Close Brothers

Close Brothers Group Interim Results

Tuesday 15th March 2011

Preben Prebensen

Good morning, and thank you for joining us today. We're delighted that you could come to the Interim Results presentation. Joining me today is Jonathan Howell who will present the financials to you. We also have Stephen Hodges, Julian Palfreyman and Martin Andrew who respectively are the Chief Executives of the bank, Winterflood and the Asset Management division.

I'd like to remind you that today's proceedings are being webcast and I welcome those of you who are joining via this facility. Please can I remind you all to switch off mobile phones and as usual after the formal presentation we'll open up with Q&A.

We're pleased to report a good set of results today with adjusted operating profit from continuing operations up 5% year on year. Banking achieved another strong performance with a 33% increase in adjusted operating profit as a result of continued good growth in the loan book and strong margins.

The securities division delivered a good result overall, largely driven by Winterflood. There was a 9% reduction in profit in the period compared to a very strong prior year period.

Asset Management is implementing its strategy and its client and asset gathering efforts are gaining momentum. Total funds under management, excluding those from our UK offshore business increased 20% since the year end to £8.3 billion including acquisitions, net inflows and positive market movements.

The group maintained its strong capital position and at the 31st January 2011 had a core tier one capital ratio of 13.1%. We're pleased to announce a maintained interim dividend of 13.5p per share.

Last week we announced the sale of the UK offshore business in Asset Management. This is consistent with our strategy of focussing on our core businesses, and as we've clearly laid out our focus in the Asset Management division is on UK based wealth and asset management. The offshore trust fund administration asset management and banking business is a small, geographically distinct business which is not aligned to our strategic direction for the division going forward.

Now I'll hand over to Jonathan.

Jonathan Howell

Good morning to you all here and thank you Preben. I'm very pleased to take you through another good set of results for the group. And turning first to the highlights of the income statement, the group delivered strong income growth of 12% to £280 million driven by net interest income in the banking division. Adjusted operating profit was £65 million up 5% and we'll go into these items in more detail when I go through each of the divisions.

Overall adjusted EPS also increased 6% to 34.1 pence and the board also declared a maintained interim dividend of 13.5 pence.

The group reports adjusted operating profit after a number of standard adjustments. In the first half the main adjustments were a £4.5 million exceptional provision for a long term lease related to the sale of the UK offshore business and a £4.5 million impairment of goodwill related to our business in the Cayman Islands.

The tax charge for the period was £16 million, equivalent to an effective tax rate of 28%, in line with the UK corporate tax rate.

Basic EPS from continuing operations reduced 14% to 27.4 pence.

The sale of the UK offshore business resulted in a loss from discontinued operations of £25 million. The trading result of the business itself was around break even for the period.

Now looking at the contribution of each of the divisions to the overall result. The Banking division was the main driver of the group's performance with a 33% increase in operating profit to £49 million.

The division saw good momentum in all its businesses and delivered 9% loan book growth with a strong net interest margin at 10%.

Securities had a good overall performance driven by strong volumes at Winterflood and Seydler's performance also improved although this was offset by lower associate income from Mako.

Overall operating profit for securities was £31 million, a reduction of 9% compared to a very strong prior year period.

The Asset Management division is in the process of investing to implement its strategy and made a small loss of £4 million in the period. And finally, group central costs net of income were slightly down at £10 million.

The group has maintained a strong balance sheet, total assets increased 4% to £6.5 billion as we continue to focus on increasing the efficiency of the balance sheet.

The loan book increased 9% to £3.2 billion and treasury assets reduced to £1.6 billion with an increased proportion of high quality liquid assets.

The net balance of assets and liabilities related to market making in the Securities division was broadly stable at £100 million.

On the liability side customer deposits reduced by some £500 million. This reflects the classification of deposits in the UK offshore business as held for sale.

Borrowings were unchanged at £1.5 billion and equity was broadly stable. I'll cover some of these items in more detail in the next few slides.

The group has maintained a strong capital position. At 31 January the group had a core tier one ratio of 13.1% and a total capital ratio of 14.9%. These strong capital ratios have allowed the group to support growth in the loan book and an acquisition in the asset

management division. And risk weighted assets increased 4% mainly as a result of loan book growth.

