HALF YEAR
FINANCIAL REPORT

2020

Building your future

Principality
Building Society
Cymdeithas Adeiladu

Where home matters
www.principality.co.uk

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Forward Looking Statements

This interim report contains certain forward-looking statements. These statements are made by the Directors in good faith based on the information available to them up to the time of their approval of this report. Such statements should be treated with caution due to the inherent uncertainties, including both economic and business risk factors, underlying any such forward-looking information. Therefore, actual results may differ materially from those expressed or implied by these forward-looking statements.

The Directors undertake no obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

Chief Executive's review

2020 has so far been incredibly challenging, for Principality as a business, for our members and colleagues and for the country as a whole.

The impact of the coronavirus pandemic has been unprecedented. In many ways it has brought communities together, but it has also caused significant concern, not least financially for those whose income has been affected, or is at risk of being impacted. The UK economy is likely to take a number of years to recover to pre-COVID levels, even with significant and ongoing levels of government intervention.

As a 160 year old building society, we have faced many difficult situations in the past. We have always been there to support our members and will continue to do so as we navigate through these current challenges.

Looking back over the last six months, I am very proud of the excellent service provided by our colleagues who have worked hard to keep our branches open for essential services and managed exceptionally high call volumes through our contact centre. We have worked quickly to support over 14,000 of our mortgage customers with payment holidays, with the aim of helping to reduce the worry and uncertainty of not knowing whether they will be able to cope financially. But we have also looked to the future, and in March we launched our new and improved savings platform, Your Account, which provides enhanced functionality and new security features, and we will continue to invest in our digital capability.

Our half-year financial performance has inevitably been impacted by the economic effects of the pandemic. In my year-end report to members, I said that the Society was in a strong position to withstand an economic downturn. That downturn has arrived and I can say with confidence that my view has not changed. Our capital and liquidity levels remain strong, well in excess of regulatory requirements and well able to withstand the current challenging economic and market conditions.

Mortgages and savings

Our net retail mortgage lending was £118.7m in the first six months of this year (June 2019: £285.6m). This growth, although lower than in recent years, has been delivered in the most challenging of circumstances, with falling consumer confidence and a subdued housing market evident even before the onset of the pandemic.

Due to the lower level of mortgage growth in the period, savings balances remained flat at £7.6bn. Balancing the needs of savers whilst remaining competitive in the mortgage market is a constant focus and the savings rates we can offer to Members are directly impacted by the interest we earn on mortgages. In March 2020, the Bank of England cut the Base Rate to a historic low of 0.1% and we had to take the difficult decision to reduce our savings rates as a result. However, we still delivered an average rate to savers of 1.13% compared to the market average of 0.72%[1] over the same period, maintaining our position as one of the best on the High Street.

The trajectory for future movements in Base Rate remains uncertain and may still impact on mortgage and savings rates in the months ahead.

Our Commercial team has continued its excellent work in supporting investment in our communities, with 50% of all completions in the first half of the year funding the construction of homes in Wales. The emphasis on Environmental, Social and Governance (ESG) initiatives is expected to be even greater post COVID and projects such as the award winning LivEco development in St Fagans in Cardiff, where occupants are benefitting significantly from lower energy costs, will be a continued area of focus in the coming years.

[1] Source: CACI's CSDB, Stock. Weighted average interest rate comparison for fixed and variable rate products from January to May 2020.

Chief Executive's review (continued)

Financial performance

As a mutual, member-owned building society, our aim has never been to maximise profit but to focus on the long-term future of the Society. Overall trading performance has been broadly in line with our expectations, notwithstanding the significant impact of the pandemic on the markets in which we operate, with the UK housing market coming to a standstill for the best part of four months.

We had always expected our reported profits to be lower this year as we have continued to invest in technology to further improve our award-winning service and broaden the range of products we are able to offer to our Members. However, the main driver of financial performance compared with the same period last year has been a £17.9m additional provision for potential future loan losses, compared with a £2.1m release in the same period last year.

We know that, during an economic downturn, a greater proportion of members will experience financial difficulties. Over 14,000 of our retail mortgage customers have been granted an initial three-month mortgage payment holiday and many of these have already requested or we expect to request a further extension, in line with the policy we and other lenders have agreed with the UK government. In addition, over 100 of our commercial customers and 1,000 of our secured personal lending customers have also been granted a temporary change to their loan terms either through a payment holiday or other form of support. The likelihood is that some of these customers may still struggle after these concessions come to an end and will fall into arrears. This of course has implications for them and also for our business.

