Operating environment

Climate agenda

What we are seeing

- The climate agenda remains a key area of focus for organisations. However, we have seen a shift in focus globally this year, with some governments and organisations de-prioritising the issue or moving away from commitments and interventions.
- Our customers and businesses continue to look for opportunities to transition to a lower carbon future through their investments in green assets, including electric vehicles, renewables, grid infrastructure and energy efficiency.
- We need to support our stakeholders in making decisions by providing sufficient information on our climate strategy.
- Investors continue to take Environmental, Social and Governance ("ESG") factors into consideration as part of their investment decisions and reporting standards require us to align our climate reporting to the recommendations of the Task Force on Climate-related Financial Disclosures ("TCFD").

How we are responding

- Our group climate strategy is driven by our commitment to support our customers and clients in their transition to a lower carbon future, and continues to develop.
- We have made significant progress on climate actions and remain committed to achieving net zero across our operations, our supply chain and the activities we finance by 2050 or sooner.
- We have achieved a reduction in operational emissions of 53% since our 2019 baseline, with a 20% reduction of Scope 1 and 2 emissions in 2025.
- We are reducing our financed emissions by aligning our financing activities with net zero commitments and helping customers meet their transition targets.
- We are enabling the adoption of cleaner technologies and business model adaptation through our green growth lending strategy.

Read more about our climate commitments in our TCFD report on pages 29 to 39.

Economic environment

What we are seeing

- The market backdrop has been mixed this year, presenting uncertainty for both individuals and SMEs.
- Consumer affordability has continued to be challenged in the higher interest rate environment and the resilience of SMEs has been tested by market volatility and uncertainty from tariffs.
- Nevertheless, the UK economy has proved resilient, with macroeconomic indicators relatively stable over the year and unemployment remaining at relatively low levels.
- Whilst the Bank of England has implemented modest rate cuts during the year, the timing and trajectory of further rate movements remains uncertain in the current market backdrop.

How we are responding

- We recognise the challenges affecting our customers and continue to monitor the potential impact of ongoing uncertainty closely, prudently assessing affordability across lending proposals and offering additional support to customers where needed.
- Our IFRS 9 models are regularly updated to reflect current economic scenarios and forecasts from Moody's, with adjustments overlaid where needed to recognise additional risk not captured in model outputs.
- We pride ourselves on supporting customers through economic cycles, and continue to do so, lending to them on responsible terms and consistently applying our prudent underwriting and pricing discipline.

Regulatory environment

What we are seeing

- The UK regulatory environment continues to see significant change as well as uncertainty arising from the FCA's review in respect of historical motor finance commission arrangements[1].
- In light of this market uncertainty, operational and financial resilience, and robust recovery and resolution planning continue to be priorities for the PRA. Regular prudential monitoring is being conducted through information and data requests, and reviews.
- The group continues to see an increase in engagement with our regulators, for example in respect of the FCA's market-wide reviews into historical motor finance commissions and the premium finance market.
- The PRA has announced that the UK implementation of the Basel 3.1 reforms will be delayed by a year, until 1 January 2027. We expect the implementation of Basel 3.1 to have a less significant impact on the group's capital headroom position than initially anticipated.
- The FCA's Consumer Duty expectations continue to be embedded within the wider market and have driven improvements in controls and arrangements in firms as well as the nature and extent of support available to vulnerable customers and those in financial difficulty.
- The FCA and PRA continue to take steps to promote growth within the UK and reduce the administrative burdens placed on firms. They have committed to consulting on streamlining existing handbook requirements and legislation, including the Consumer Credit Act 1974, as well as reducing regulatory reporting requirements where possible.

How we are responding

- We continually monitor the landscape to stay abreast of regulatory change.
- We maintain an open and cooperative relationship with our regulators, including the FCA and PRA, through regular engagements and meetings.
- We have been engaging constructively with our regulators in respect of historical motor finance commission arrangements.
- We continue to complete Annual Assessments of Customer Outcomes, where the board is required to review and approve the assessment of delivering good customer outcomes.
- We have continued to engage with relevant industry trade bodies and associations on key matters impacting the sectors in which we operate.

1. Read more about historical motor finance commission arrangements on pages 8 to 9.

Technology and digital adaption

What we are seeing

- Increased adoption of public cloud across industries is enabling easier access to, and integration with, external data sets for better decision making, easier integration with partners and intermediaries, and increased cost transparency.
- Increased adoption of automation and Artificial Intelligence capabilities for improved productivity and efficiencies.
- Current cyber threat level in the UK remains significant with ransomware remaining the foremost threat.