We do not expect the new Basel 3 three rules to affect our capital position. Firstly, the majority of our capital is already core tier one as you can see on the chart. Secondly, with a core tier one ratio of 13.1% we are already well ahead of the Basel 3 minimum capital ratios. And thirdly, our securities businesses do not have complex trading exposures which require additional capital. Overall this puts us in a strong position and we currently have flexibility to pursue growth.

We remain soundly funded with total available funding of £5 billion, 1.6 times the loan book. This excludes some £550 million of customer deposits in our UK offshore business which were classified as held for sale at the balance sheet date.

Our approach to funding is to use a diverse range of sources and we have further diversified our wholesale funding during the first half. This includes £1 billion raised through a syndicated facility, the securitisation of the premium finance loan book and a repurchase agreement secured on our FRN portfolio.

Customer deposits have been resilient at £2.7 billion, excluding those deposits that are held for sale. In addition to our corporate deposit base we continue to have an active presence in the retail deposit market. We've also further diversified our deposit base since the period end with the acquisition of a £300 million structured deposit book announced in February.

We've set out on the slide the portion of our funding which is term funding with a remaining maturity of over one year at the balance sheet date. At 31 January we had £2.2 billion of term funding which covered 71% of the loan book and had an average maturity of 34 months. This compares very favourably to the average maturity of our loan book which is 12 months.

The focus of the group's treasury operations is on funding the loan book whilst holding an appropriate amount and mix of liquid assets. During the period the group has improved the efficiency of its balance sheet by using more of its funding towards loan book growth.

The group is managing down its portfolio of FRNs which reduced from £600 to £450 million and funds from CDs which matured in the period were redeployed in the loan book or placed on deposit with the Bank of England. As a result there was a 23% overall reduction in treasury assets to £1.6 billion but the group's holding of high quality liquid assets which includes gilts and deposits with the Bank of England increased 29% to £1 billion at 31st January.

Overall our strong liquidity position gives us significant flexibility and leaves us well positioned for the FSA's new liquidity framework.

Now looking at each of our divisions in more detail, starting with the banking division which had another strong performance in the period. Income increased 24% to £159 million reflecting good loan book growth at high margins. Operating expenses increased 19% and this reflects both higher, volume related costs and investment in the division's infrastructure and staff resources to support growth.

Overall the division's headcount increased 13% over the prior year, including a significant addition to sales teams across the division. As a result, the compensation ratio was stable at 27% and the expense income ratio improved two percentage points to 46%. The bad

debt ratio improved slightly to 2.4% and overall this resulted in a 33% increase in operating profit to £49 million and a good return on equity of 20%.

The division continues to see good demand for its lending services and was able to grow its loan book whilst maintaining or improving margins across all of its businesses. Overall this resulted in a 24% increase in income for the period. This was driven by firstly a 23% increase in the average loan book year on year and secondly, a slight improvement in the net interest margin to 10%.

Performance was good across each of the three business units with a 25% increase in retail, 29% in commercial and 23% growth in property. Meanwhile, treasury income reduced slightly reflecting the lower holdings of treasury assets.

The loan book increased 9% in the first half to £3.2 billion. The retail loan book increased 12% reflecting the expansion of the branch network and sales teams in motor and good demand in premium, particularly for personal lines.

Commercial increased 8% reflecting good new business levels in asset finance. Growth for invoice finance was lower reflecting seasonally weaker business volumes in January. Property increased 4%, principally driven by short term bridging loans. We continue to see reduced competition in this area which has allowed us to lend selectively and improve the quality of our loan book. Overall our businesses remain well positioned and we continue to see good prospects for future growth.

Turning now to look at bad debts. Bad debts in the first half were 2.4%, down slightly year on year but in line with the second half. This reflects a modest improvement in the commercial loan book as a result of recovering asset values and strong collections. Retail remains at low levels whilst property was affected by a bad debt charge on a legacy loan. Combined with a robust net interest margin of 10% this resulted in a return on the loan book of 3.2%. The growth in the loan book has been achieved whilst maintaining prudent and disciplined lending criteria and given the underlying improvement to date we expect the bad debt ratio for the year as a whole to be slightly down on 2010.

Turning now to look at Securities which also had a good performance. Overall, income reduced 3%, operating expenses were flat at £56 million and adjusted operating profit was £31 million. This is down 9% from a very strong prior year period. Winterflood had a good performance driven by strong retail trading activity and accounted for the majority of profits with £25 million. Seydler's performance improved to £5 million although this was offset by lower income from Mako at £1 million.