Current accounting standards require that we make an estimate of the losses on loans that may arise and provide for these at an early stage, taking into account economic forecasts based on factors including unemployment levels and residential and commercial property prices. We have taken a conservative approach in setting what we consider to be an appropriate level of provision against possible future loan losses, and have done so in the knowledge that our underlying financial strength means we are well equipped to respond to any further economic challenges we are likely to face in the months and years ahead. This has had a significant impact on our results for this interim period, resulting in an underlying loss before tax[2] of £3.5m (six months to 30 June 2019: profit of £21.2m) and statutory loss before tax, after fair value movements, of £6.4m (six months to 30 June 2019: profit of £19.8m).

Our capital and liquidity remain strong and provide a solid platform for growth and future investment in our business. Providing a safe and secure home for our Members' savings is fundamental to the ongoing success of our business and our aim is to continue to build scale, strength and resilience for the future, notwithstanding the fact that in the short-term our profits will be reduced.

Transforming our business

During the first half of the year we have had to deal with a number of operational challenges, not least enabling 700 colleagues from our head office to work effectively from home, a task which was extremely well executed. At the same time we have maintained our focus on an investment programme which will enable us to offer current and future Members increased flexibility in managing their savings and mortgage needs.

It has been a very difficult period for the High Street but we have maintained our support with our dedicated branch colleagues continuing to meet members' needs by completing essential transactions. As lockdown has been eased we have seen branch footfall increase and our commitment to the High Street is undimmed. However, this does not deflect us from our focus on developing technology to respond to the demand from members and customers for digital solutions to enable them to manage their financial affairs.

[2] The definition of underlying loss/profit is shown on p.5.

Chief Executive's review (continued)

Members, Communities and Colleagues

I am very proud of the efforts our colleagues have made to improve the lives of others. As a purpose led business, we will continue to work hard to help our communities deal with the many challenges they face. This has included helping communities during the floods across Wales in February and providing support to various projects during the pandemic crisis. A little help goes a long way to raising spirits of those who need it most.

Given the detrimental impact COVID-19 has had on charities, we donated £60,000 to be split between our two charity partners Teenage Cancer Trust Cymru and Alzheimer's Society Cymru, who need support from us now more than ever.

We have continued in our efforts to educate young people and give them the financial skills to prepare them for adult life. In 2020, we have partnered with Young Money for their Fiver Challenge which encourages the development of entrepreneurial skills for children, while raising money for local causes. More than 6,000 children have already signed up for this digital challenge through their schools and we hope to see many more joining them by the end of the year.

Our people are our greatest asset and we strive to create a friendly, open and inclusive culture. It was wonderful to be acknowledged once again as one of the best places to work in the UK by Great Place to Work®. Our colleagues continue to make us stand out in the sector and are renowned for their warmth, personal approach and empathy. This is reflected in our Net Promoter Score, with 81.2% of Members saying they would recommend us to family or friends based on their level of satisfaction with Principality (December 2019: 81.5%).

For the third year running we have also received the What Mortgage Award for Best Building Society Customer Service, yet another great endorsement of what makes us stand out from our competitors.

Outlook

We expect the economic environment to remain challenging through the remainder of 2020 and beyond as the impact of the coronavirus pandemic continues to be felt. In these difficult circumstances, I want to assure you that Principality remains a safe home for your savings, and has the strength and resilience to withstand the turbulence we are all presently facing.

Our long term priorities remain unchanged and, while our immediate focus remains on helping members through these uncertain times, we remain committed to developing and growing our business in a safe and secure way.

R Michael Jones
Interim Chief Executive Officer
4 August 2020

Business review
for the six months ended 30 June 2020

Key Performance Indicators

Performance against our strategy is measured through a number of key performance indicators that are aligned to our strategic pillars.

	Six months to 30 June 2020	Six months to 30 June 2019	Year ended 31 December 2019
Purpose Led Organisation			
Net Retail Mortgage Growth	£118.7m	£285.6m	£499.3m
Net Retail Savings Growth	£0.9m	£172.3m	£596.0m
Brand Consideration	18.5%	18.8%	16.4%
Cost Income Ratio[1]	78.8%	68.8%	69.4%
Brilliant People			
Employee Engagement Score[2]	77.0%	76.0%	77.0%
Stand-Out Experience			
Net Promoter Score[3]	81.2%	80.8%	81.5%
(Loss)/Profit Before Tax	£(6.4)m	£19.8m	£39.6m
Underlying Loss/(Profit) Before Tax	£(3.5)m	£21.2m	£39.8m
Net Interest Margin	0.99%	1.15%	1.09%
Common Equity Tier 1 Ratio[4]	24.48%	24.73%	26.20%

[1] The cost income ratio measures management expenses (administration expenses, depreciation and amortisation) as a proportion of total income.
[2] The employee engagement survey is performed annually in the second half of the year.
[3] Source: Internal survey data for the six months ended 30 June 2020.
[4] Excluding unaudited interim losses/profits. The equivalent ratio including unaudited interim losses at 30 June 2020 would be 24.26%.