How we are responding

- Migrating our services from data centres to Azure cloud, and benefiting from increased service resilience, improved security, pay-as-you-consume commercial models, and better control of software costs. Cloud migration is also enabling the simplification and decommissioning of our legacy infrastructure, leading to annual run-rate savings on infrastructure costs.
- Adopting cloud-based virtual desktops for third-party suppliers and cloud hosted contact centre capabilities for service partners supports flexibility of locations and regions for provision of some services, enabling cost saving opportunities.
- We are taking a deliberate, disciplined, and incremental approach to the adoption of AI technologies. We have adopted an AI usage policy underpinned by security and data privacy controls, and have made careful but meaningful inroads into AI adoption, applying appropriate guardrails. We have launched our first large language model based AI solution to handle unstructured complaints data, partnered with a third party for an AI solution for fraud detection and to enhance our ability to identify suspicious activity, and are rolling out Microsoft Copilot to colleagues for personal productivity.
- We are developing internal capabilities through our AI Centre of Excellence supported by strategic partners, upskilling c.70 colleagues through an intensive training programme, and providing opportunities for colleagues to learn about safe AI use and opportunities through interactive training on Microsoft Copilot.
- We continue to invest in tuning and optimising our defensive and protective capabilities with specific focus on cloud security posture management and evolving counter threats. Over the next 12 months we will be bolstering eyes-on-glass security operations by growing the team and adopting AI capability to improve mean time to detect and resolve events.

Customer behaviour

What we are seeing

- Customer expectations continue to evolve as they adapt to new market dynamics and advancing technologies. Strong sector expertise and long-term relationships remain key to building loyalty.
- Customer service, responsiveness, clarity of communication, price and value of products, as well as ease of doing business are key customer requirements.
- Digital channels, alongside new technology and the use of AI, are expected to provide a differentiated offering and an improved customer experience. However, the human element continues to add value for customers and partners, strengthening long-term relationships and providing additional support.
- Customers continue to need support in financing their transition to net zero, with growing demand for green lending, SMEs are looking to reduce their carbon footprint and motor customers are considering alternative fuel vehicles.

How we are responding

- We have a range of products, routes to market and customer segments across our businesses, which are all underpinned by a focus on good customer outcomes, providing excellent service and building long-term relationships.
- Our Asset Finance business has broadened its exposure in sustainability funding and is among the first lenders to offer asset finance into the hydrogen industry at scale, whilst also increasing its green energy lending across wind farms, solar parks and battery storage.
- Savings has launched key digital self-service features, such as a document library and the ability to amend contact details online, achieving 86% digital adoption across its customer base. The use of behavioural analytics tools further enables real-time optimisation of the customer journey.
- The Premium Finance business is using internal robotics capabilities to automate manual process tasks, freeing up the Customer Service team's time to focus on supporting our customers.
- Motor Finance introduced a new online settlement webform to provide a faster and clearer way for customers to request settlement quotes. Customers can now also understand what options are available for financing a new vehicle and go through a full finance application online. 67% of our customers told us they wanted self-serve channels.
- Property Finance is supporting the All Party Parliamentary Group ("APPG") for SME Housebuilders. We are not only backing our customers with funding, but also standing alongside them in advocating for meaningful change across the industry. By engaging with policymakers and supporting initiatives like the APPG, we are helping to ensure that the voices of SME developers are heard, and that the environment they operate in continues to improve.

Competitive landscape

What we are seeing

- In Banking, borrower confidence remains mixed, with higher funding costs, inflationary pressures and the uncertain economic outlook weighing on market sentiment.
- We have seen further consolidation across the banking sector this year, albeit the specialist lending market remains fragmented.
- The motor finance market continues to be impacted in the short term by the ongoing review of historical motor finance commission arrangements, contributing to an uncertain outlook for lenders.
- The savings market remains highly competitive, with a number of new entrants in recent years and more interest being paid by high street banks, as a result of rising interest rates and the FCA's market activities focusing on fair value.

How we are responding

- In Banking, we remain committed to our model of maintaining margin and underwriting discipline, notwithstanding competitor pricing. We continue to focus on delivering excellent client service and building deep relationships with our customers.
- We are actively evaluating our portfolio of specialist businesses, prioritising capital allocation towards those businesses that offer sustainable growth and attractive risk-adjusted returns.
- We continue to see growth opportunities as we look to extend our capabilities into new areas that fit with our model, either through partnerships or bringing in specialist teams to complement our expertise.
- Our Savings business actively sought to grow our retail deposit base, which increased 20% during the year. The introduction of the Easy Access Account in the 2024 financial year has helped us to access a larger proportion of the potential deposit pool. We carefully monitor pricing and help maximise opportunities, whilst ensuring fair outcomes for customers.

Read more about the opportunities across our businesses on pages 61 to 67.