Looking more closely at the drivers of operating income Winterflood benefited from strong retail investor activity with good flows in AIM stocks. This resulted in a 7% increase in bargains per day to 48,000, Winterflood's highest number of bargains per day so far in any half year period. Income per bargain was £11.20 which is 12% down on a very strong prior year period but in line with the 2010 financial year as a whole.

And Winterflood once again demonstrated the consistency of its trading result with no loss days in the period. Seydler performed well, income increased 24% to £16 million as it benefited from increased activity in the debt and equity capital markets. However, Mako was affected by continued difficult trading conditions due to low volatility and low volumes across both fixed income and equities.

Turning now to Asset Management which is in a period of investment as it implements its wealth and asset management strategy. And I just want to remind you that the numbers

shown here exclude the UK offshore business which has been classified as a discontinued operation in these results. Asset management achieved good growth and income which increased 13% to £35 million reflecting higher funds under management. However, operating expenses also increased £10 million, this includes £5 million of non-recurring investment in our wealth management proposition and ongoing costs of increased staff and infrastructure to support the implementation of strategy. As a result the business made a small loss of £4 million in the first half of the year. The division remains on track for a total of £18 to £20 million of non-recurring investment as we set out at the results in September.

Turning now to look at the components of income in this business. The first thing to point out is the increase in income from management fees on FUM which increased 16% in the period to £27 million. As you can see this is becoming an increasingly important proportion of the total income which demonstrates the focus on growing the wealth and asset management part of the division.

The increase in the period was principally the result of 15% higher average FuM of £7.6 billion. The revenue margin on FuM was broadly stable at 71 basis points and income on AuA deposits was £5 million, which following the sale of UK offshore principally reflects income from our businesses in the Cayman Islands.

Turning now to look at our funds under management, the division has made good progress on asset gathering in the private client's business, both through organic growth and acquisitions. Overall there was a 20% increase in funds under management to £8.3 billion. This reflected £127 million of net new funds reflecting good new business levels from high net worth clients. And £531 million of positive market movements and £705 million from the acquisition of Chartwell which was announced at the time of our results in September.

Since the year end we have also acquired Allenbridge, an execution only retail broker with around £440 million of client assets. And we've completed the sale of the property funds business which was announced in October with around £550 million of FuM. At the period end private clients accounted for 55% of total FuM and after these acquisitions and disposals the figure would be over 60%.

And finally turning to the outlook for the full year the group remains strongly capitalised and well positioned to capture growth opportunities. In Banking we expect a good second half and a modest improvement in bad debts. The Securities division remains well positioned and so far activity levels have remained resilient.

And the Asset Management division is continuing to invest in its strategic plan and expects a further small loss for the second half of the year. Overall the group expects to deliver a satisfactory performance for the year. Thank you.

Preben Prebensen

Thank you, Jonathan. In September we laid out our strategy in detail and so now I want to spend just a few minutes providing you with a quick update on the progress we've made in implementing the strategy as we're now very much in the execution stage.

As you know, Close Brothers is focused on three key business areas, we lend money to our clients in the Banking division, we make markets for our clients through our securities division and we advise and manage money for our clients through our Asset Management division. And as we've set out for you in the past our key strategic focus in each of these areas remains unchanged. In Banking we'll continue to capture growth opportunities. In Securities we'll maintain leadership principally through Winterflood and in Asset

Management, we're transforming the business to become a leader in UK wealth and asset management.

So looking first at the Banking division where we're focused on growing the business and maintaining our distinctive business model. We're implementing this principally in three ways. First we're expanding our geographic footprint, mainly in the UK. We now have 12 motor finance branches around the UK, including those newly opened in Swindon and Northern Ireland and our property bridging loans business has expanded into Scotland.

Secondly, we're investing in resources and infrastructure to increase origination capacity. Over the last 12 months we've increased headcount by 13% or 180 people, including a significant increase in sales teams across the division. We also need to invest in building the support functions and technology infrastructure to be capable of running a larger and more scalable banking division.

