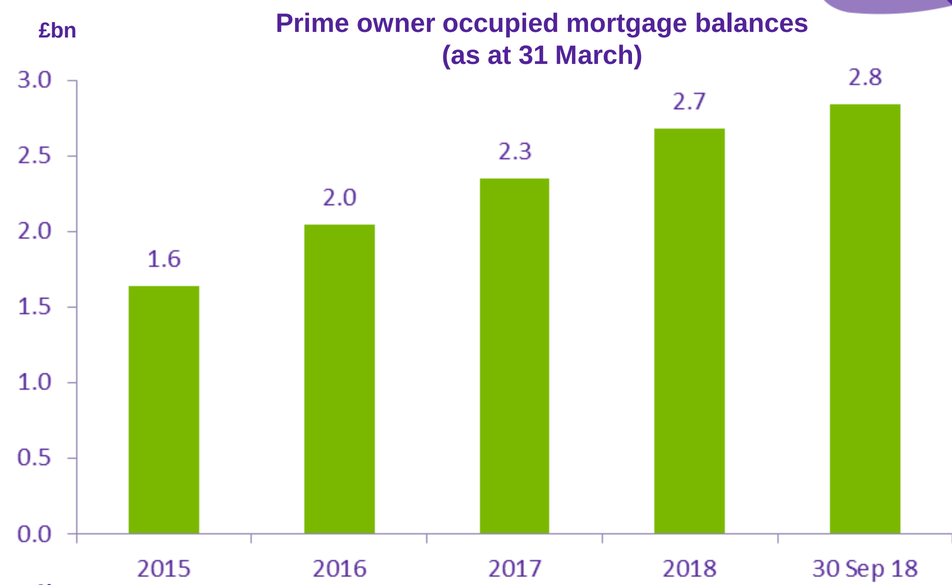
	HY30 Sep 18	HY30 Sep 17	FY31 Mar 18
Net Interest Income (£m)	29.0	28.4	55.5
Profit/loss before tax (£m)	6.0	4.2	8.8
Net Interest Margin	1.02%	0.98%	0.96%
Management Expenses	0.88%	0.89%	0.87%

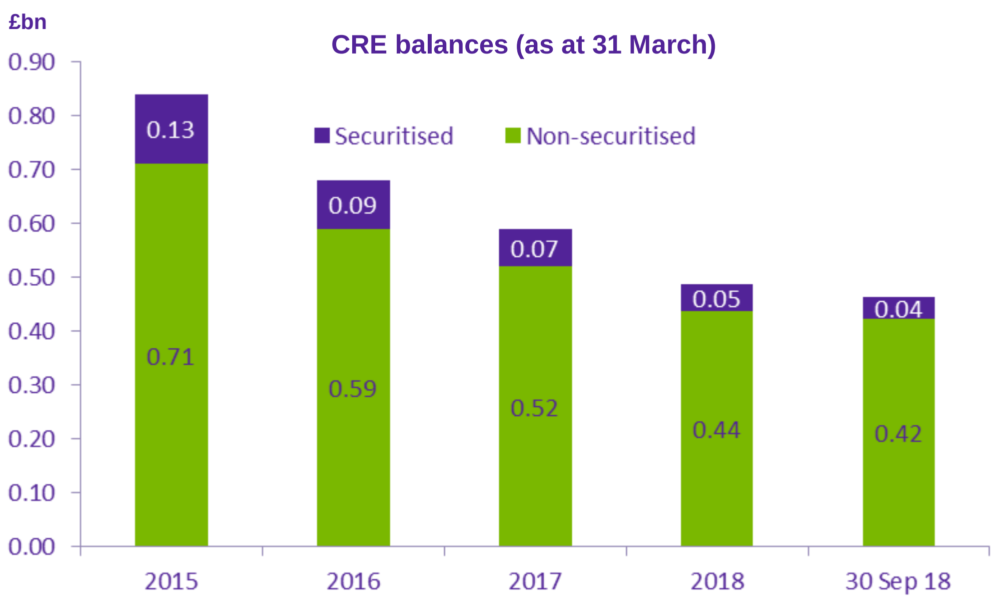
Source : Annual Report and Accounts year ended 31 March 2018 and Interim Statement as at 30 September 2018

