Chairman's statement

"Provident Financial prides itself on its 140 year history of providing valued customers with access to credit where others will not. Recent events have demonstrated a need to refresh the group's direction, focus and culture.

Stuart Sinclair
Interim Non-Executive Chairman

Provident Financial prides itself on its 140 year history of providing valued customers with access to credit where others will not. We deeply regret the impact that recent events have had on customers and shareholders which clearly demonstrate the need to refresh the group's direction, focus and culture. The Board firmly believe that the group continues to have an important role to play in serving customers responsibly in the non-standard credit market, and that it can do so whilst providing an attractive return to shareholders. However, in order to do this, there is a need to restore the group's capital base.

On 27 February 2018, the group agreed a settlement with the FCA on its investigation into Vanquis Bank's ROP. The agreed settlement relates to a failure by Vanquis Bank to disclose in its sales calls that the charges for ROP would be treated as a purchase transaction and therefore potentially incur interest. Vanquis Bank will refund those customers with the interest element of ROP charges in the period between inception of the product in 2003 and the communication to ROP customers which was conducted in December 2016. The total cost of settlement is estimated to be £172.1m and has been reflected as an exceptional cost in the 2017 results. The settlement comprises balance reductions for existing customers, cash refunds, a higher expected forward flow of ROP complaints more generally in respect of which compensation may have to be paid, costs of administering the settlement and an FCA fine. Vanquis Bank will be working with the FCA on a plan to resume sales of ROP to new customers.

Manjit Wolstenholme

Everyone at Provident Financial was shocked and deeply saddened at the sudden death of Executive Chairman Manjit Wolstenholme on 23 November 2017. It was a great privilege to know her personally and to work alongside her over the last few years. She showed exceptional leadership in stepping up to the role of Executive Chairman in the months leading up to her death. Manjit was known and respected for her achievements and championing diversity in British business, and we would like to pay tribute to her contribution to the business landscape. Her passion, belief and commitment for the role PFG plays in customers' lives was unwavering and we owe her a huge debt of gratitude.

Moneybarn continues to cooperate with the FCA in its ongoing investigation into affordability, forbearance and termination options. The scope of the investigation is understood and the estimated cost of £20.0m, being management's prudent estimate of the expected outcome in respect of the investigation, has been reflected as an exceptional cost in the 2017 results. A final resolution to the investigation is likely to take up to 24 months.

Following the operational disruption in home credit as a result of the poorly executed migration to the new operating model and the estimated costs of resolving the FCA investigations, the group's CET 1 capital ratio reduced to 14.5% as at 31 December 2017, which is below the group's regulatory capital requirements set by the Prudential Regulation Authority (PRA). In addition, the group has agreed a revised regulatory capital requirement with the PRA. This has resulted in the group's total regulatory capital requirement increasing, primarily due to an increase of approximately £100m in respect of conduct and operational risk assessments.

Following a thorough review of the various options available to the group to improve its capital position in light of the group's short and medium-term priorities, the Board has decided to pursue a fully underwritten rights issue and a prospectus will be issued later today. The group is seeking to raise additional capital of approximately £300.0m (£331m gross proceeds before deduction of expenses of £31m) through the proposed rights issue, which is subject to shareholder approval at a general meeting on 21 March 2018. Full details of the rights issue are provided in a separate prospectus.

The net proceeds of the proposed rights issue will ensure that the group has appropriate levels of regulatory capital to meet its current and future regulatory capital requirements as well as ensure its balance sheet is strengthened with the appropriate level of buffers in order to enable it to pursue underlying organic growth opportunities. In addition, the Board believes that this level of capital is aligned with leverage expectations for investment grade credit status and as such, the group expects to re-establish normal access to funding from the bank and debt capital markets. Taking into account the receipt of the net proceeds of the proposed rights issue and the intended use of proceeds, on a pro forma unaudited basis the CET 1 capital ratios of the group and Vanquis Bank would have been 28.7% and 25.4% respectively, up from 14.5% and 21.6% respectively at 31 December 2017.