And thirdly, we're extending the existing business model. For example in motor finance we've developed a key accounts team who deal with mid to large dealerships and manufacturers, alongside the traditional used car financing to smaller dealers. And within invoice finance on the commercial side we've invested in a larger ticket sales team to satisfy demand generated partly as a result of relationships that came through the GMAC acquisition last year.

But importantly in all of these areas where we've been pursuing growth this has not been at the expense of our key lending disciplines, namely short term duration, low average loan size, secured on high quality collateral, written on conservative loan to values and generating strong margins. And all of these will continue.

For example, we're still predominantly a short term, small ticket lender. Around 90% of the number of loans have a maturity of less than one year and around 70% of the loan book is loans less than half a million pounds in size. And importantly these proportions look the same today as they did back in July of 2008 so the overall shape of the loan portfolio is unchanged.

I'm also pleased to say that these growth initiatives are really paying off. Not only have we achieved 23% growth in the loan book over 12 months but customer numbers have also increased. We now lend to 1.7 million individuals and businesses, a 16% increase in the year.

And furthermore it's not just new customers who are driving this growth, on average two thirds of our overall retail loan book is repeat business largely driven by premium where the customers and intermediaries are very sticky. In 11 years we've only lost two significant premium intermediary accounts and won many more. The repeat business for commercial is over 50% and property around 40%.

So the market is clearly favourable for us at the moment and as the 25 year history of the Banking division shows our customers tend to stay with us once we acquire them and we have confidence that the growth we're capturing is indeed sustainable.

Turning now to our Securities division which comprises Winterflood, Seydler and our investment in Mako. A key priority for the division is to maintain its leadership principally through Winterflood and Winterflood has successfully retained its position as the leading market maker for UK retail brokers. In this market it is twice the size of its nearest competitor by both volume and value across each of the main UK indices from AIM through to the FTSE 100.

Its good first half performance further underscores this leadership position. Winterflood delivered average bargains per day of over £48,000, the highest in any financial half year period while income for bargain has been broadly stable with the last financial year. And as you've heard Winterflood continues to deliver consistently with no loss days in the period.

Our focus for Winterflood is to maintain this market leadership position. As we told you in September we're also exploring a number of new opportunities to increase flow. These include applying for broker dealer status in the US which will happen over the next few weeks, researching opportunities in Europe and developing our outsource dealing and execution services where we've made progress in testing technology and core systems. All of these initiatives are still in their early stages but may present interesting opportunities in the medium term.

Now briefly onto our smaller securities businesses. Seydler's first half performance reflects its ability to take advantage of strong capital markets activity and Mako has a strong position in its core derivatives market making businesses, although this is currently being impacted by exceptionally low volumes and volatility. The Pelagus Fund is continuing to perform well and now stands at over $1 billion of third party investor funds.

And finally now looking at the Asset Management division, as you've heard our strategic priority here is the transformation of this division to become a leader in UK wealth and asset management and in order to implement this strategy we're doing two key things, first we're addressing non-core activities and secondly we're building our core proposition. In addressing the non-core activities we've exited from our private equities businesses two years ago. More recently we've exited from the property funds businesses and last week we announced the disposal of our non-core UK offshore business. And we're also considering our options for our trust fund administration and banking business in the Cayman Islands.

This rationalisation of activities enables us to focus on our core UK wealth and asset management business where we believe our growth opportunities are.

My comments today about the progress we've made on building our core proposition will largely be about the private client side as plans for our institutional business are at an earlier stage.

To successfully implement our private clients strategy we're doing four things, we're developing the private client proposition for advice seeking and self directed clients. This is in the middle of its build stage. Initially we're piloting our new face to face proposition to advice seeking clients using the Bristol office location that we acquired from Chartwell. Later in the year we'll roll out our proposition to self directed clients. Together these propositions will be highly differentiated and will offer a range of competitively attractive features, particularly around asset and portfolio consolidation and an integrated service via the web, telephone and face to face channels.

We're attracting assets and clients directly. We've had good sales levels in private clients in the first half of the year with an inflow of £172 million in funds under management, particularly from the high net worth business. Incidentally, this is a business which has grown from £500 million of funds under management five years ago to £2 billion in January of this year.

Additionally through our new IFA sales team we've started to attract IFA's assets to Close's discretionary offering and our traditional employer seminar channel is also expanding in terms of number of seminars and type of executives being approached.