The above key performance indicators, apart from loss/profit before tax, are alternative performance measures (APMs) which are used internally to inform key management decisions. Further information on these APMs can be found within the 2019 Annual Report and Accounts within the strategic report and glossary sections.

Financial performance

Income statement

As detailed in the Chief Executive's review, the underlying loss before tax for the six months to 30 June 2020 was £3.5m (30 June 2019: £21.2m profit). Statutory loss before tax was £6.4m (30 June 2019: £19.8m profit). Both have been impacted by a significant increase in provision for loan losses in the first six months of this year due to the expected economic impacts of the coronavirus pandemic.

The table below details the adjustments made to statutory (loss)/profit to arrive at underlying (loss)/profit:

	30 June 2020 £m	30 June 2019 £m	31 December 2019 £m
(Loss)/profit before tax	**(6.4)**	**19.8**	**39.6**
Adjusted for:			
Losses from derivatives and hedge accounting	2.9	1.4	0.2
Underlying (loss)/profit before tax	(3.5)	21.2	39.8

The purpose of the underlying measure is to reflect management’s view of the group’s underlying performance, presented to aid comparability across reporting periods by adjusting for items which affect statutory measures but are deemed to be either non-recurring or uncontrollable in nature. This aligns to measures used by management to monitor the performance of the business.

Net interest margin

Net interest margin for the period was 0.99% (30 June 2019: 1.15%). This reduction was in part due to the Bank of England base rate being cut to 0.1% in March which had an immediate impact on net interest income, together with the continued planned reduction in the loan assets held in the secured personal lending portfolio to £155.2m (31 December 2019: £179.3m).

Fair value movements

Fair value movements represent the change in value of certain assets and liabilities to reflect underlying market rates. These movements are primarily timing differences, which will reverse as the asset or liability approaches maturity. During the period, the group recognised a loss of £2.9m in the income statement (30 June 2019: £1.4m loss) in relation to these movements in fair value.

Operating expenses

Operating expenses remained broadly flat when compared with the same period last year at £39.7m (30 June 2019: £39.2m). These had been expected to increase due to continued investment to transform our core mortgages and savings business; however, the coronavirus pandemic drove a number of business decisions which resulted in cost savings, including reduced property and marketing costs. The increase in the cost income ratio is due primarily to a reduction in net interest income. However, focus on managing the core cost base of the business as a proportion of assets remains a priority and this has led to a further reduction in the management expense ratio compared with the prior year.

Total operating expenses are set out in the table below:

	30 June 2020 £m	30 June 2019 £m	31 December 2019 £m
Retail financial services	38.0	36.7	75.2
Commercial lending	1.2	1.8	3.6
Secured personal lending	0.4	0.7	1.3
Total operating expenses	39.6	39.2	80.1
Management expense ratio[1]	0.75%	0.80%	0.79%
Cost income ratio	78.8%	68.8%	69.4%

[1] The management expense ratio measures cost as a proportion of mean assets.

Impairment provisions for losses on loans and advances

Impairment provisions for the first half of the year was a charge of £17.9m (30 June 2019: £2.1m release). In recent years the performance of the group's loan portfolios has been strong with low arrears levels and loan closures driving releases in provisions during 2019. However, in an economic downturn arrears levels and therefore provisions inevitably increase.

The accounting standard which governs the recognition of provision for loan losses, IFRS 9, came into effect in 2018. This requires earlier recognition of losses than was previously the case. The charge for the first half of the year reflects the group's expectation of losses to be incurred during the economic downturn which has already begun and is expected to continue over the next few years. This view will be revised at each financial reporting date based on the latest expectations at that time.

Business review (continued)
for the six months ended 30 June 2020

Impairment provisions for losses on loans and advances (continued)

The group takes a prudent approach to lending and has robust affordability, credit quality and underwriting standards. However, the current challenges to the economic environment, driven by the coronavirus pandemic, and the negative impact this will undoubtedly have on house prices, levels of employment and arrears levels over the next few years, means that higher provisions have been required to ensure that the business is well positioned to deal with the future losses that may arise.