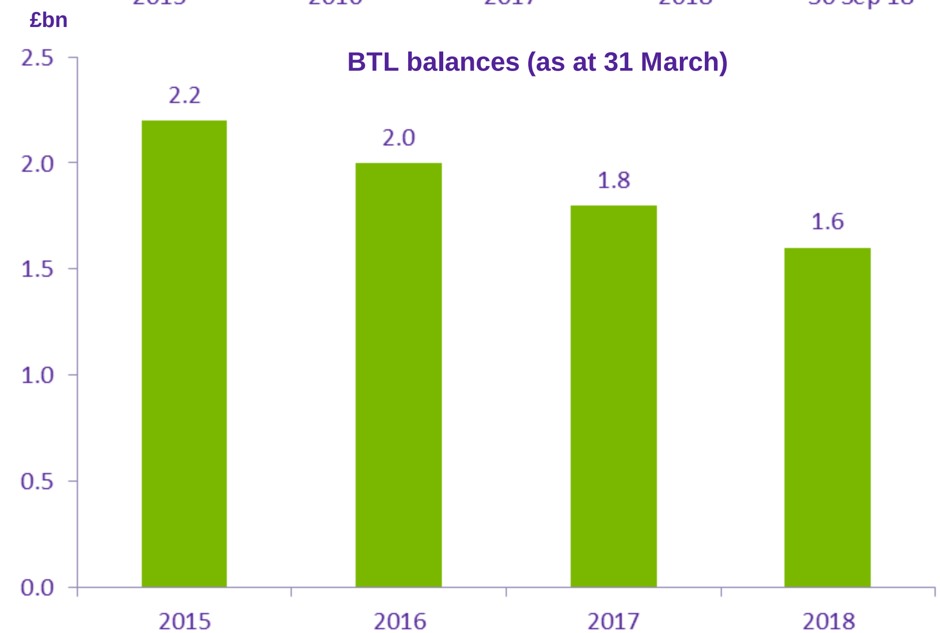
Strategic highlights

De-risking the balance sheet and promoting home ownership:

- Since re-entering the mortgage market in 2012/13 prime owner occupied residential loan balances have more than doubled, from £1.38bn to £2.84bn with half-year owner occupied net lending of £173m (30 September 2017: £243m).
- Over the same period non-core CRE balances reduced by nearly 60% from £1.10bn to £0.46bn. At 30 September 2018 total remaining gross balance sheet exposures stood at £464m (31 March 2018: £488m), £41m of which is securitised (31 March 2018: £53m) with no residual exposure to the Group.
- Legacy buy to let mortgage balances continue to reduce. The Society considers limited company BTL lending a market opportunity over the immediate planning horizon.







Source : Annual Report and Accounts year ended 31 March 2018 and Interim Statement as at 30 September 2018

P&L summary

Profitable growth of the residential mortgage book:

- Net interest income at £29.0m was broadly in line with the comparative period (30 September 2017: £28.4m), despite a fiercely competitive market.
- Fees, commissions and other operating income increased 16% to £3.6m (30 September 2017: £3.1m).
- A £1.8m revaluation gain on the Group's residential investment property portfolio (30 September 2017: £3.0m) resulting from positive house price movements.
- A c.£500k reduction in core administrative expenses delivered with sustainable cost reductions a key focus. A half-year sustainable cost saving of c.3.5%.
- The above, combined with a 41% lower charge for impairment, have delivered a profit before tax of £6.0m for the six months to 30 September 2018, a year on year increase of 43% (30 September 2017: £4.2m).

Group income statement 30 September 2018	HY30 Sep 18 *unaudited £m	HY30 Sep 17 *unaudited £m	FY31 Mar 18 *audited £m
Interest receivable and similar income	**54.3**	48.7	97.3
Interest expense and similar charges	**(25.3)**	(20.3)	(41.8)
Net interest receivable	**29.0**	28.4	55.5
Fees and commissions receivable	**1.6**	1.2	2.7
Other operating income	**2.0**	1.9	3.8
Fair value gains on financial instruments	**0.2**	2.3	2.5
Net realised profits	**-**	-	-
Total income	**32.8**	33.8	64.5
Administrative expenses	**(21.6)**	(22.1)	(43.5)
Depreciation and amortisation	**(3.3)**	(3.7)	(7.2)
Operating profit before revaluation gains, impairment and provisions	**7.9**	8.0	13.8
Gains on investment properties	**1.8**	3.0	3.8
Impairment on loans and advances	**(3.7)**	(6.3)	(7.9)
Provisions for liabilities and charges	**-**	(0.5)	(0.9)
Profit before tax	**6.0**	4.2	8.8
Taxation	**(1.1)**	(0.8)	(0.9)
Profit for the period	**4.9**	3.4	7.9

Note: The Group has adopted IFRS 9 'Financial Instruments' with effect from 1 April 2018 and comparatives have not been restated. The condensed consolidated Income Statement is therefore presented on an IFRS 9 basis for the six months ended 30 September 2018 and an IAS 39 basis for the six months ended 30 September 2017 and year ended 31 March 2018.

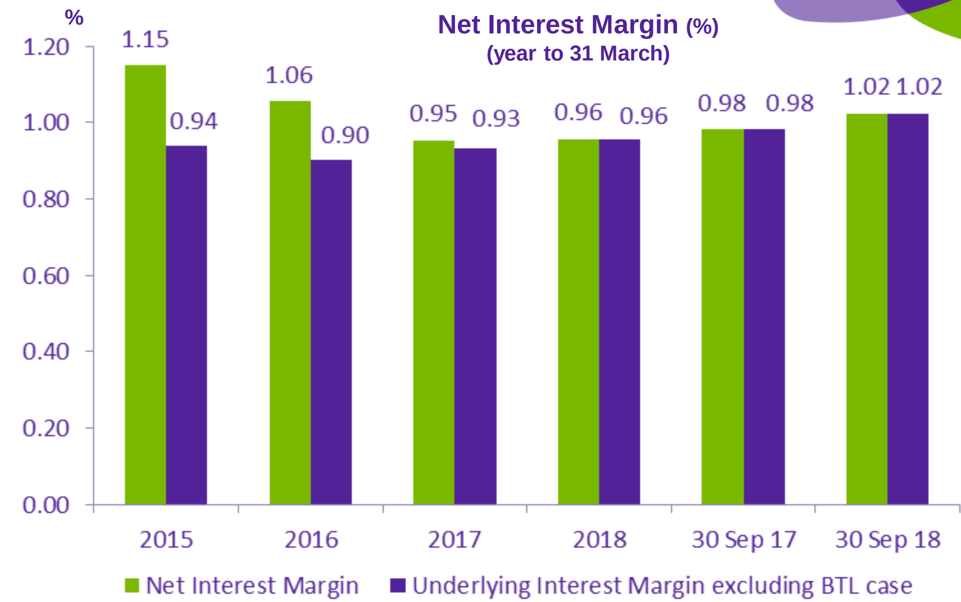
Source : Annual Report and Accounts year ended 31 March 2018 and Interim Statement as at 30 September 2018