The company expects to use the net cash proceeds of the proposed rights issue to: (i) inject approximately £50m into Vanquis Bank by way of a subscription of equity as an additional management buffer; (ii) repay an £85m bridge facility provided by Barclays Bank plc and JP Morgan Securities in February 2018 which will be used to allow Vanquis Bank to draw down £85m under an intercompany term loan facility between the group and Vanquis Bank, reducing the reliance of Vanquis Bank on Provident Financial plc; and (iii) create £165m of additional liquidity headroom by either holding cash on deposit or repaying amounts due under the syndicated revolving credit facility.

The Board continues to believe in the strong growth opportunities available to the group's attractive businesses and aims to leverage the rights issue and its revised strategy to build a robust foundation for the long-term strength of the group. The Board remains confident of the group's underlying prospects and value, and is committed to restoring sustainable earnings growth and reliable operational performance, together contributing to attractive future shareholder returns.

Developments over the last 12 months

On 28 February 2017, the group announced developments to the home credit business's operating model that focused on changing from a self-employed agency model to an employed workforce, aimed at delivering a more efficient and effective business. The proposals were intended to enhance the home credit operating model by: (i) serving customers through full-time employed Customer Experience Managers (CEMs) rather than self-employed agents to take direct control of all aspects of the relationship with the customer; (ii) changing the field management structure in the UK, with newly defined roles and ways of working; and (iii) developing further technology to improve efficiency and effectiveness. The migration to the new home credit operating model, with more centralised control over a distributed workforce and greater evidencing of customer interactions through voice recording technology (currently unique to Provident in the home credit sector), was also intended to enhance regulatory standards. It sought to achieve this by improving first line oversight of field staff through more consistent evidencing of interactions with customers than might be the case in circumstances where dual visits (when self-employed agents were accompanied by field management to monitor the interaction between the agent and the customer for regulatory purposes) and apps are utilised to perform the same function.

On 20 June 2017, the group provided an update on the transition to the new home credit operating model indicating that operational disruption associated with the transition was higher than anticipated, with agent attrition rates and vacancy levels adversely impacting collections, sales penetration, customer retention and profits. At that time, it was expected that collections would normalise after the transitional period but the disruption relating to the transition to

Chairman's statement continued

Over the last six months, the group has:

- Conducted a search to identify suitably qualified candidates for the role of group Chief Executive Officer. On 2 February 2018, the group announced the appointment of Malcolm Le May as group Chief Executive Officer. In making this decision, the Board has consulted with, and received support from, certain of the group's leading shareholders, as well as discussing his appointment with the FCA. The Board firmly believes that under Malcolm's leadership the group can once again return to delivering attractive returns for shareholders whilst establishing strong relationships with all the group's stakeholders, including customers and regulators;
- Undertaken a review to clearly understand the root causes of the issues in deploying the new operating model in the home credit business which included insufficient recognition of the importance of the front line customer relationship to the performance of the business. In addition, an inflexible approach was adopted in implementing the new operating model which lacked customer focus. These were clearly largely managerial failings in implementation, rather than fundamental flaws in the main concepts behind the new approach;
- Strengthened leadership of the home credit business through the reappointment of Chris Gillespie as Managing Director of CCD at the end of August 2017 with a mandate to improve the operating model in order to re-establish relationships with customers and restore collections and stability in the business. Chris Gillespie previously acted as Managing Director of CCD from 2007 to 2013;
- Swiftly designed and implemented the recovery plan for the home credit business based on a revised and more flexible operating model alongside a right-sizing of the cost base, with a focus on re-establishing customer service levels and relationships. The recovery plan is expected to be substantially implemented by the end of the first half of 2018;
- Assessed conduct risks and improved internal controls, including commissioning an external review of the effectiveness of CCD's first and second-lines of defence in the risk management process, as well as its governance and culture in general;
- Worked closely with the FCA to resolve the group's immediate challenges, including implementing the home credit recovery plan, improving risk management controls and oversight in CCD and to resolve fully the FCA's investigation into Vanquis Bank's ROP and to continue to cooperate with the FCA with its ongoing investigation into certain issues in Moneybarn;
- Addressed governance and culture issues more widely across the group, refocusing on the customer first. The Board has placed positive customer outcomes and enhanced regulatory engagement firmly at the centre of the group's strategy;
- Closely monitored the capital and liquidity position of the group on a consolidated basis and of Vanquis Bank on a solo basis, whilst maintaining regular and frequent dialogue with the group's bank lending group, M&G, rating agency, the PRA (primarily through Vanquis Bank) and the FCA;
- Developed a new capital plan based on revised forecasts for the group's three businesses to establish the appropriate scale and nature of resources required to execute the group's strategy and generate capital with a view to restoring the shareholder dividend as soon as possible; and
- Assessed the various options available to the group to meet the potential costs of restitution and to ensure the group has appropriate levels of regulatory capital.

