

The **Abbey National**  
Group

**2001 Autumn Business  
Statement**

## Chief Executive's Review

**"The Group has delivered a solid performance in the third quarter. Abbey National's strength across its diversified portfolio of businesses means it is well-positioned to weather the current economic uncertainty."**

### Business Overview

"Profit before tax is running comfortably ahead of last year's levels, despite uncertain market conditions. Revenues remain strong and we are on target to meet our year-end cost objectives for both the Group and the Retail Bank. We have taken a prudent stance on credit over the last two years and have been benefiting from our significant investment in credit decision-making and debt management systems. As a result, retail and consumer credit quality remains strong. The Wholesale Bank has had a strong third quarter, and profit before tax continues to run well ahead of last year's levels. In the Wholesale Bank, we have seen no significant deterioration in credit quality since the half-year, but the full impact of the heightened volatility in US markets remains uncertain.

### Business Highlights

The Retail Bank continues to compete aggressively, underlining the strength of the retail franchise. We are currently punching our weight in mortgage lending, delivering record net lending of almost £2 billion, and gross lending of £5 billion in the third quarter. With falling base rates, we have made the commitment to protect savers – and in response to recent Bank of England rate cuts have been true to this promise. In the third quarter alone we achieved over £0.8 billion of retail deposit inflows, bringing the year to date total to over £2 billion across the Group.

The Wholesale Bank recently opened a US branch and we are already seeing significant benefits in terms of the level and cost of funding. On 8 October, we announced the appointment of Mark Pain as the new Managing Director of Wholesale Banking. Mark takes over a strong business from his predecessor Gareth Jones - a business that will continue to represent an important growth area for the Abbey National Group, and will focus on those areas that deliver attractive returns to shareholders, whilst optimising the use of capital and enhancing the quality of earnings.

Life Assurance new business premiums are slightly ahead of last year's record levels, despite the impact of volatile equity markets and a sharp reduction in single premium business in line with the industry. However, in First National, the retail finance and motor finance markets have deteriorated, with volumes and margins depressed. We are continuing to compete selectively, paying particular attention to credit quality, and as a result, asset balances are down and we expect full year profit before tax from First National as a whole to be around 60% of last year's levels.

### Business Development

In the Retail Bank, our internal branch-franchising pilot has been a resounding success, and we have extended it to cover one-third of the network. The pilot of our new SME banking proposition will be launched in the next few weeks, and will include overdraft facilities, supported by newly developed telephone and internet banking systems, as well as asset financing solutions to all forms of business customers. We completed the acquisition of Scottish Provident on 1 August. We are already benefiting from the increased breadth of our life assurance portfolio, and in the light of recent stock market volatility have seen sales of the Scottish Provident protection product increase markedly."

**Ian Harley**

## **Summary of Operating Results by Business**

### **Retail Banking**

- .. punching our weight in the mortgage market ...* In the third quarter, gross lending of £5 billion was over 50% higher than in the same period last year, capital repayments have again been kept well below our stock share and, at approaching £2 billion, net lending was at record levels. New business margins have increased in the third quarter, and currently, 75% of new business written is into flexible products. We expect our full year net lending market share to be around 10%.
- .. strong deposit inflows...* At a Group level, retail deposit net inflows were £0.8 billion in the third quarter, boosting year-to-date inflows to over £2 billion. This reflects the breadth of our savings portfolio, and early signs of a return to cash-based savings in response to equity market volatility.
- .. on track to exceed Retail spread target...* The full year Retail Banking spread is expected to exceed the 175-180 basis points range targeted at the beginning of the year.
- .. a real alternative in personal banking ...* We are also making an impact in markets previously dominated by the big four banks. We have maintained the pace set in the first six months of the year, and have seen full bank account openings of 280,000, 70% ahead of the same period last year. This has been boosted by a wider product portfolio targeting the youth, new-to-work and graduate markets. The total current account base is up 8% since we launched our attack on this market in September last year. The unsecured personal loan asset is now 12% higher than a year ago, driven by record levels of gross lending.
- On 9 July, the Abbey National branded MBNA credit card was launched, and to date over 85,000 new account applications have been approved. More recently, a student credit card has been launched to complement our student banking portfolio.
- .. robust profitability in Abbey National Life ...* Abbey National Life new business premiums have fallen in comparison to a very strong second quarter, reflecting the impact of volatile equity markets on consumer confidence and a sharp reduction in single premium ISA business in line with the industry. Despite this impact, profitability remains robust.
- .. meeting cost targets...* The Retail Bank is continuing to improve its underlying operating efficiency, and fully expects to keep costs well below 2000 levels despite ongoing investment.