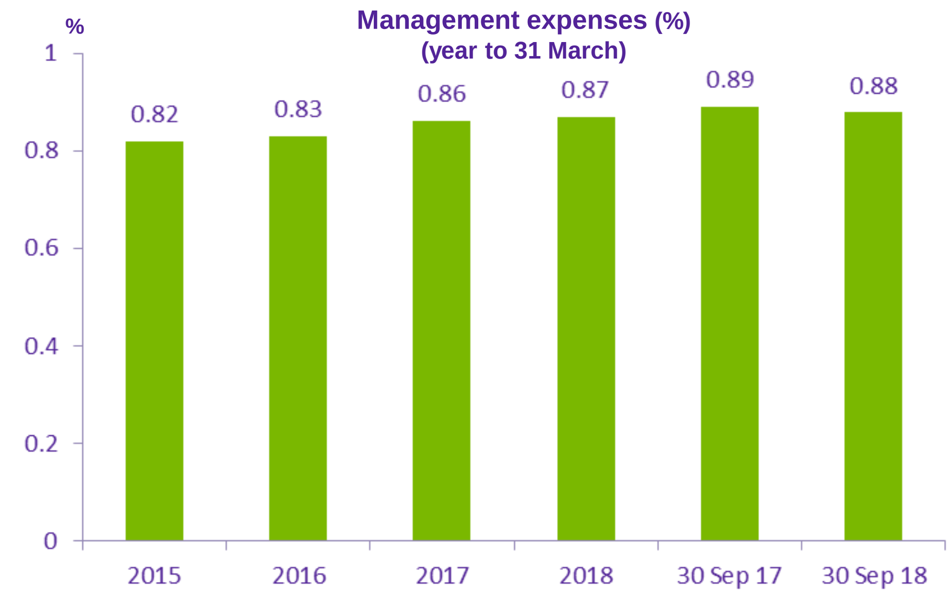
Income summary

Maintained traction in a highly competitive retail space with legacy positions managed down effectively:

Segmental performance	HY30 Sep 18		HY30 Sep 17		FY31 Mar 18	
	P&L (£m)	Assets (£m)	P&L (£m)	Assets (£m)	P&L (£m)	Assets (£m)
Retail	5.9	5,525.2	5.4	5,677.3	8.8	5,709.0
CRE	(2.2)	399.6	(4.6)	491.9	(4.8)	449.5
Property	2.3	136.5	3.4	134.2	4.8	134.8
Consolidation adjust.	-	(502.3)	-	(559.0)	-	(511.8)
Total (Group)	6.0	5,559.0	4.2	5,744.4	8.8	5,781.5

- Retail – Improved performance despite fiercely competitive mortgage market.
- Commercial (CRE) – Loss position reduced with the book deemed strategically non-core. Group exposure reduced in the first half of the year by 5% and provisions for the first half of 2018 are under IFRS9 (see p15).
- Property – core P&L drivers more than offset a £1.2m reduction in gains on investment properties to £1.8m, reflecting a cooling of house price valuation rises.
- Net interest margin increased to 1.02% (30 September 2017: 0.98%). As a mutual, our strategy is not to maximise net interest margin but to maintain it at a level which balances the immediate and long-term benefits to both our borrowing and saving members.



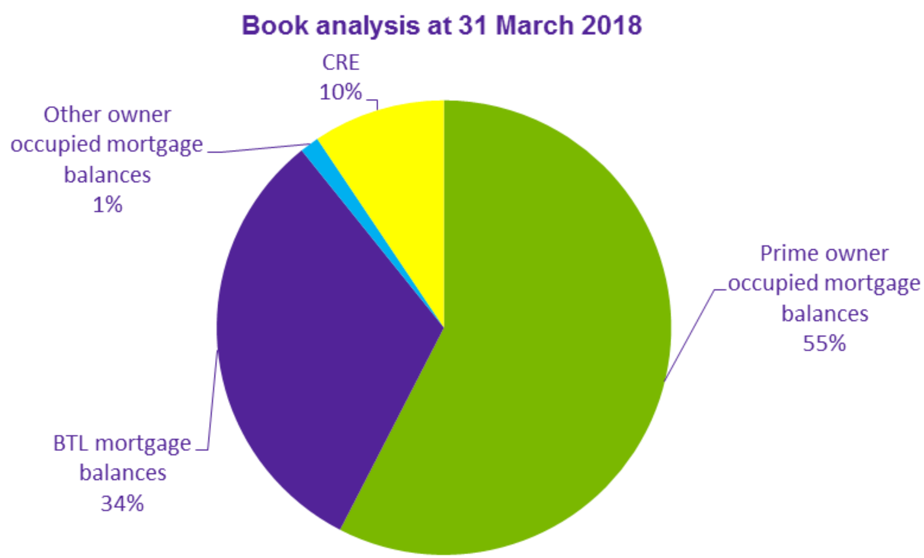


Source : Annual Report and Accounts year ended 31 March 2018 and Interim Statement as at 30 September 2018