the new operating model would result in 2017 full-year pre-exceptional pre-tax profits for CCD reducing to around £60m (2016: £115.2m).

On 22 August 2017, the group released a further trading update on the home credit and Vanquis Bank businesses. The disruption in the home credit business was more severe than originally anticipated, and the full year profit guidance for CCD was significantly reduced to a pre-exceptional pre-tax loss of between £80m and £120m for 2017. The group also announced that the FCA was conducting an investigation into Vanquis Bank's ROP and that in April 2016 it had agreed to enter into a voluntary requirement with the FCA to suspend all new sales of ROP and to conduct a customer contact exercise, which has since been completed. Vanquis Bank also agreed to enter into a voluntary requirement with the PRA pursuant to which it agreed not to: (i) pay dividends to or make any distribution of capital to the group; (ii) provide loans or facilities to the group; (iii) conduct non business as usual liquidity transactions which have or may have the effect of transferring any cash or assets in favour of any member of the group; or (iv) provide any security for the obligations of any member of the group, without the PRA's consent. As a result of the impact of the disruption and the investigation, the interim dividend for the 2017 financial year was withdrawn and the Board indicated that a full year 2017 dividend was unlikely, to retain liquidity and balance sheet stability (on 13 October 2017, the Board confirmed no final dividend would be paid). Under the circumstances, Peter Crook stepped down as group Chief Executive Officer and Manjit Wolstenholme assumed the role of Executive Chairman.

During this time the group continued to assess and discuss with the FCA the processes applied by Moneybarn in relation to customer affordability assessments for vehicle finance and the treatment of customers in financial difficulties. This included Moneybarn entering into a voluntary requirement with the FCA pursuant to which it agreed to amend its processes for dealing with loan terminations to ensure that customers receive information which enables them to make an informed decision as to which termination option to adopt. On 5 December 2017, however, the group was informed that the FCA had commenced an investigation into Moneybarn covering the adequacy of creditworthiness assessments as well as the treatment of customers in default or arrears with forbearance and due consideration, and the provision of information about termination processes.

As the issues above emerged during the summer of 2017, the group moved swiftly to put in place a near-term action plan focused on ensuring stability and addressing the immediate challenges. The most pressing issues were stabilising and turning around

Review of governance arrangements

The group has completed an initial review of its governance arrangements. The review has identified where enhancement and change was needed to ensure greater Board effectiveness, clarity of group purpose and divisional roles and responsibilities, and significantly improve group risk and conduct management.

Following completion of the review, the group has:

- Appointed a new group Chief Executive Officer and initiated the recruitment of a new external Chairman;
- Reaffirmed a clear purpose, vision, mission and set of values which are centred firmly on the customer, and helping them to help themselves to build brighter financial futures;
- Re-constituted a wider group Executive Committee which will play a far greater role in delivering on the group's vision and in enhancing the information flows and control between the group and its divisions;
- Brought together all its senior executive and non-executive management from the whole group to discuss where the group has fallen short and why, what the group's aspirations should be going forward, and what needs to change as a result;
- Re-initiated a clear and consistent 'tone from the top' from the Board in line with these customer-centric values that also emphasises the need to collaborate more effectively and work together across the group;
- Provided greater clarity over the roles and responsibilities of each of the divisions as well as those that exist at the broader group level, and in doing so begun to disseminate the more consistent and clear vision, mission and values more widely;
- Established a group Chief Risk Officer (CRO) role for the first time who will, once appointed, work closely with the Board and the group Chief Executive Officer to provide group-wide oversight of governance, risk and conduct and ensure that these all remain a key focus of the group and appointed an interim group CRO;
- Begun the recruitment of a number of executives to create key group functions. An interim IT Strategy & Procurement Executive has been appointed and the group also intends to appoint a Group HR Executive. These appointments are intended to improve coordination, cooperation and efficiency across the group in pursuit of the group's aims and in support of the Executive Committee;
- Initiated the recruitment of two additional new non-executive directors with directly relevant experience (and in line with a Board skills needs assessment), to work alongside the new group Chief Executive Officer to deliver on the Board's vision; and
- Begun the process of establishing a new Board committee, to be chaired by one of the new non-executive directors noted above, focusing on the customer, culture and ethics to help drive changes in behaviours and attitudes across the group.