### **Wholesale Banking**

- .. strong financial results and new business pipeline ...* The Wholesale Bank has had a strong third quarter, and profit before tax continues to run well ahead of the levels achieved in 2000. The strength of the results reflects the breadth of activities, the sound business mix and the global reach of the funding franchise.
- The new business pipeline is strong and we remain well positioned in attractive growth markets. Earnings growth continues to be driven by the Asset Financing and Securities Financing businesses. We believe there will continue to be value-enhancing opportunities through selective acquisition of good quality assets and refinancing opportunities in the current market conditions.
- Return on equity in the third quarter has been maintained at first half levels, and operating expenditure has increased to support business growth, marginally increasing the cost: income ratio.

## **Business to Business**

- .. First National competing selectively...* Trading conditions facing First National have worsened in the second half of the year. First National has continued to pursue its policy of not competing at the expense of credit quality and consequently default levels remain satisfactory. However, the performance of the retail finance and motor finance businesses has been disappointing. The impact of reduced volumes and margins in these businesses is likely to result in current year profit before tax for First National falling to around 60% of last year's levels.
- .. strong growth of Business Finance operation ...* The Consumer Finance division continues to perform well and the Business Finance operation is rapidly increasing its market presence. It has now opened over 50,000 business accounts, up 60% on last year, and deposit balances are in excess of £2 billion, increasing by 48% in the current year alone. Lending in all other areas is also running above last year, and we remain optimistic about prospects in Business Finance.
- .. motor point-of-sale finance market down 10% ...* The overall market for both new and used car point-of-sale finance has fallen in size by 10% year-on-year. As a result, profitability has been impacted as assets have fallen, and margins have not recovered as expected.
- .. point-of-sale retail finance market down 15%...* The retail point-of-sale finance business has also suffered volume reduction, largely reflecting the contraction of the PC and accessories market. The point-of-sale credit market is down some 15% on 2000, and this is reflected in asset balances and pressure on margins. Investment in the business has in part offset this impact, delivering better credit quality, lower provisions and lower overheads.
- .. Scottish Mutual new business levels 8% ahead of last year ...* Scottish Mutual new business sales (excluding Scottish Provident) are 8% higher than in the same period last year, boosted by single and regular premium pension sales as well as particularly strong growth through Scottish Mutual International where volumes are up 55%. Despite market conditions and margin pressures, profitability in these businesses remains strong.
- .. award winning life assurance portfolio ...* The Scottish Provident acquisition was successfully completed on 1 August 2001. Sales are already benefiting from the enhanced branding proposition as part of the Abbey National Group. The enlarged individual protection product range, now re-branded Scottish Provident, has continued to perform well in the IFA channel given the depressed equity markets, and further expansion into international territories is well under way. The Scottish Provident range recently picked up six awards at the prestigious Planned Savings Awards for Product Excellence.

## **Business to Consumer**

- .. strong retail deposit growth ...* Deposit balances are now in excess of £9 billion, boosted by the acquisition of Fleming Premier Banking, but also by strong net inflows into cahoot and Abbey National Offshore. Total deposits are up over 80% since the start of 2001.
- .. targeted 200,000 accounts already achieved by cahoot ...* cahoot has already exceeded its target for the year, with over 250,000 accounts now accepted, and over 20,000 unsecured loan applications approved. In September, a range of structured savings accounts was added to the product range.
- .. Inscape building market presence ...* Inscape is continuing to build its presence, but equity market conditions continue to impact on customer recruitment.

## **Credit Management**

*.. Retail Bank ...* Credit quality in the mortgage book remains strong. Mortgage arrears and repossessions are at their lowest levels for a decade, with the number of cases more than three months in arrears now below 20,000, a 12% reduction from the end of last year.

The lending mix is also improving, with loan to value lending of over 90% now significantly lower than a year ago. This is, in part, a reflection of the reduced proportion of first time buyer business, now at 28% compared with 39% two years ago.

With interest rates at their lowest point since 1964 and unemployment at low levels, the economic backdrop remains positive.

Bank account and unsecured lending credit quality is robust, with arrears growth below or in line with the growth of these books. The new credit card alliance with MBNA has removed the credit risk associated with this asset.

*.. First National ...* In First National, credit quality remains satisfactory. The business has invested heavily in its debt management systems, and for some 15 months, it has taken a discerning approach to new business, refusing to compete at the expense of credit quality. As a result, the level of provisions as a proportion of assets has remained constant.

*.. Wholesale Bank ...* Within the Wholesale Bank, we have seen no significant deterioration in the performance of our assets since the half-year. However, the economic outlook remains uncertain.