Balance Sheet summary

De-risking the balance sheet to support our purpose:

- Further 5% reduction in higher risk weighted non-core CRE.
- Society continues to cement its position as a well-recognised residential mortgage lender with gross lending totalling £466m (30 September 2017: £478m) and owner occupied net lending of £173m (30 September 2017: £243m).
- 87% of our residential lending balances provided by members' savings (31 March 2018: 93%). Of these savings balances 69% are held in branch based accounts, a higher proportion than at the year end (31 March 2018: 66%).
- Wholesale funding supports the Society's diversified funding strategy.



Condensed consolidated half-yearly Statement of Financial Position	HY30 Sep 18 (£m) *unaudited	HY30 Sep 17 (£m) *unaudited	FY31 Mar 18 (£m) *audited
Assets			
Cash and balances with the Bank of England	**130.1**	212.4	324.7
Loans and advances to credit institutions	**106.0**	143.8	120.6
Investment securities	**259.4**	316.0	311.9
Derivative financial instruments	**17.9**	11.2	19.5
Loans and advances to customers	**4,843.6**	4,866.3	4,805.4
Deferred tax assets	**19.7**	15.0	15.3
Trade and other receivables	**3.6**	3.3	6.4
Intangible assets	**15.1**	13.7	15.3
Investment properties	**134.0**	131.6	132.2
Property, plant and equipment	**29.6**	31.1	30.2
Retirement benefit assets	**-**	-	-
Total assets	**5,559.0**	5,744.4	5,781.5
Liabilities			
Shares	**3,869.2**	4,160.0	4,051.4
Amounts due to credit institutions	**760.1**	683.9	571.3
Amounts due to other customers	**96.7**	189.2	133.1
Derivative financial instruments	**33.0**	53.0	38.7
Debt securities in issue	**369.7**	169.3	493.3
Current tax liabilities	**4.0**	-	-
Deferred tax liabilities	**4.2**	4.9	4.5
Trade and other payables	**9.7**	7.7	12.0
Provisions for liabilities and charges	**1.5**	2.5	2.1
Retirement benefit obligations	**4.0**	5.1	5.1
Subordinated liabilities	**22.8**	-	-
Total liabilities	**5,174.9**	5,275.6	5,311.5
Equity			
Profit participating deferred shares	**-**	173.8	175.0
Core capital deferred shares	**127.0**	-	-
Subscribed capital	**8.9**	75.0	75.0
General reserves	**244.7**	213.7	215.8
Revaluation reserve	**3.4**	3.4	3.4
Available for sale reserve	**-**	1.5	0.8
Fair value reserve	**0.1**	-	-
Cash flow hedging reserve	**-**	1.4	-
Total members' interests and equity	**384.1**	468.8	470.0
Total members' interests, equity and liabilities	**5,559.0**	5,744.4	5,781.5

Note: The Group has adopted IFRS 9 'Financial Instruments' with effect from 1 April 2018 and comparatives have not been restated. The condensed consolidated Income Statement is therefore presented on an IFRS 9 basis for the six months ended 30 September 2018 and an IAS 39 basis for the six months ended 30 September 2017 and year ended 31 March 2018.

Source : Annual Report and Accounts year ended 31 March 2018 and Interim Statement as at 30 September 2018

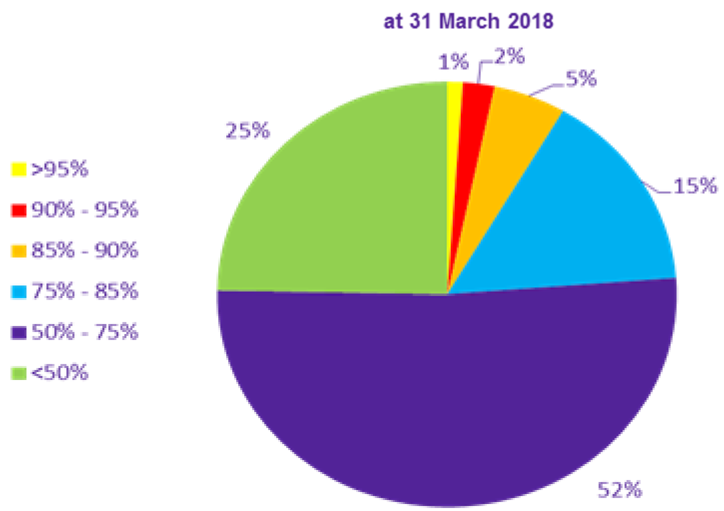
Residential Mortgage Portfolio: as at 31 March 2018

