Summary Financial Statement 2013

PRINCIPALITY
BUILDING SOCIETY

Summary financial statement for the year ended 31 December 2013

This financial statement is a summary of information in the audited Annual Accounts, the Directors' Report and Annual Business Statement, all of which will be available to Members and depositors free of charge on demand at every office of Principality Building Society and on the internet at principality.co.uk from 3 April 2014.

Approved by the Board of Directors on 4 February 2014 and signed on its behalf by:

Dyfrig D.J. John	Chairman
Graeme H. Yorston	Director and Group Chief Executive
Stephen Hughes	Group Finance Director

Summary Directors' Report

Strategy and business review

Strategy

Principality is a Welsh financial services institution with a UK focused retail mortgages and savings business model at its core. This model is supplemented with the provision of other complementary products and services. The Principality Group also incorporates a UK commercial lending business and a second charge residential lending business. The current Group strategy is based on two components:

- Strengthening the Member offering by providing a sector leading service to Members and customers; and
- Growing the Society's residential first charge mortgage portfolio. Income in the second charge residential lending portfolio will be optimised whilst risk is reduced in the commercial lending portfolio.

This strategy resonates with our core purpose as a building society established over 150 years ago – to provide safety and protection for Members' funds whilst helping other Members to own their own homes.

Business review

In a year where the economy has shown increasing signs of recovery, Principality has continued to grow both profitability and mortgage assets. In 2013, we achieved a profit before tax of £28.7m (2012: £25.7m restated), further consolidating our already strong Tier 1 capital position. The Society has increased mortgage lending by 10.7%, and we are now the sixth largest building society in the UK with assets at £7.1bn. We have increased overall lending by 5.6%, grown our mortgage market share of first-time buyers in Wales, delivered value to loyal Members and created 58 new jobs to help stimulate the local economy.

There is growing evidence that market stimulants have been successful in aiding economic recovery. While borrowers are experiencing greatly improved access to mortgage funding, we recognised that this was still difficult for some. The launch of our 95% mortgage in early 2013 has helped over 600 first-time buyers and home movers overcome the deposit barrier. Furthermore, we have worked closely with the Welsh Government towards the successful launch of Help to Buy - Wales, making mortgages available to home buyers who are purchasing a new-build property and who meet the Help to Buy - Wales scheme criteria.

Nevertheless, the result of a volatile housing market over the past few years has been a structural shift in the number of people aspiring to own their own home. The average age of a first-time buyer has increased, and this means that the rental market now has a much stronger role to play in the provision of housing. Recognising this, we have responded and supported the buy-to-let mortgage market, helping to ensure that landlords can continue to meet the demand of this new generation.

The question of whether this is a sustainable recovery however, remains. Fundamentally there is an imbalance between housing supply and demand, and there is not adequate provision now or planned for the future to meet the expected growth in demand. This imbalance will, until addressed, continue to underpin the house pricing structure for a number of years to come. While the housing market may appear resilient, there are still obstacles to overcome, particularly as we look to the future when support schemes will begin to draw to a close. In light of this, we will continue to focus on high quality, prudent lending, concentrating on ensuring that borrowers are able to afford their mortgage both now and in the years to come.

Recognising that the growth in internet and mobile application use is changing the way that customers behave, we believe that offering customers a way to do business through the channel of their choice is becoming an expectation rather than a differentiator, and combining these channels seamlessly is critical to future success. We believe that our 70 strong branch and agency network across Wales and the borders is a vital part of this multi-channel approach, but we must foster the essence of this and translate it for the digital age. Over the last year we have made progress improving functionality across our website to help customers better manage their accounts online. There is still much to do within this area, and we remain focused on moving our business forward to embrace the modern world of money and help further simplify banking for our customers. We recognise that many of our customers do value the traditional branch service that we offer, and this remains an important part of what we will continue to provide.

2013 trading highlights

- 6th largest building society in the UK
- £28.7m profit before tax
- Over £7bn total assets
- Net retail mortgage growth of 10.7%
- Our 95% LTV mortgage helped over 600 home buyers
- Society gross mortgage lending of £1.1bn
- IRB status achieved during the year
- Most recommended savings provider in Wales.[1]

Our balance sheet remains strong with appropriate provisions, high quality assets and diversified funding. We have continued to invest in improving our infrastructure and capabilities to deliver our business strategy. We have stayed true to our core principles of providing a secure home for savings and helping people to buy homes, as well as continuing to play an important role in supporting the housing market in Wales.