Total impairment provisions held are as follows:

	30 June 2020 £m	30 June 2019 £m	31 December 2019 £m
Retail mortgages	21.9	10.8	11.0
Secured personal lending	10.4	8.6	6.5
Commercial lending	11.0	10.3	8.0
Total	43.3	29.7	25.5

Statement of financial position

Total assets have reduced to £10,513.1m (31 December 2019: £10,695.8m). A reduction was anticipated, as wholesale funds raised through the group's residential mortgage backed issuance (RMBS) at the end of 2019 were used for mortgage growth and to repay more expensive forms of funding held, including the redemption of the group's £60m Permanent Interest Bearing Shares (PIBS) which were repaid in the period. However, a £100m reduction in traditional wholesale deposits was also seen as investors sought to retain their cash balances.

Loans and advances to customers

Despite the challenging market conditions, the retail mortgage portfolio increased to £8,112.3m (31 December 2019: £7,993.5m), and the quality of the loans remains strong with an average balance to value of 52.8% (31 December 2019: 52.0%). The Commercial lending portfolio increased to £835.7m (31 December 2019: £827.9m), and the secured personal lending portfolio continued to run off, decreasing to £155.2m (31 December 2019: £179.3m).

Funding

Funding levels are closely monitored to maintain a diverse and balanced funding base. The majority of funding comes from retail savings, which remained flat at £7,588.0m (31 December 2019: £7,587.1m) as growth in mortgages was curtailed due to the partial closure of the market due to the lockdown in the first half of the year.

Capital and liquidity

The group's Common Equity Tier 1 ratio, which measures qualifying capital reserves as a proportion of risk weighted assets, reduced to 24.48% in the period (31 December 2019: 26.20%). This reduction has largely been driven by a relative increase in the level of risk attributed to certain loan assets in the current economic climate, including impacts of movements in house prices. The leverage ratio, which measures Tier 1 capital as a proportion of total on and off balance sheet assets, decreased to 5.1% (31 December 2019: 5.2%).

The capital position remains robust and both ratios are well above the minimum regulatory requirements.

Business review (continued)
for the six months ended 30 June 2020

Capital and liquidity (continued)

The business continues to hold a prudent buffer of high quality liquid assets, with a liquidity ratio of 12.2% (31 December 2019: 15.8%). The high ratio at year-end was due to the funding received from the RMBS in late November 2019 and has now reduced back to its planned level. The Liquidity Coverage Ratio (LCR) is 180.0% at 30 June 2020 (31 December 2019: 223.1%), which remains well above the current regulatory minimum of 100%.

Principal risks and uncertainties

The principal risks and uncertainties affecting the group were set out in the Risk Overview section of the Strategic Report in the Annual Report and Accounts for the year ended 31 December 2019. These risks are categorised as: credit, market, liquidity and funding, conduct, operational, business, solvency and legal and regulatory risk, and are common to most financial services firms in the UK.

These remain the principal risks to the group at 30 June 2020. The onset of the coronavirus pandemic has increased the extent of some of these risks in the period. The main impacts and the mitigating actions being taken are summarised below:

Principal risk	COVID-19 impacts	Mitigating actions
Business risk The risk arising from changes to the business model and also the risk of the business model or strategy proving inappropriate due to macroeconomic, competitive, geographical, regulatory or other factors.	The UK mortgage market came close to a standstill during April and May 2020 as all physical valuations ceased due to lockdown and caps had to be placed on loan to value criteria that could be accepted on the basis of desktop valuations only. Remortgage business has continued, albeit at significantly lower levels than would usually be the case. The market did start to reopen in June as lockdown was eased but will take time to return to pre-lockdown levels.	Forecasts for mortgage growth and funding required have been revised for the rest of 2020 and into 2021 to take account of the market changes. Growth remains an ambition but only in a safe and sustainable way. Loan to value criteria has been tightened to take account of the ongoing risk to house prices in the short to medium term.
Credit risk The risk that borrowers or counterparties do not meet their financial obligations as they fall due.	The UK is facing into an economic downturn, even with the significant levels of government intervention taking place. Rising unemployment is expected to result in an increase in arrears and falling residential and commercial property prices are likely to increase the level of loan losses experienced by the group.	Lending criteria for the retail and commercial portfolios remains tightly controlled. Provisions for loan losses at 30 June 2020 have taken into account the worsening economic conditions.
Market risk The risk that the value of income derived from the Society's assets and liabilities is adversely impacted as a result of changes in interest rates.	The Bank of England reduced base rate to a record low of 0.1% in March. This had an immediate impact on net interest margin due to income receivable and expense payable on interest rate swaps held.	The decision was taken to reduce the rates on variable mortgages and savings products for both new and existing business, in order to manage the impact of the reduction in base rate.