Thirdly, we're gathering assets and clients by acquisition. In September we told you about the acquisition of Chartwell, an IFA business which had £705 million of client assets at the time of completion. And today I'm pleased to announce the acquisition of Allenbridge, a London based execution only business with around £440 million of client assets. The acquisition of these businesses brings assets and clients, advice seeking and self directed. They also provide high quality advisers, management capability, local hubs and infrastructure which help scale up the business.

After these acquisitions and recent disposals private clients would be over 60% of our funds under management and we would expect it to increase as we continue to execute our strategy of attracting and acquiring assets.

And fourthly, to support this asset gathering and at the cornerstone of our proposition is the development of our wealth management technology platform. We're leveraging existing leading platform technology and integrating it into our systems. We're currently in discussions with a major platform provider to support our propositions with a sophisticated wealth management platform and we hope to be in a position to roll out the full financial planning and advice proposition on this platform towards the end of the 2011 calendar year.

Underpinning all our asset gathering activities is our range of multi asset class investment management capabilities which we're increasingly leveraging across many client segments and distribution channels.

And so to conclude on Asset Management as you can see we're focussing the business on areas of high growth and high earnings quality. This will take time but we're already making real progress and we look forward to giving you a more detailed update from the division's management team in our forthcoming seminar on asset management which will be held on 4th May.

So to summarise, our key priorities for the divisions are in Banking we'll continue to focus on growth opportunities while maintaining our distinctive business model. In Securities we'll seek to maintain our leadership, principally through Winterflood. And in Asset Management we're currently undergoing a transformation to become a leader in UK wealth and asset management.

That concludes the presentation and we'd now like to open the floor to Q&A. Could I ask that you identify yourselves as you ask a question.

Question and Answer Session

Question 1

Justin Bates - KBW

Morning, it's Justin Bates from KBW. Could I ask a couple of questions please? Firstly on the premium finance business, I think it was up 10% relative to the movement that we've seen in rates, motor finance rates, is that slightly disappointing or should we be expecting a larger increase perhaps in the second half? And then secondly, could you just talk about the rationale for Allenbridge, were you buying that for the assets or the platform?

Answer: Preben Prebensen

Okay. I think, Stephen, you may want to come in on the premium business. That business is both personal lines and SME business. The personal lines side of it has been growing rather more quickly than the commercial side and it's actually in the personal lines side that we would hope to see more premium inflation. But the rise in our business, and Stephen, you may add to this, is really a question of more customers as opposed to premium inflation. Do you want to add anything to that?

Answer: Stephen Hodges

The only thing I would add is that we're very happy with the growth in the premium business across the piece. There is a seasonal impact towards the end of January caused by a particular class of insurance, Solicitor's PI, which gets repaid in that period and therefore that does impact the numbers but broadly speaking we're seeing growth very much in line with our plans across the piece. Commercial lines hasn't seen the premium inflation that we've seen in personal lines but we're increasing levels of penetration within our existing broker's offices well and we've got a big project on to maintain that. Personal lines has seen growth in all areas, we've picked up more brokers, particularly following the withdrawal of Finsure, one of the competitors during the period from the personal lines market. We're seeing premium inflation in personal lines and we're also seeing more customers.

Answer: Preben Prebensen

And then you had a question about the Allenbridge acquisition and, Martin, you may want to come in here too. That acquisition brings a client base, it brings a capability in the self directed side of the business that we're building and we intend to put that together with the self directed business that also lay within the Chartwell acquisition. And our strategy is very much to build a proposition which allows people to be both advice seeking and self directed. Our research suggests that most people are actually neither entirely one thing or the other, but they're actually a little bit of both, or predominantly advice seeking with some self directed. Martin, do you want to add anything?

Answer: Martin Andrew

Yes, I'll just reiterate that, Preben, we acquired Allenbridge because of the client base primarily and the people rather than the platform per se. We intend to roll out our own platform to that business in due course. And between the Allenbridge business and the direct business within Chartwell we've got some over 30,000 execution only clients which really kick starts our ambitions in that area.

Further question

Sorry, can I ask, the ambitions, is it more akin to a Hargreaves Lansdown model than a straightforward execution only broker?

Answer: Preben Prebensen

It's a very good question and I think one that we should address but it really is this combination of wanting to develop a proposition which allows people to be both advice seeking and planning seeking and also self directed to an extent that they would like to be.