The changes listed above have already been implemented or initiated. Additional changes are planned in the longer-term through to 2020 in order to continue to refocus the culture on the customer first thereby improving regulatory compliance, and the group will reassess its structure to ensure the changes made endure.

the performance of the home credit business, reaching a resolution with the FCA in relation to its investigation into ROP in Vanquis Bank, continuing to cooperate with the FCA with its ongoing investigation into Moneybarn and ensuring that the group's capital base and liquidity were appropriate to rebuild the business.

During this time, while working to push forward these actions Manjit Wolstenholme tragically died suddenly on 23 November 2017. Malcolm Le May assumed the role of Interim Executive Chairman until his appointment on 2 February 2018 as group Chief Executive Officer. I was appointed as Interim Chairman on 2 February 2018 pending the completion of the group's search for a new external Chairman.

On 16 January 2018, the group released a trading update which disclosed the expectation of a pre-exceptional pre-tax loss for CCD of approximately £120m, consistent with the upper end of the guidance previously issued on 22 August 2017. Although the actions taken by management had delivered a significant improvement in customer service and operational performance in the home credit business since August 2017, the rate of reconnection with those home credit customers whose relationship had been adversely impacted following the poorly executed migration to the new operating model in July 2017 was at the lower end of expectations through the fourth quarter of 2017.

As part of an ongoing process of reviewing its cost base, the home credit business announced at this time a proposed rationalisation of its central support functions which is subject to workforce consultation. This is a necessary step to align the cost base to the reduced size of the business. In addition, the business expects to secure improvements in the effectiveness and efficiency of the field organisation as the new business model continues to be embedded. However, customer facing resource is being managed very carefully in order to ensure that further improvements in customer service are delivered.

Culture and governance

Provident Financial was founded 140 years ago with a clear social purpose of providing much valued access to credit for customers in the non-standard credit market who often find themselves ignored or under-served by mainstream lenders. The group's customers, who come from many different walks of life, have always valued highly the way the group provides access to credit closely tailored to their needs and the realities of their lives, often involving smaller sums, shorter terms and more flexible repayment options. Customers on modest and less predictable incomes want, and deserve, access to credit to help them cope with everyday challenges, and to allow them to participate fully in the traditional and online economies.

Recent events have demonstrated that although the group's intentions were good in what it was seeking to do for customers, the delivery methods and the culture and governance around them have not always been at the high standards which should have been expected. As a result of these shortcomings, it is clear to the Board that the group needs to address culture and governance, refocusing on the customer first, thereby improving regulatory compliance and as a result begin to rebuild and enhance its reputation with regulators. Malcolm Le May has a clear agenda of engagement to address these issues that the Board is fully supportive of.

Chairman's statement continued

Our values:

Collaborative

We work together to deliver better outcomes for our customers and hold ourselves accountable.

Fair

We are decent, fair and reasonable in our dealings with all stakeholders and treat everyone with respect.

Responsible

We conduct our business dealings responsibly and ensure we have a positive impact on the environment and communities we serve.

Accessible

We provide our customers with access to products which meet their evolving needs and help them to help themselves.

Straightforward

We are straightforward, transparent, open and honest in all our dealings, building trusting relationships.

Progressive

We are innovative and help our customers anticipate and respond to the challenges of a changing world to build brighter financial futures.

The group plans to realign its culture more closely to the developing needs of the customer, and to better coordinate and cooperate internally across businesses to deliver better customer outcomes more efficiently as a result. More specifically, the group will focus on helping customers on their creditworthiness journey, where possible helping them to help themselves build brighter financial futures, using all its resources and offers, going beyond granting the much valued financial inclusion to as many people as is responsible within each area of the group.