Group overview

In the current market conditions we understand the frustration keenly felt by savers. Our savers are hugely important to us as a business, and as a management team we have frequent discussions around how we can protect our loyal customers against the backdrop of a low interest rate environment. We have stayed reliant on retail savings for funding, paying above the average market rate on the high street for the past year. We positioned our Promise Saver as the leading account on the high street and rewarded over 6,000 Members through our loyalty bond. Above all we are focused on delivering outstanding levels of service, and I am pleased to report that we were awarded Best Internet Account Provider in the Moneyfacts 2013 Awards for our consistently competitive rates and straightforward approach. We have also maintained our position as Wales' most recommended savings provider.[1]

In 2014 there will be another significant change in regulation with the implementation of the Mortgage Market Review. This requires that customers satisfy lenders that they can afford the mortgage, and most interactive sales (for example face to face and telephone) must be advised. We are well advanced with our preparations for this, which will represent the biggest change in the market since 2004. As a responsible lender we have, for some time, been acting in accordance with a number of the changes, but there is no doubt that the additional changes will increase costs and complexity in our business which will ultimately have to be met.

During 2013 we received recognition from the regulator for our expert risk management capability in the form of approval to use the Internal Ratings Based approach (IRB). We believe that we are the first financial institution in the UK to be granted this since the onslaught of the credit crisis. We are one of only three building societies to have received this approval, and this demonstrates the level of confidence in Principality and the management team.

The Group is undertaking a detailed and comprehensive review of processes and documentation in relation to compliance with consumer credit legislation which commenced in the second half of 2013 and is planned to be completed during the first half of 2014. To date a number of areas, which require further review have been identified and a charge of £8.0m has been recognised in respect of potential costs which will require remediation over the next 12 months. The provision assumes almost all customers being contactable. For each 10% decrease in customers will be contactable, the provision required would decrease by £0.8m.

All of our Group businesses play an important role in overall Group performance. Peter Alan Estate Agents in particular has delivered an exceptional performance. House sales have increased by 17%, reflecting the improving confidence in the housing market. Recognising the growth in the lettings sector, we have also developed a very successful lettings agency business which has now become South Wales' biggest lettings agent, following the acquisition of Mead Property Management and Thomas George Lettings Agent in Cardiff.

Our newest division of Peter Alan, pa black, has seen a 64% increase in sales year on year with an increased market share. We are delighted that our success in this sector has been recognised as Peter Alan was awarded The Sunday Times Estate Agent Award for Best Wales Estate Agency for the third consecutive year.

Our secured personal loans business, Nemo Personal Finance, has also performed very strongly, fulfilling an important role in helping consumers manage their finances more effectively, despite an impairment provisions charge of £5.3m (2012: £3.5m) and the £8.0m already mentioned in light of potential costs in relation to a review of compliance with consumer credit legislation. After these provisions, Nemo delivered a profit before tax of £16.4m (2012: £16.0m). Nemo is widely recognised as a leading player in the UK, and as the economy recovers and banks complete the restructuring of their balance sheets, we are seeing increased competition in this space. Despite this, I am confident that Nemo will continue to play a key role going forward and is very well placed to cope with competition and increasing regulatory changes that are set to be implemented over the next 12 to 24 months.

Reflecting the negative sentiment towards commercial property and the uncertainty surrounding the economic outlook for this

[1] Source: GfK NOP Financial Research Survey (FRS), 12 months ending September 2013, NPS score of savings customers in Wales, answering likelihood to recommend, c. 2,400 adults. Competitor list includes the following: Barclays, Halifax, HSBC, Lloyds TSB, NatWest, Nationwide, NS&I, Santander

sector, we have made provisions of £16.7m in the year. We think that perhaps a corner has been turned in the commercial market, and with this we anticipate an improved performance in 2014. Focus is maintained on all loans experiencing difficulty to ensure positions are tightly managed and the potential for losses arising is realistically and conservatively assessed. Joint action plans are implemented with borrowers wherever possible to minimise the likelihood and extent of defaults. There are no arrears in respect of lending to Registered Social Landlords.

Member focus and having your say

We recognise that by investing time in our Members, we can understand how best to meet their needs. Our Customer Insight team is dedicated to increasing our understanding of what our customers want so we can drive our business decisions in the right way for our Members.