The diverse geographic spread and sector mix of the portfolio remains unchanged, with over 93% of the balance sheet at investment grade. Investment in high yield securities is lower than at the interim results, with around 65% of this portfolio attracting a credit rating of BB or above.

## **Capital Management**

*.. capital update...* Following the acquisition of Scottish Provident, the Group's tier 1 ratio stands at 8.6%. The Group has sufficient capital to support business growth and comfortably accommodated the recent equity market volatility.

## **Business Development**

- .. award winning Retail Banking...* By the year end, a total of 22 new-look stores across the UK will have been rolled out, 19 of which will include a Costa coffee shop as part of our ongoing strategic partnership. Our 'superstores' reaffirm our commitment to place high street banking at the heart of our integrated 'bricks and clicks' approach. These formats offer customers a completely fresh and innovative retail environment with an e-commerce discovery zone, customer lounge, kid's play area and child friendly interview rooms. Our flagship Croydon branch received the 'Retail Innovation' award in the Retail Innovators Awards 2001, acknowledging not only the concept, but also the fundamental reassessment of our retailing proposition – making us the first bank ever to be nominated, let alone to win.
- .. successful branch franchising pilot extended ...* A third of our branch network has now been internally franchised, with rollout continuing into the fourth quarter. The combination of entrepreneurial drive and local market knowledge is consistently generating significant sales uplift. In a new phase beginning in November, four local markets will transfer to new subsidiaries for a one-year trial of external franchising. Abbey National will retain responsibility for credit quality and compliance, and will continue to enforce service standards on the franchised areas to protect the brand and customer experience.
- .. business banking initiative progresses ...* Plans are on track to offer our new current account service for SMEs to selected customers over the next few weeks, with a wider launch planned by the end of the year. The new service will include overdraft facilities and a newly developed telephone and internet banking system. The enhanced offering will enable a wider range of small and medium sized businesses to benefit from in-credit interest and competitive banking, including indefinite free banking. This represents a highly attractive offering targeting new customers and further supporting our rapid expansion in the business market – a market that is ripe for change.
- .. e-commerce update...* Over one million customers are now registered to the Retail e-banking service. This channel has already generated more than 200,000 product applications. Through cahoot, accounts accepted now exceed 250,000, including structured savings and unsecured loan accounts. Across the Group, we now have over 13,000 introducers doing business with us online, including over 11,000 mortgage introducers through which over £5 billion of mortgage agreements in principle have been given since its launch 12 months ago.
- .. strategic alliances delivering ...* Our strategic alliances with MBNA, EDS and Capita Eastgate are delivering immediate cost savings and service improvements in the Retail Bank. Our new home insurance proposition, allowing us to sell from a panel of insurers, has now been launched online, with a telephone version following next year.
- ..Scottish Provident acquisition completed in August ...* Competition in the protection market has increased in 2001 and there has been, as expected, an element of margin compression. Despite the inevitable disruption of an 11 month de-mutualisation process, Scottish Provident has maintained a leading position in the IFA channel and integration is progressing well, with management of this business now fully integrated. We remain confident of achieving the targeted £55 million cost synergies and of extracting revenue benefits from the enlarged Group.
- ..the Wholesale Bank opens a US office in Connecticut ...* The Wholesale Bank continued to develop its international presence with the establishment of a US branch at the beginning of October. A broker-dealer will also be established in the fourth quarter. These developments represent important steps in the continued evolution of the business by gaining even better access to the deep and liquid US financing markets.

### **Forward-looking statements**

This document contains certain “forward-looking statements” with respect to certain of Abbey National’s plans and its current goals and expectations relating to its future financial condition, performance and results. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances which are beyond Abbey National’s control including among other things, UK domestic and global economic and business conditions, market related risks such as fluctuations in interest rates and exchange rates, the policies and actions of regulatory authorities, the impact of competition, inflation, deflation, the timing, impact and other uncertainties of future acquisitions or combinations within relevant industries, as well as the impact of tax and other legislation and other regulations in the jurisdictions in which Abbey National and its affiliates operate. As a result, Abbey National’s actual future financial condition, performance and results may differ materially from the plans, goals, and expectations set forth in Abbey National’s forward-looking statements.

### **Additional Information**

A version of this statement is available at the Abbey National Group website:  
[www.abbeynational.com](http://www.abbeynational.com)

A version of the June 2001 Retail Banking presentation is available at the Abbey National Group website:  
[www.abbeynational.com](http://www.abbeynational.com)

A version of the April 2001 Wholesale Banking presentation is available at the Wholesale Bank’s website:  
[www.ants.co.uk](http://www.ants.co.uk)

### **Diary Dates**

2001	Pre-close Statement	10 December 2001
2001	Preliminary full year results	21 February 2002
2002	Interim results	24 July 2002

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