<u>Question 2</u>

Paul Measday – J.P. Morgan Cazenove

Thanks, it's Paul Measday from J P Morgan Cazenove. You referred to £90 million of deposit growth during the period and clearly you agreed to buy another £300 million and you closed a premium gold offer recently I think, I wonder if you could comment on that and your plans for further customer deposit gathering during the course of the next year. Thanks.

Answer: Preben Prebensen

Again I'll start that but Jonathan and or Stephen, pitch in. I think the important point about our funding strategy is that it's based on ensuring that we have a diversified source of funding and if you go back several years we only really had two sources of funding, we would now say that we have a number which includes retail deposit gathering, SME deposit gathering, wholesale funding through bond securitisation and bank markets. So the deposit gathering through the retail side is but one of the strings to our bow, although an important one. We will be in that market going forward as and when it's attractive and the premium gold offerings, you will see in various maturities, in order to be part of that overall funding picture.

The Dunbar acquisition of that book is a good addition to our funding as it'll bring £300 million with an average life of about 1.6 years. That'll close in a few months time and that may also add a structured capability to that deposit gathering business. Stephen, do you want to add anything, or Jonathan?

Answer: Jonathan Howell

Yes, I just want to add in addition to the diversity and that's a very, very important part of the strategy that we've developed over the last two years with regards to funding, the other point to note is obviously the maturity transformation is always in our favour and in this set of results we've got a little bit of additional disclosure which effectively says: Look, we've got £5 billion of funding, that covers the loan book about 1.6 times and then we split out all forms of funding, wholesale and retail in excess of a year in term at the balance sheet date. And that comes to a number of about £2.2 billion and that is just over 70% of the total loan book. And to reinforce, this sort of maturity transformation which is to our advantage in terms of funding that has an average term of 34 months against the average term of the loan book of 12 months. So all in all we've got a much, much greater diversity and we've got I think a very much more sophisticated handle on how we manage the maturity profile of our funding overall.

Question 3

Nitin Arora – HSBC

Nitin Arora from HSBC. A couple of questions, firstly on Banking. The net interest margins increased by 30 basis points to ten percentage points, will you comment on is there more inefficiency or slack within the balance sheet which can push up interest margins further from here? And secondly on Asset Management, it's a loss making business today, how do you see the profitability of that business moving over the next two or three years?

Answer: Preben Prebensen

Okay, why don't I address the second one first and then we can turn to net interest margins. In terms of Asset Management, we set out in September that our strategy is basically the transformation of that division and refocusing it on UK wealth and asset management and we also said that that will take time. It's a medium term endeavour and you need to judge it over that medium term. So we've indicated what we're going to spend on non recurring development expenditure, that's the £18 to £20 million, six of that was last year, another five of that roughly was in this first half and so there is more of that to come. And on top of that obviously we're building a business which will be able to operate at a bigger scale than we have right now. So there is recurring as well as non recurring expenditure there.

It will take time but the objective as we also said in September is that this will be a material contributor to the group's overall profitability and that is the test for us but we will apply that test over the medium term rather than the short term. And on net interest margins?

Answer: Jonathan Howell

Just on the net interest margin Nitin, I think the important thing that we've stressed for the last two years probably about net interest margin is not, you know, we've been operating in this range of 9% to 10%, we think that is a sustainable range for the short to medium term. And from this set of results we're only at half year so the results, don't read any medium term directional trend into that, don't read that that's going to continue going up on the basis of what you've seen over the last six months and equally don't necessarily continue that's going to sort of fall outside of this relatively high range that we're operating in at the moment. So I think steady as she goes and we'll keep updating you on the net interest margin on a quarterly basis and at pre close trading statements.

Further question

If I have a look at your funding I think you have hardly deployed any deposits, customer deposits, and to grow from here there is little slack within the term of warehouse facilities now, so if you have to grow the loan book by let's say 500 or a billion over the next 18 months or so or 24 months I guess you have to dip into the customer deposits. Are you willing to do that or will you be looking for warehouse facilities to increase?