We develop this understanding in several ways – by seeing patterns in behaviour and trying to anticipate Members' next steps when we see consistent trends occurring, and also through an extensive programme which enables us to talk to our Members directly. We have a panel of 5,000 Members who regularly take time out to give us feedback on many aspects of our business. Whenever we write new literature explaining our products, for example, we will ask our Member panel whether we have been clear enough and whether there is anything we can do to improve it further. In addition, we hold regular "Talkback" events around Wales to which all of our Members are welcome, and attended by our senior leadership team. These provide Members with the opportunity to hear about our business performance and also to have their say on what they love about Principality and what they would like to see improved.

In 2013, we established a Customer Experience team, tasked with identifying ways to improve our already strong Member and customer service standards. Talking and listening with our Members and acting on what they tell us is key to that improvement, and during 2013 we held four Member Forums and four Member Talkback sessions to allow Members to meet our senior management team and to ensure that the voices of our Members are heard. Thank you to everyone who participated in these events.

Mutuality, community and heritage

The mutual sector has a critical part to play in supporting the UK economy. Across the UK, mutual deposit takers and lenders have assets of over £300 billion. We strongly believe in the benefits of being a mutual organisation owned by you, our Members, and welcome the opportunity that this has given us to support the Welsh economy and the communities in which we live and work. In 2013, we have built on that strong foundation through our continued support of sustainable and affordable housing initiatives. We continue to support The Mill development at Ely Bridge, Cardiff – a scheme to transform 53 acres of urban wasteland into an innovative £100m housing development. We also continue to work with Welsh housing associations – this year saw the 10th anniversary of our partnership with Valleys to Coast in Bridgend, the first stock transfer of social housing in Wales, which has enabled thousands of families to be housed in good quality homes. We have supported and introduced initiatives to ensure that people across Wales are able to own their own homes. In May, nearly 14% of first time buyers in Wales chose Principality as their lender, and we supported the Welsh Government in introducing the Help-to-Buy Wales scheme in November. All of this has been bolstered by the tremendous effort that the people who work for this organisation put in to support local charities and community projects. That has ranged from members of our arrears team redecorating Rhoose Community Centre, to colleagues helping bring a pond back into use at Whitchurch Primary School.

At Principality, we are immensely proud of our Welsh heritage and culture and have adopted a wide ranging sponsorship programme that allows us to help celebrate sports, the arts and culture in Wales. We have been sponsors of Principality Premiership rugby since 2005, continue to support the National Eisteddfod and since 2012 sponsored Access all Eirias, a major music festival held in North Wales. We were delighted to sponsor two major farming awards – the NFU Cymru/Principality Welsh Rural Community Champion and the NFU Cymru/Principality Wales Woman Farmer of the Year. These awards recognise the hard work of Welsh farmers in helping their local communities and the huge contribution that women in farming make to rural life in Wales.

The Society's Charity of the Year in 2013 was British Heart Foundation Cymru, and we have raised over £60k, a record for the Society. This donation will be invested back into Wales through the foundation's "No Time to Wait" appeal, helping to buy more life-saving defibrillators and training people in emergency skills. We would like to thank everyone who has participated in these events ranging from sponsored cycles to cake sales and to those who sponsored people to achieve this fantastic contribution to the charity.

Your board

The strength of an organisation's Board is critical to the strength and continued success of the organisation, and Principality is no exception. In a year where the Boards of a number of organisations have come under intense criticism, you can be assured that Principality has a Board of the highest calibre and is utterly committed to protecting your interests for the future. In early 2013, two new executive directors were appointed. Stephen Hughes stepped up from the role of Deputy Group Finance Director to become Group Finance Director and Michael Jones, Director of Risk, who has been with the Society for over 16 years, was appointed Group Risk Director. Guy Thomas became Group Chief Operating Officer. These are key appointments, and all three of them bring great depth of skill and knowledge. There have also been some changes among non-executive directors. Christopher Jones and Keith Brooks stepped down from the Board in April and September after serving seven and six years respectively. Everyone at Principality would like to thank them for their contribution to the success of the Group over that time.

We have recruited two new non-executive directors, Laurence Adams and Nigel Annett, whose skills and experience will enhance and strengthen your Board further and we welcome them both. Laurence has extensive experience of working in financial services and Nigel's background in a highly regulated environment will serve us well as the regulator makes continuing demands on the Group. As our Chairman, Dyfrig John, steps down from the Board in April, he expresses confidence that he leaves a strong Society focused for growth in the future.

Going concern

Having considered the plans and forecasts for the Group, the directors are satisfied that there are adequate resources and no material uncertainties that lead to significant doubt on the Group's ability to continue in business for the foreseeable future. Accordingly, the financial statements continue to be prepared on a going concern basis.