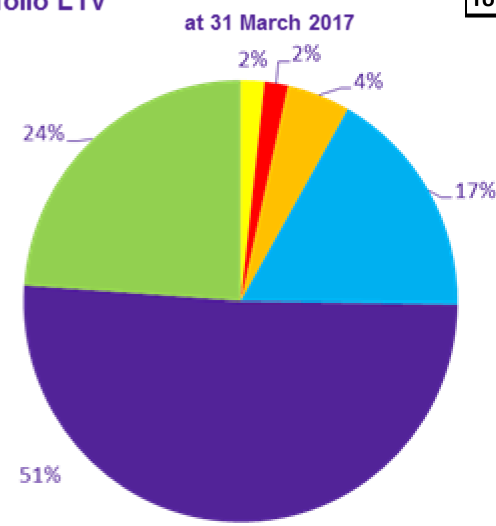
Managing exposure through responsible lending:

- As illustrated by the strategic overview the mortgage portfolio continues to be rebalanced towards residential lending with the Society lending across first-time buyer, home mover and remortgage markets.
- As a building society first-time buyers remain a key strategic focus, with advances to this segment increasing to 38% (30 September 2017: 28%) of our total new lending during the last six months.
- Diverse regional spread of residential owner-occupied property assets to mitigate geographical concentration risk, with c77% of the residential loan portfolio 75% loan to value or below (2016/17: 75%) and only 1% of balances above 95% LTV.
- The Group's average residential indexed loan to value at 31 March 2018 financial year end was broadly unchanged at 55.0% (2016/17: 55.7%).

At 31 March Residential loans analysis by region	**2018**	2017
	%	%
East Anglia	**3.0**	2.9
East Midlands	**10.3**	9.8
Greater London	**11.9**	13.1
Northern Ireland	**0.1**	0.1
North	**4.3**	3.9
North West	**12.5**	11.7
Scotland	**2.4**	2.7
South East	**16.5**	17.7
South West	**8.3**	8.3
Wales	**5.0**	4.9
West Midlands	**16.3**	16.7
Yorkshire	**9.4**	8.2
Total	**100.0**	100.0

Group Residential loan portfolio LTV distribution



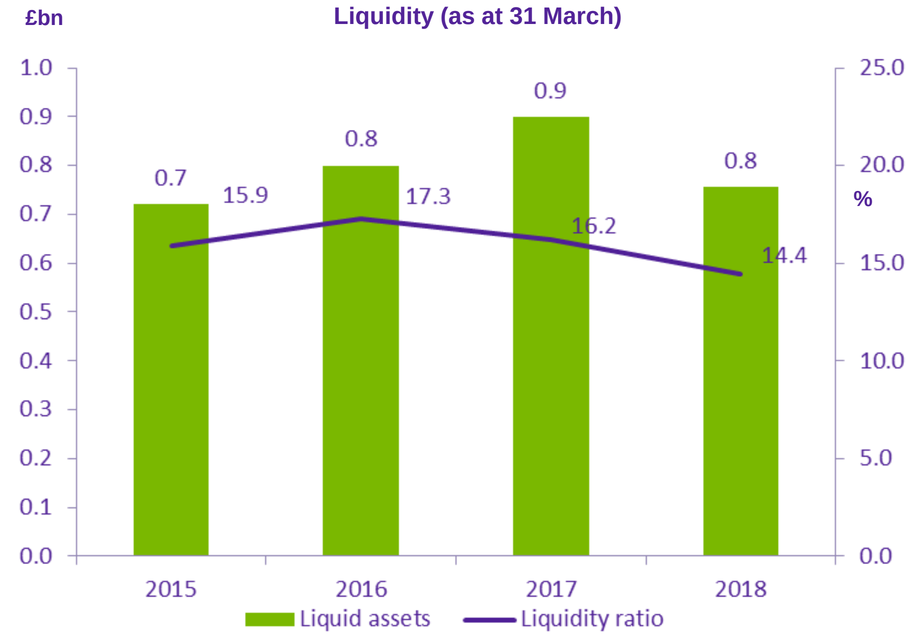


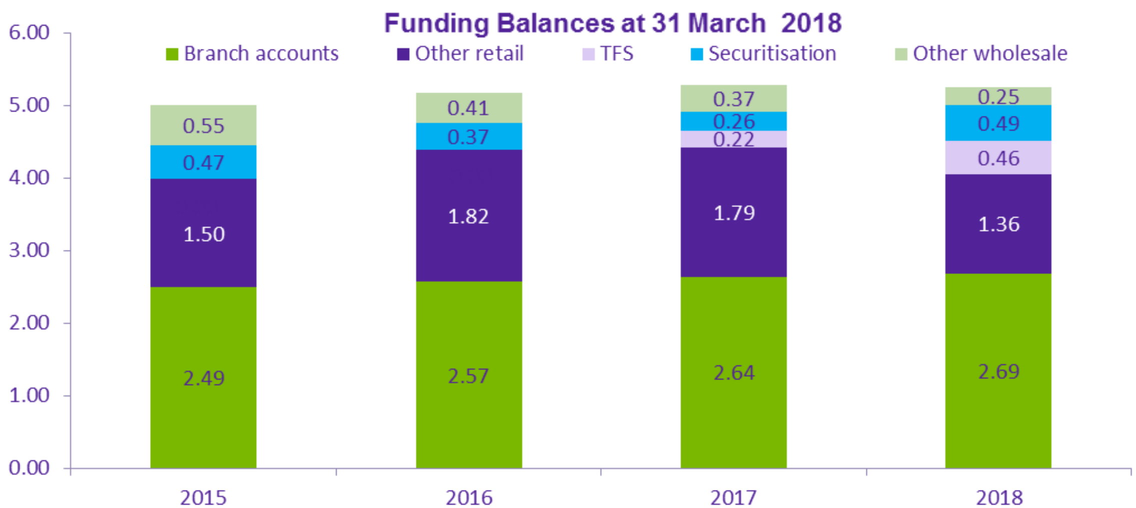
Source : Annual Report and Accounts year ended 31 March 2018 and Interim Statement as at 30 September 2018