Answer: Preben Prebensen

Can I just hit that first? I think this goes back to the diversification point so as we look to fund the loan book we want to maintain a conservative funding picture that we've always had and we will always do that. So we will look to the several sources of term funding in order to do that. We have a lot of access to term retail funding and we have that in the form of premium gold offerings, we have actually an 18 month offering and a three year offering in the market

right now and we had a two year offering in the market a month ago. So those will reappear all the time, we have a much more sophisticated approach to those now so we can offer notice accounts as well as straight term and that kind of thing.

But beyond that we have access to securitisation markets, we have access to bond markets, and then clearly the old favourite which is the bank market. All of those things will be used by us to support the growth of the loan book. You won't see us very suddenly shifting towards using short term deposits as opposed to this more conservative funding strategy that we've employed. We'll try and make it as efficient as possible and manage the balance sheet as efficiently as possible, so as Jonathan pointed out, you know, treasury assets have run down and loan assets have run up, that's a good use of the balance sheet but it's not true to say that we must dip into short term deposits in order to fund the loan growth. We can raise the money we need to raise in the medium term markets to finance medium term loan growth.

Question 4

Arnaud Giblat - UBS

Hi, it's Arnaud Giblat from UBS. Just a question on the banking business. The cost base has grown broadly in line with income. I'm just wondering have you done all the investments you wanted in staff or how should we be looking at cost base growth versus net income growth?

Answer: Preben Prebensen

Good question.

Answer: Jonathan Howell

Yes, Arnaud, a good question, thank you. In terms of the increase in costs that you've seen in the first half much of that was driven by a 13% increase in headcount, 180 people. Those heads were predominantly in sales and customer facing areas and that just reflects the announcement that we made at the preliminary results back in September about that headcount increase to service the very strong growth that we've got. And as a result of that strong growth we've seen the cost income ratio come down by two percentage points, notwithstanding the cost increase. In addition to that though we are investing in operating capability, we are investing in infrastructure so that we have got a greater scalable base to this business and over time we would like to see and will be focused on trying to drive some operational efficiencies across this larger platform. That's not going to happen really during the course of this year because there is this requirement to sort of put this investment in place, to do a bit of catch up whilst at the same time servicing the front office requirements to support this growth. And just to sort of underline the growth, year on year this is loan book growth of 23% so it does require some investment alongside it.

Question 5

Ian Poulter - Canaccord Genuity

Morning, it's Ian Poulter from Canaccord. Just a quick question whether you've seen any real increases in regulatory costs or the costs of dealing with regulators perhaps.

Answer: Preben Prebensen

There's a very long answer to that question. I think most of the cost is time rather than financial as far as we're concerned. There's a tremendous call on our time to meet the regulatory changes and the requirement by the regulators to know more and to have more information from us. So I would say that that's probably the greater burden rather than financial. I don't know if you want to add anything?

Answer: Jonathan Howell

Just to add, I mean if you're looking on the pure financials what are the areas where there's a lot of regulatory change at the moment? One is capital levels, and the other is on liquidity requirements on banks. And as you'll see in today's announcement we set out a fair degree of detail about where Basel 3 leaves us and in short as we look at it Basel 3 is not going to have a material impact upon our capital requirements and indeed we're positioned very comfortably above any minimum requirements that Basel 3 currently has.

In terms of liquidity as you can see we sort of gave a detailed breakdown of the treasury assets that we have, those treasury assets now go to £1.6 billion, £400 million of those are FRNs, leaving us about £1.2 billion of either gilts, deposits at the Bank of England or CDs very much at the higher end of the quality spectrum and that puts us in a very good position to be able to meet any of the requirements of the new liquidity regime that the FSA are putting in place.

So just sort of dealing with our balance sheet structure and new regulatory requirements there's going to be no material change in the foreseeable future on our economics or on our P&L or in the way we run our balance sheet.

Further question

You haven't had to hire more people on the client side for instance in Asset Management or anything like that?

Answer: Preben Prebensen

Well, I think that there's a separate issue which is probably something which would be driven by us as opposed to driven by the regulator which is that as the business grows in the bank for example and we reconfigure the structure of the business into divisions we need to support that with the right people in risk and compliance and so on. Those are decisions that we would have been making irrespective of the regulator. As we grow the Asset Management business it comes with a need for that kind of infrastructure and support but those are commercial decisions really as opposed to regulatory ones.

Concluding comments – Preben Prebensen

Any other questions? If not, thank you very much indeed. Thank you all for coming.

End