Preparing for the future

There are now sufficient signals that a recovery is underway; however challenges remain in the Eurozone and the global recovery, while upbeat, remains fragile. We also recognise that there is pressure on household income with wage inflation failing to keep pace with overall inflation, and this could reach a peak when rates inevitably start to rise, potentially putting prolonged recovery at risk. Our job at Principality is to ensure that people who borrow from us can stay in their homes for the long term, even through rising interest rates. We therefore, unashamedly, will continue to test a borrower's ability to pay their mortgage not only at the point of borrowing from us but also against this rising interest rate scenario. This will ensure that our prudent approach to lending continues and we have a sustainable business into the future as well as ensuring that as many people as possible maintain a roof over their heads.

Group Summary Financial Statement

For the year ended 31 December 2013

Income statement	2013	2012 (restated*)
	£m	£m
Net interest receivable	116.4	99.1
Other income and charges	22.8	24.5
Administrative expenses	(75.6)	(71.2)
Impairment provisions	(22.4)	(16.3)
Provisions for other liabilities and charges	(12.5)	(11.9)
Operating profit	28.7	24.2
Other gains	-	1.5
Profit for the year before taxation	28.7	25.7
Taxation	(6.5)	(6.7)
Profit for the year	**22.2**	**19.0**
Statement of recognised income and expense		
Profit for the year	22.2	19.0
Actuarial loss on retirement benefit obligations	(4.3)	(7.6)
(Losses)/gains on available-for-sale assets	(8.2)	1.8
Taxation expense	2.2	1.3
Total comprehensive income	**11.9**	**14.5**

Group Summary Financial Statement

For the year ended 31 December 2013 (continued)

Balance sheet	2013	2012 (restated*)
	£m	£m
Assets		
Liquid assets	1,042.1	1,074.3
Mortgages	5,904.6	5,591.7
Fixed and other assets	111.4	118.3
Total assets	**7,058.1**	**6,784.3**
Liabilities		
Shares	5,562.6	5,467.0
Borrowings	902.8	710.5
Other liabilities	58.4	82.1
Pension liability	17.1	13.2
Subscribed capital	70.2	76.4
Subordinated liabilities	92.3	92.3
Reserves	354.7	342.8
Total liabilities	**7,058.1**	**6,784.3**

Prior year comparatives and opening reserves have been restated to reflect changes in accounting standards. A full explanation of these changes is described in Note 1 of the Annual Report and Accounts.

Summary of key financial ratios

At 31 December 2013

	2013	2012 (restated*)
	%	%
Tier 1 capital ratio (2013 IRB/2012 standardised)	18.73	13.71
Gross capital as a percentage of shares and borrowings	8.00	8.28
Liquid assets as a percentage of shares and borrowings	16.12	17.39
Profit for the year as percentage of mean total assets	0.32	0.29
Management expenses as a percentage of mean total assets	1.09	1.08

* Restated following the implementation of International Financial Reporting Interpretations Committee (IFRIC) 21 *Levies* and International Accounting Standard (IAS) 19 *Employee Benefits* (2011).

Gross capital represents retained earnings, subscribed capital and subordinated liabilities as shown in the Group balance sheet.

The gross capital ratio measures the proportion which the Society's capital bears to the Society's liabilities to holders of shares and borrowings.

The liquid asset ratio measures the proportion of the Society's shares and borrowings which are held in the form of cash, short-term deposits and Government securities that are readily realisable.

The profit ratio measures profit after tax as a proportion of the average of total assets during the year. This is equivalent to a company's "return on assets".

The management expense ratio measures administrative expenses and depreciation as a proportion of the average of total assets during the year.

Independent Auditors' Statement

to the Members and Depositors of Principality Building Society on the Summary Financial Statement for the year ended 31 December 2013

Pursuant to Section 76 of the Building Societies Act 1986, we have examined the Summary Financial Statement for the year ended 31 December 2013 which comprises the summary Income Statement, Statement of Recognised Income and Expense and Balance Sheet together with the summary Directors' Report.

This report is made solely to the Society's Members, as a body, in accordance with Section 76(5) of the Building Societies Act 1986. Our work has been undertaken so that we might state to the Society's Members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's Members as a body, for our audit work, for this report, for our audit report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Summary Financial Statement, in accordance with applicable United Kingdom law.