Funding & Liquidity

High quality liquid assets:

- As at 30 September 2018 69% of retail savings balances were held in branch based accounts, a slightly higher proportion than at the year end (31 March 2018: 66%).
- The majority of wholesale funding is longer-term in nature, with 68% of wholesale funding being for periods exceeding two years as at 30 September 2018.
- In the first half of the 2018/19 financial year the Society's wholesale funding ratio increased modestly from 22.8% to 24.1%.
- The key regulatory measure of liquidity is the Liquidity Coverage Ratio (LCR) which, at 144% (31 March 2018: 194%), was considerably above the current minimum regulatory requirement. The liquidity figure at 31 March 2018 year end was higher than normal, as the Society had raised £350m of 5 year term funding through a residential mortgage backed securitisation, in January 2018.





Source : Annual Report and Accounts year ended 31 March 2018 and Interim Statement as at 30 September 2018

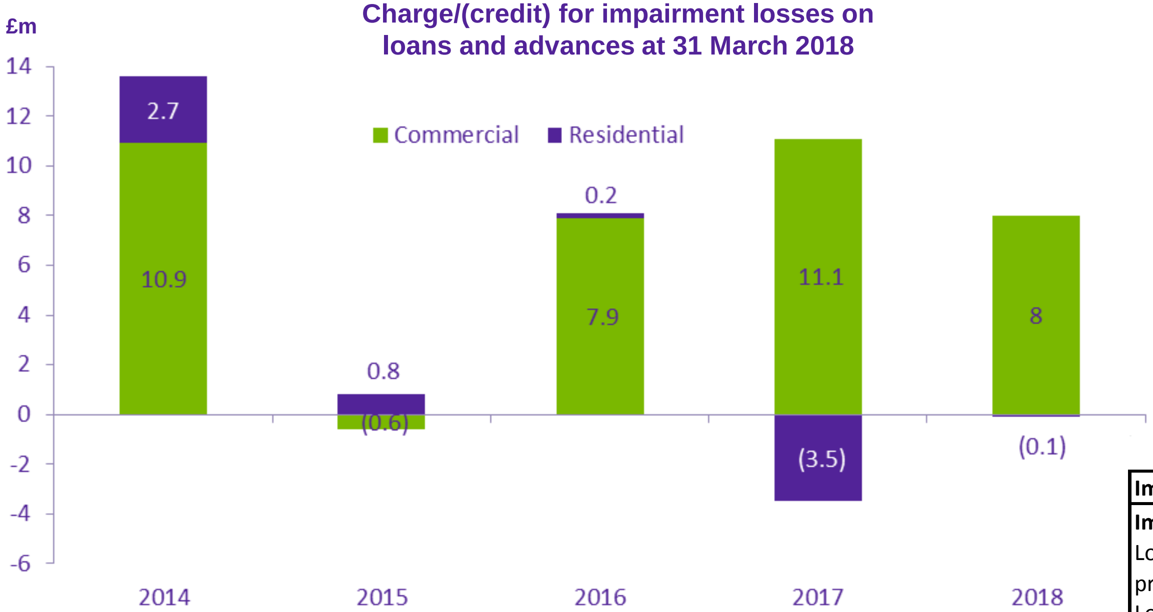
Impairment Provisions

- The strategy of reducing non-core exposures and lending only into traditional residential lending segments has resulted in a material change to the Society's balance sheet, improving the Society's risk weighted asset structure.
- The number of residential customers experiencing difficulty with their payments remains significantly below the market average. As at 30 September 2018, core residential arrears of 3 months or longer arrears stood at 0.29%, compared with the UK Finance average of 0.78%.
- Improving asset quality has resulted in a 41% lower charge for impairment than across the same period 2017/18.