Remuneration has an important part to play in realigning the group's culture. The group plans to continue to operate within the constraints of the remuneration policy approved by shareholders at the 2017 AGM. However, in light of recent events, and the latest shareholder feedback, in the short-term director remuneration has been reduced so as to operate well within the parameters of the current policy. In addition to reducing the level of pension and benefits for new executive director appointments, there will be no further grants of matching shares under the performance share plan (PSP), although part of the annual bonus will continue to be deferred for three years. For awards under the Long Term Incentive Scheme (LTIS), the group plans to change the performance condition from absolute Total Shareholder Return (TSR) to a more common relative TSR metric, in relation to a suitable comparator group for all new grants. LTIS awards and the annual bonus will also be subject to a more rounded set of metrics designed to improve culture and performance by focusing on risk, balance sheet and customer performance indicators. Furthermore, the group will introduce a post-vesting sale restriction period of two years to all new LTIS grants, and have enhanced the withholding (malus) and recovery (clawback) provisions currently in place. In the longer-term, the group will work with external advisors to develop a more comprehensive balanced scorecard approach to performance management with an appropriate balance of financial, customer, risk and strategic metrics which is reflected in a revised executive remuneration policy to support the group's desired culture and approach to greater coordination of group resources for the benefit of customers. In due course, any proposed new remuneration policy will be discussed fully with shareholders and submitted for their approval thereafter at a subsequent AGM.

Given the position of the group in the non-standard credit sector, there is an opportunity and an expectation that the group will lead by example, becoming a true champion for less creditworthy customers and taking positive steps to help them. The group plans to leverage the newly established role of the group CRO (once appointed) to champion the interests of the customer internally and thereby begin to transform the nature of interactions with regulators and provide greater consistency and coordination across the group's regulated businesses. The group has begun to build and staff a group risk and compliance function for the first time under the leadership of the interim group CRO. This new function will lead the design and implementation of the governance and risk management changes required, and improve group oversight of divisional risk and compliance functions. The interim group CRO is, and once appointed, the permanent group CRO will be, responsible for maintaining involvement in all regulatory interactions across the group so as to ensure consistency with the culture, direction and risk appetite set by the Board, reflecting the greater importance being placed on the group's key regulatory relationships.

Having taken action to strengthen governance in the short-term, the Board believes that the group is well placed to address the longer-term matter of implementing an appropriate corporate structure, including the nature and interaction of the regulated entities within the group. The group, under the direction of the new group Chief Executive Officer, Malcolm Le May, will consider all opportunities to improve coordination and organisation of resources to deliver better customer outcomes and regulatory interactions in a more effective and efficient manner. In evaluating these opportunities, the group aims to carefully balance the benefits and advantages of any changes with the costs and risks involved, in light of the need to continue to grow the group's businesses and adapt to the changing external environment.

Board changes

The Board appointed Malcolm Le May as group Chief Executive Officer from 1 February 2018. This follows a Board process which I led over recent months. I believe that Malcolm Le May is an outstanding candidate for the role, given his existing knowledge of the group, his deep knowledge of the business and sector, his regulatory understanding and turn-around and leadership skills. In making this decision, the Board has consulted with certain of its leading shareholders and discussed his appointment with the FCA.

David Sear joined the Board on 1 January 2017 to assist with the development of the group's strategy for the broad IT direction. The group now finds itself in very different circumstances and with different strategic priorities and he therefore resigned with effect from 26 January 2018 .

The group has investigated a process to appoint a new external Chairman as well as two additional non-executive directors as soon as practicable.

Closing remarks

Our priorities for 2018 are to rebuild trust with our customers, regulators, shareholders and employees which, Malcolm will discuss further in his Chief Executive Officer's review.

2017 has been a very challenging year but in recent months we have made good progress in resolving our regulatory uncertainties and the turnaround of the home credit business. I would like to thank all our employees for their continuing hard work and dedication throughout this difficult period for the group.

Stuart Sinclair
Interim Non-Executive Chairman
27 February 2018