Our responsibility is to report to you our opinion on the consistency of the Summary Financial Statement with the full Annual Accounts, Annual Business Statement and Directors' Report and its compliance with the relevant requirements of Section 76 of the Building Societies Act 1986 and regulations made under it.

We conducted our work in accordance with Bulletin 2008/3 issued by the Auditing Practices Board. Our report on the Society's Annual Accounts describes the basis of our audit opinion on those financial statements.

Opinion

In our opinion the Summary Financial Statement is consistent with the Annual Accounts, the Annual Business Statement and Directors' Report of Principality Building Society for the year ended 31 December 2013 and complies with the applicable requirements of Section 76 of the Building Societies Act 1986 and regulations made thereunder.

Deloitte LLP

Deloitte LLP

Chartered Accountants and Registered Auditors
Cardiff, United Kingdom

4 February 2014

Report of the Remuneration Committee

For the year ended 31 December 2013

The report has been divided into separate sections for audited and unaudited information.

Unaudited information

Introduction

I am pleased to present the Remuneration Committee's 2013 Report which sets out the Remuneration Policy and provides details of the remuneration paid to executive and non-executive directors for the year to 31 December 2013.

The Remuneration Policy aims to align executive remuneration with the delivery of the Board's strategy.

The leadership team has delivered another good performance this year. Sound management and the benefits of strategies put in place in previous years have meant that the Group has a secure financial position which is key to ensuring that Members' savings are safe and our products and services are competitive and offer real value for our Members. The Committee believes that having appropriate remuneration policies in place, as summarised in this Report, has contributed to this positive result.

We keep the Remuneration Policy under review to ensure that it continues to support what we aim to achieve for the Society and its Members. In respect of 2013 the Committee implemented an important change to the calculation of pay for the executive directors by establishing a single, annual variable pay scheme, with deferral. This scheme significantly reduces the maximum variable pay award that can be achieved. The effect of this change has been to reduce both the "on target" and the potential maximum remuneration payable to executive directors by over 20%.

This important change follows other changes that the Committee has made in recent years to the application of its Policy including increasing the importance of achieving good outcomes for Members and customers in the calculation of variable pay. While it is appropriate that the remuneration of the leadership team reflects financial and service performance, we do not want Members to have any concern that too much weight is being placed on variable pay, or on only a small number of key performance measures. Alongside the overall level of remuneration we offer, getting the balance right between base salary and variable pay is an important judgement that has to be made by the Committee on behalf of the Society and Members. This judgement is informed by best practice elsewhere as well as regulatory guidance. The variable pay policy is also important in signalling to colleagues and to Members what the Board's priorities are with regard to the outcomes it aims to achieve, in particular the management of risk.

Principality is committed to best practice in corporate governance, and as such we provide full details of directors' remuneration and ask Members to approve the Remuneration Report through an advisory Member vote at the Annual General Meeting. The Report includes the key disclosure requirements of the UK Corporate Governance Code relevant to the Society and follows sector best practice as well as complying with regulatory requirements, including the PRA Remuneration Code. On behalf of the Remuneration Committee of the Board, I am happy to recommend this Report to Members for approval at the Annual General Meeting.

Nigel Annett

4 February 2014

Remuneration Policy

We are proud to be a mutual building society owned by our Members. Our purpose is to deliver good outcomes for Members and customers, looking after Members' funds and helping other Members to own their own homes. This means we must keep Members' savings safe, and we must offer good and competitive products and services to Members and customers that meet their needs. To do all of this, we must generate sufficient profits to ensure that we maintain a strong capital base and secure financial position. We must also run the Group efficiently, keeping costs under control and always taking a prudent and cautious approach to managing risks. This thinking underpins the Remuneration Policy which is designed to ensure that the Group is run safely and successfully for Members.

The Remuneration Policy aims to:

- Attract, motivate, reward and retain high quality people who can ensure that Principality continues to deliver value to Members and to be profitable in a competitive and often uncertain marketplace by positioning basic salaries and benefits, both in terms of total amount and structure (i.e., the balance of fixed and variable pay), at around market levels for similar roles within the UK mutual building society sector, as well as more broadly where this is appropriate;
- Incentivise performance by having a competitive variable pay scheme which rewards executive directors for meeting or exceeding challenging objectives set by the Board each year where performance is judged against a basket of financial and customer service measures; and
- Encourage sound risk management practices, in particular by setting capital and liquidity hurdles that must be met before any variable payment can be made and by deferring an element of variable pay which allows the Remuneration Committee to reduce or withhold the deferred element if it turns out that the basis on which the variable pay award was made was wrong or that financial performance has deteriorated materially before the deferred payment is made.