At 31 March 2018 Group arrears		
	Total balances £m	**3 months+ %**
Prime owner occupied	**2,677.5**	**0.45**
Buy to let	**1,637.1**	**0.17**
Other	**56.6**	**3.22**
Core residential	**4,371.2**	**0.38**
Second charge lending	**14.8**	**7.94**
Total residential	**4,386.0**	**0.53**

At 31 March 2017 Group arrears		
	Total balances £m	3 months+ %
Prime owner occupied	2,349.6	0.70
Buy to let	1,803.6	0.30
Other	63.6	6.81
Core residential	4,216.8	0.63
Second charge lending	18.3	8.58
Total residential	4,235.1	0.81

Charge/(credit) for impairment losses on loans and advances at 31 March 2018



Charge/(credit) for impairment on loans and advances 30 September 2018

	HY30 Sep 18 (£m)	HY30 Sep 17 (£m)	FY31 Mar 18 (£m)
Impairment charge for the period	**3.7**	6.3	7.9
Impairment provision at end of period			
Loans fully secured on residential property	**6.3**	16.4	13.2
Loans fully secured on land	**77.4**	50.6	42.1
Total	**83.7**	67.0	55.3

Note: See p15 for IFRS9 impairment provisions.

Source : Annual Report and Accounts year ended 31 March 2018 and Interim Statement as at 30 September 2018

Impairment Provisions: IFRS 9 update

- Following adoption of IFRS 9 on 1 April 2018, provisions are now recognised on an expected loss basis. This has increased the level of provision coverage from 8.6% at 31 March 2018 on an IAS 39 basis to 16.7% at 30 September 2018 on an IFRS 9 basis.
- Since our financial year-end disclosures, we have continued to improve the methodologies that underpin our provisioning approach, particularly around the market sensitivities inherent within our CRE book.
- To this end, IFRS 9 implementation has resulted in a reduction in general reserves of £27.9m almost entirely due to additional CRE provisioning requirements under this new standard.
- The Group's closed CRE book is particularly sensitive to uncertainties in the economic outlook, for the retail sector and generally, which are now captured within the IFRS 9 impairment calculation.

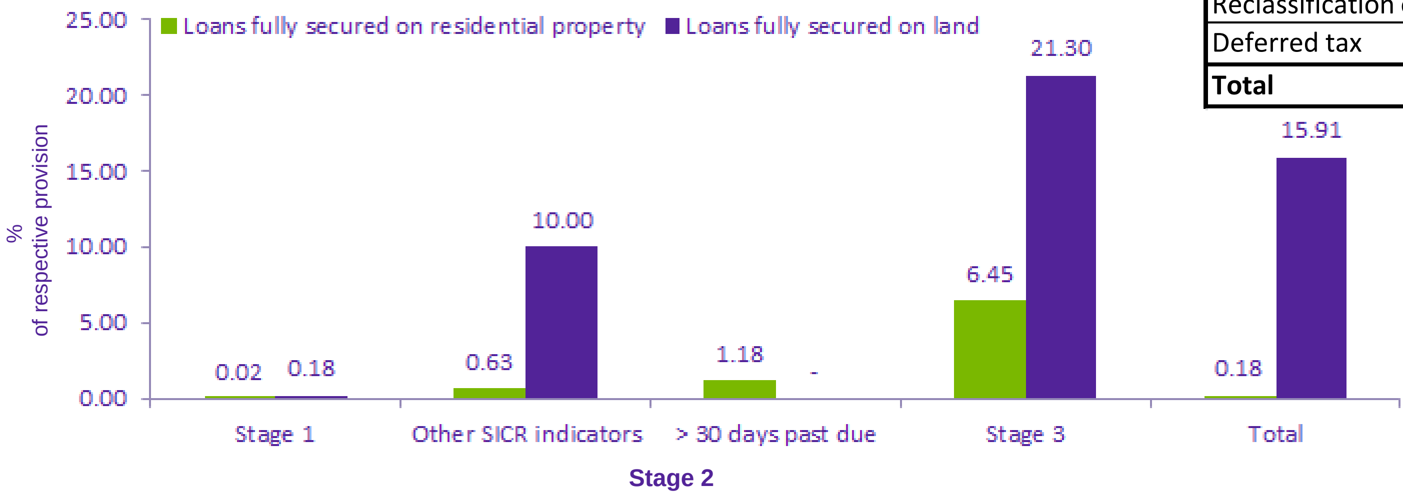
Reconciliation of impairment provisions from an IAS 39 to IFRS 9 basis

Impairment provision (unaudited)	Loans fully secured on residential property (£m)	Loans fully secured on land (£m)	Total (£m)
At 31 March 2018 (IAS 39 basis)	**13.2**	**42.1**	**55.3**
Reclassification	(7.0)	-	(7.0)
IAS 39 collective provisions	(2.5)	(11.4)	(13.9)
12 month ECL on assets not individually impaired under IAS 39	0.6	0.1	0.7
Lifetime ECL on assets not individually impaired under IAS 39	3.1	21.2	24.3
Changes to calculation methodology for assets individually impaired under IAS 39	(1.0)	22.4	21.4
Post model adjustments	1.4	-	1.4
At 1 April 2018 (IFRS 9 basis)	**7.8**	**74.4**	**82.2**

Impact of IFRS 9 adoption on equity and regulatory capital

Increase/ (Decrease) in general reserves 1 April 2018	(£m)
Impairment losses on residential mortgage loans	(1.6)
Impairment losses on non-securitised CRE mortgage loans	(31.4)
Reclassification of financial instruments designated at FVTPL under IAS 39	(0.1)
Reclassification of equity release portfolio	(0.5)
Deferred tax	5.7
Total	**(27.9)**

IFRS 9 provision staging



Source : Annual Report and Accounts year ended 31 March 2018 and Interim Statement as at 30 September 2018