We do not anticipate any changes to the Remuneration Policy in 2014.

The work of the Remuneration Committee

The members of the Remuneration Committee during 2013 were Christopher Jones (as Chairman until he retired from the Board in April 2013), Keith Brooks (until he retired from the Board in September 2013), Dyfrig John, Nigel Annett and Laurence Adams. In October Nigel Annett was appointed Chairman of the Remuneration Committee and at the same time he was joined by Laurence Adams as a member. All members of the Remuneration Committee are independent non-executive directors.

The Committee is responsible for determining, on behalf of the Board, the overall remuneration practices and policies for all colleagues and, in particular, the level of remuneration of the four executive directors as well as nine other senior "Code Staff", who are key individuals who have been identified by the Committee as having a potential material impact on the Society's risk profile (as defined by the PRA Remuneration Code). The Terms of Reference for the Remuneration Committee can be found on the Principality website.

The Committee met formally on three occasions during the year (2012: nine), and a number of remuneration matters during the year were considered by the Board rather than at a meeting of the Remuneration Committee. Activities during the year included:

- The implementation of the new executive variable pay scheme;
- Agreeing the performance targets for awards to be made under the 2013 executive variable pay scheme and reviewing the outcomes which were paid in respect of the year;
- On-going work in relation to sales incentive schemes in the light of the FCA guidance paper on "Risks to Customers from Financial Incentives";
- Agreeing the arrangements for auto-enrolment into the pension scheme for the Group. Under government legislation employers must automatically enrol their employees into a pension scheme with a minimum level of contributions. Colleagues across the Group who are not in the pension scheme will be automatically enrolled in the Society's pension scheme effective from 1 January 2014; and
- Approval of the annual pay review.

The Committee draws on the advice of independent external advisors as necessary. This year KPMG has provided advice on auto-enrolment as well as the future pension strategy following the completion of the annuity purchase in 2012.

Elaine Morris, Group Secretary, acts as secretary to the Committee. The Group HR Director and the Group Risk Director attend most Committee meetings and provide specialist advice as required. The Group Chief Executive and the Group Finance Director are also asked to attend the Committee's meetings when their input is required on specific issues. Executives are not involved in any Remuneration Committee discussions concerning their own pay.

Implementation of the Remuneration Policy

Executive director remuneration comprises base salary plus benefits (car allowance, pension and medical cover) plus variable pay which rewards performance against challenging targets set by the Board and personal objectives for each executive director.

Base salary

Base salary determined by the Committee reflects the individual's skills, experience and performance as well as the responsibilities associated with the role. The Committee considers salary levels for similar roles within a comparator group of the largest building societies. When determining executive salaries the Committee has regard to economic factors, remuneration trends and the general level of pay across the Group.

R Michael Jones, Group Risk Director, and Stephen Hughes, Group Finance Director, were appointed to the Board in February and March 2013 respectively. Their base salaries and total remuneration were benchmarked and set prior to appointment. Guy Thomas was appointed as Group Chief Operating Officer in February 2013. His salary and total remuneration were benchmarked, and while his base salary was increased the total potential earnings was reduced by around 20% because of the Committee's decision to reduce the maximum variable pay level.

Graeme Yorston, Group Chief Executive, having been appointed in October 2012, did not receive a pay increment in 2013; indeed, the total remuneration package of the Chief Executive in 2013 was 19% lower than that of the previous Chief Executive. Michael Jones and Stephen Hughes, following their appointments to the Board, also did not receive a pay increment in 2013. Guy Thomas did receive an annual salary review in 2013 and was awarded an increment of 2.25%, equal to the average increase for all colleagues in 2013.

At the end of 2013 Michael Jones took on more responsibility and so his remuneration will be benchmarked and reviewed in 2014. All the other executive directors have been awarded a pay increment of 2.25% for 2014 which is the same as the average pay increase for all colleagues in 2014. In formulating and applying the Remuneration Policy including increments to base salary, the Committee considers remuneration arrangements across the Group and indeed more generally.

Variable pay

The reduction in variable pay for executive directors – reducing the maximum that can be achieved from 100% to 40% and reducing "on-target" variable pay to 20% of base salary – is an important change in the application of the Remuneration Policy and signals a general shift in the structure of remuneration practices across the Group. In particular in the Society, the variable pay of customer service colleagues is now much more limited and is based on team performance and customer satisfaction as well as behaviours and personal objectives rather than sales volumes.