Capital Position

	Transitional CRD IV rules HY30 Sep 18 £m	Full implementation of CRD IV HY30 Sep 18 £m	Transitional CRD IV rules FY31 Mar 18 £m	Full implementation of CRD IV FY31 Mar 18 £m
Equity attributable to members (excluding Additional Tier 1)	**375.2**	**375.2**	395.0	395.0
Other adjustments	**5.4**	**5.4**	(20.8)	(20.8)
Common Equity Tier 1 (CET 1) capital	**380.6**	**380.6**	374.2	374.2
Additional Tier 1 capital	**8.9**	**-**	30.0	-
Total Tier 1 capital	**389.5**	**380.6**	404.2	374.2
Tier 2 capital	**21.7**	**21.7**	16.3	16.3
Total regulatory capital resources	**411.2**	**402.3**	420.5	390.5
Risk weighted assets (RWA)	**2,508.7**	**2,508.7**	2,523.1	2,523.1
Leverage ratio exposure	**5,706.7**	**5,706.7**	5,885.2	5,885.2
Capital ratios (%)				
Common Equity Tier 1 ratio (as a percentage of RWA)	**15.2**	**15.2**	14.8	14.8
Tier 1 ratio (as a percentage of RWA)	**15.5**	**15.2**	16.0	14.8
Total capital ratio (as a percentage of RWA)	**16.4**	**16.0**	16.7	15.5
Leverage ratio	**6.8**	**6.7**	6.9	6.4

Capital maintained at levels which comfortably exceed minimum internal and regulatory requirements:

- The LME transaction executed in April 2018 represented a significant landmark for the Society, modernising our capital base and increasing members' general reserves by £52m. Under the distribution policy for the CCDS the Board has disclosed that it does not intend to declare any distributions in respect of the financial year ended 31 March 2019, with the Board targeting incremental distributions to be paid from financial year 31 March 2020 onwards and a stable distribution policy intended to be adopted from financial year 31 March 2023. The Board shall have full discretion whether or not to declare any distribution, and (if declared) the amount of any such distribution.

- Combined with the profit for the half year and a further reduction in higher risk weighted legacy lending, this has resulted in our CET 1 capital ratio increasing to 15.2% (31 March 2018: 14.8%).

- The stable leverage ratio of 6.8% (31 March 2018: 6.9%) compares favourably with others in the sector and is significantly above the current regulatory minimum of 3%.

- The figures above also reflect IFRS 9 transitional rules which enable banks and building societies to phase in the capital impact of IFRS 9 adoption over a period of five years. Had these transitional arrangements not been in place, the CET 1 ratio at 30 September 2018 would have been 14.3% and the leverage ratio would have been 6.2%.

the West Brom

Source : Annual Report and Accounts year ended 31 March 2018 and Interim Statement as at 30 September 2018

Development Focus

Delivering a thriving Society focused on the needs of current and future members:

- An active change programme seeks to take advantage of immediate market opportunities and deliver longer term digital transformation in the interests of both current and future members.

Agile response to market opportunity

- **Focus on prime residential lending with controlled entry into 'new traditional' lending markets**
  - BTL limited company
  - Self-build mortgages
  - Shared equity (help to buy)

Balanced funding

- **Continued growth in branch balances**
  - Help to buy ISA
  - Children's accounts
- **Wholesale funding forms the key part of the Society's diversified funding strategy**

Extended capabilities

- **Investment in systems**
  - Digital roadmap development
  - Mortgage system upgrade
  - Information and cyber security focus
- **Enhanced risk capabilities**
  - Active Internal Risk Based programme

Outlook

- To support the West Brom’s Purpose our core strategic objectives are clear; sustainable levels of residential lending funded primarily by retail savings, cost efficient services delivered to the standards members rightly expect and continuing the managed exit of non-core legacy positions.
- In a time of extraordinary geopolitical turbulence, future market movements are difficult to predict. The Society will actively monitor market developments in relation to:
  - The economic impact of any changes to the UK – EU trading relationship (Brexit) and any prevailing ‘downside’ economic scenario;
  - The withdrawal of the TFS stimulus that has contributed to highly competitive mortgage pricing;
  - The impact of any further interest rate rises on residential borrower’s ability to pay; and
  - The response of the non-core CRE loan book, that has historically proven sensitive to any downturn in the economic environment, to ensure effective management of the run-off for best economic outcome.
- The Society is actively investing in its technological capabilities. Technology is fundamental to delivering excellent customer service, accessing consumer and business-to-business markets and providing operational resilience and a robust defence against cyber risks.
- The Society currently applies the Standardised Approach to credit risk and is making significant progress on its regulatory project to move to the Internal Rating Based (‘IRB’) Approach. The Society’s current expectation that given the nature of the Society’s residential exposures, the capital required to support its credit risk should reduce under the IRB Approach, resulting in a positive impact on the Society’s already robust capital ratios.
- Against the recent backdrop of low interest rates and economic uncertainty, caused in part by Brexit, the Society has demonstrated the ability to grow its prime residential mortgage book, reduce non-core activities in a controlled manner, deliver healthy and sustainable underlying profits, invest in the future and exceed all regulatory capital and liquidity requirements.

Key Contact

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