Variable pay for executive directors is calculated on the basis of performance against targets set by the Board for the following four measures, two of which are financial and two of which capture customer satisfaction with the service we give Members. In addition, each executive director has personal objectives which if not achieved can reduce the variable pay award. The Committee reviews and approves actual variable pay awards having considered what has been achieved by the Group and by each executive director.

Basket of financial and customer satisfaction measures

Metric	Note	Weighting	On-target	Maximum	Actual results
Return on assets ratio compared with our peers	1	25%	10 basis points better than the average result	20 basis points better than the average result	Will not be available until June 2014
Group profit before tax		25%	£25.7m	£30.8m	£28.7m
Customer satisfaction index	2	25%	Score of 85%	Score of 87%	Score of 86%
Customer net promoter score	3	25%	6th best	3rd best or above	1st

Notes:

1 Return on assets ratio is the Society's post-tax profit expressed as a percentage of the average value assets held during the year. This ratio is used by the sector as a comparator of financial performance.

2 Customer satisfaction index is independently collected by a firm measuring customer satisfaction over the 12 month period.

3 The net promoter score is compiled by an independent company which carries out research across the financial services sector with customers to gauge the standing of each firm by asking customers if they would recommend to others the firm they have their savings with; this allows us to judge where we rank against other firms in the financial services sector.

Certain additional conditions must be satisfied before any variable pay can be awarded. In particular, the variable pay scheme specifies capital and liquidity hurdles, set above minimum regulatory requirements, which the Society must meet before any variable pay award can be made. These capital and liquidity hurdles relate to the capital and cash or cash equivalents we must hold to support lending activities. At the end of 2013 capital and liquidity levels were materially above the minimum regulatory requirements.

In accordance with the variable pay scheme rules, half of the scheme's award for 2013 will be paid in two tranches, in February and in June 2014 when we will know how the return on assets ratio compares with peers. Under the scheme rules, the remaining half of the award will be deferred and paid in February 2015. The deferred award is subject to annual review, and may be reduced or withdrawn at the discretion of the Committee in the event that the original assessment of performance was misleading or if performance declines substantially prior to the payment of the deferred award.

In respect of 2013, the variable pay awards to the executive directors are as follows:

Graeme Yorston, Guy Thomas and Stephen Hughes are eligible for an award of 24.4% in respect of performance for 2013 against the targets for group profit before tax, customer satisfaction index and customer net promoter score (see table on page 14). R Michael Jones, Group Risk Director, does not participate in any variable pay scheme as we believe it is inappropriate for the executive responsible for Risk to do so.

The Committee does not anticipate any changes to the executive variable pay scheme in 2014 although it will be kept under review against the test of ensuring that our Remuneration Policy and its implementation align with our aim of delivering the best outcomes for our Members.

Service contracts

Executive directors' terms and conditions of employment are detailed in their individual contracts which include a notice period of 12 months. Each contract includes a provision for a termination payment in lieu of notice up to a maximum of 12 months' salary and benefits. In addition a discretionary payment may be made in respect of a variable pay award depending on the circumstances and according to the rules of the executive variable pay scheme.

	Date of contract
Graeme Yorston	31/12/07
Guy Thomas	14/11/06
Stephen Hughes	07/03/13
R Michael Jones	01/02/13

Pension arrangements

All executive directors receive pension contributions of 15% of base salary payable into a defined contribution scheme or elected to be paid as a cash allowance. These pension contributions are recorded in the directors' remuneration table on page 16. Life assurance of four-times basic salary in the event of death in service is provided.

Non-executive directors' remuneration

The Chairman, Deputy Chairman, Senior Independent Director and non-executive directors do not have service contracts and are subject to re-election at each year's Annual General Meeting.

Non-executive directors are paid a basic fee for participation on the Board. The non-executive directors receive additional fees payable for providing services on Board Committees and for their membership of subsidiary company boards. The fees for the Chairman, Deputy Chairman, Senior Independent Director and non-executive directors are set by the Board, based on recommendations from the executive directors and external benchmarking from time to time.

In 2013 the Chairman, Deputy Chairman, Senior Independent Director and non-executive director basic fees were increased by 2.25%, equal to the average increase for all colleagues while the fees for services on Board Committees and subsidiary company boards were not increased.

In October 2013 Langley Davies was appointed as Deputy Chairman, Gordon MacLean as Senior Independent Director and Menna Richards as Chair of the Customer and Conduct Committee, and their fees in 2013 reflect these additional responsibilities. Details of non-executive directors' remuneration are set out on the following page. The Chairman, Deputy Chairman, Senior Independent Director and non-executive directors do not participate in any variable pay schemes or any pension arrangements.

Audited information

Directors' remuneration in respect of the year to 31 December 2013

The following disclosure in this report (and the following section concerning executive directors' pension arrangements) contains information which is audited.

	Salary & fees £000	Benefits £000	Annual bonus £000	Sub-total £000	Pension £000	Total £000
Executive 2013						
Graeme Yorston	310	14	77	401	47	448
Guy Thomas	256	14	64	334	38	372
R Michael Jones (from 01/02/13)	170	7	–	177	26	203
Stephen Hughes (from 07/03/13)	176	9	59	244	26	270
Total	**912**	**44**	**200**	**1,156**	**137**	**1,293**
Executive 2012						
Peter Griffiths (to 30/09/12)	232	10	139	381	35	416
Guy Thomas	216	13	130	359	32	391
Graeme Yorston	231	11	111	353	35	388
Total	**679**	**34**	**380**	**1,093**	**102**	**1,195**

	Salary & fees	
	2013*	2012
	£000	£000
Non-executive directors		
Dyfrig John	91	87
Christopher Jones (to 18/04/13)	15	43
Gordon MacLean	61	58
Langley Davies	63	68
Keith Brooks (to 29/09/13)	50	65
Joanne Kenrick	45	44
Menna Richards (from 01/06/12)	45	21
Natalie Elphicke (from 23/07/12)	49	18
Laurence Adams (from 28/08/13)	12	–
Nigel Annett (from 21/10/13)	12	–
Sub-total	**443**	**404**
Executive remuneration total	**1,293**	**1,195**
Total	**1,736**	**1,599**

*Includes the impact of changes to non-executive committee appointments made in 2012.

1 The 2012 variable pay scheme contained a return on assets measure against the average performance of a comparator group of mutual building societies. This was recalculated in June 2013 once the full set of comparator information was available. This resulted in an additional variable pay award of £6k earned by executive directors. This sum is payable over three years.

2 The 2013 variable pay scheme contains a return on assets measure against the average performance of a comparator group of mutual building societies. Since all the results of other societies are not available until May 2014 an assumption has been made in respect of Principality's on-target performance relative to the comparator group (i.e., 5% of base salary). This figure will be adjusted upwards or downwards to reflect actual performance once the 2013 results for the comparator group are published.

3 50% of the variable pay award is paid in 2014 and 50% is paid in 2015 subject to review and confirmation by Committee.

4 The figures under benefits include company car/car allowance, fuel allowance and personal medical insurance.

5 Awards under the variable pay scheme are non-pensionable.

Executive directors' pension arrangements

In addition to the current pension arrangements noted on page 15, Guy Thomas is a member of the Society's defined benefit pension scheme which closed to future accrual in 2010. The scheme is a 'career average' scheme whereby members earn a pension of 1/60th of their salary each year, index linked to the Retail Prices Index, up to retirement age.

Guy Thomas's accrued annual pension entitlement at 31 December 2013 was £21k (2012: £21k). His normal retirement date is 5 November 2015. Michael Jones' accrued annual pension entitlement at 31 December 2013 was £18k (2012: £17k). His normal retirement date is 19 June 2018.

Established 1860
Regulated by the Financial Conduct Authority and the Prudential Regulation Authority
Member of the Building Societies Association

Directors:

Dyfrig John - Chairman
Graeme H. Yorston
W. Guy Thomas
Gordon MacLean
Langley Davies
Joanne Kenrick
Menna Richards
Natalie Elphicke
R. Michael Jones (Appointed 01/02/13)
Stephen Hughes (Appointed 07/03/13)
Laurence Adams (Appointed 28/08/13)
Nigel Annett (Appointed 21/10/13)

Senior management team:

David Cunningham-Jones
Peter Hughes
Susan Lane
Elaine Morris
Julie-Ann Haines

Subsidiary companies:

Peter Alan Limited
Managing Director:
Andrew Barry

Nemo Personal Finance Limited
Managing Director:
Phillip E. Jones

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You've chosen to receive information from us in English. However, if you'd prefer us to write to you in Welsh whenever possible, (including receiving the Summary Financial Statement in Welsh) please call Head Office on 0330 333 4000 or inform your local branch.

PRINCIPALITY
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