Business review (continued)
for the six months ended 30 June 2020

Principal risks and uncertainties (continued)

Principal risk	COVID-19 impacts	Mitigating actions
Liquidity and funding risk Liquidity risk is the risk that the Society has insufficient funds to meet its obligations as and when they fall due. Funding risk is the risk that the Society is unable to access funding markets or to do so only at excessive cost.	Traditional wholesale deposits have declined in the period but make up a relatively small part of the group's overall funding therefore the impact has been limited. Mortgage payment holidays have also negatively impacted liquidity, albeit again not materially.	The group has strict liquidity policies and is monitoring levels closely. Liquidity levels were high going into 2020 following the RMBS issuance at the end of the prior year and, with lower growth in the mortgage portfolio, funding requirements have been lower than anticipated. The group has drawn down £350m of funds from the Bank of England's new Term Funding Scheme and repaid £250m of funds previously borrowed. Liquidity and funding levels remain well in excess of regulatory requirements.
Operational risk The risk of loss arising from inadequate or failed internal processes, systems, human error or from external events.	The pandemic and subsequent lockdown resulted in over 700 colleagues switching from head office to work from home. Branch and call centre opening hours were reduced, with branches only able to undertake essential transactions for members and customers, in line with government requirements.	Daily monitoring of critical business functions was put in place, including internal functions and those of key third party suppliers. Changes to business controls and processes have been limited and, where necessary, made through the appropriate governance channels. Web conferencing technology has been used to facilitate communication across all areas of the business.
Solvency risk The risk that the Society does not maintain sufficient capital resources in excess of minimum regulatory requirements.	Whilst the group has made a loss for the first six months of the year as a result of the loan loss provisions made, this has had no significant impact on capital resources held. The main driver for the reduction in CET1 is due to a marginal increase in the level of risk attributed to certain loan assets in the current economic climate.	Capital levels are monitored regularly and remain well in excess of minimum regulatory requirements. The most recent ICAAP has been completed and, even under stressed scenarios, the group expects at all times to continue to meet these requirements.

Business review (continued)
for the six months ended 30 June 2020

Principal risks and uncertainties (continued)

Principal risk	COVID-19 impacts	Mitigating actions
Conduct risk The risk that the Society does not treat its customers fairly resulting in inappropriate or unfair outcomes. ***Legal & regulatory risk*** The risk that the Society does not comply with legislation and regulation.	The business has had to move quickly to make changes to processes to enable the granting of over 15,000 mortgage payment holidays across the retail and secured personal lending portfolios. An increased volume of transactions have taken place through our contact centre and online as branch access has been limited.	The business has monitored closely all legal and regulatory pronouncements with the aim of ensuring that all business activity conforms to legal and regulatory requirements and guidelines. Conduct metrics continue to be monitored, outcome testing has been performed and member and customer feedback obtained.

Although the business remains exposed to a number of potential risks and uncertainties, it is well placed to meet these challenges, with a diversified and flexible funding base, and strong levels of capital and liquidity.

Tom Denman
Chief Financial Officer
4 August 2020

Condensed consolidated income statement
Group interim results for six months to 30 June 2020

	Notes	6 months to 30 June 2020 £m (Unaudited)	6 months to 30 June 2019 £m (Unaudited)	Year ended 31 December 2019 £m (Audited)
Interest receivable and similar income	3	107.2	114.9	233.9
Interest payable and similar charges	4	(55.1)	(58.7)	(122.5)
Net interest income		52.1	56.2	111.4
Fees and commission receivable	5	1.9	2.4	4.9
Fees and commission payable		(1.0)	(0.8)	(1.5)
Net fee and commission income		0.9	1.6	3.4
Other operating income		0.3	0.5	1.0
Other fair value losses	6	(2.9)	(1.4)	(0.2)
Net operating income		50.4	56.9	115.6
Administrative expenses	7	(35.6)	(35.6)	(72.8)
Depreciation and amortisation		(4.0)	(3.6)	(7.3)
Operating expenses		(39.6)	(39.2)	(80.1)
Impairment (charge)/credit for losses on loans and advances	14	(17.9)	2.1	4.1
Provisions for liabilities and charges	11	0.7	-	-
Operating (loss)/profit and (loss)/profit before taxation		(6.4)	19.8	39.6
Taxation (expense)/credit	9	1.2	(3.6)	(7.6)
(Loss)/profit for the period/year		(5.2)	16.2	32.0

Condensed consolidated statement of other comprehensive income
Group interim results for six months to 30 June 2020

	6 months to 30 June 2020 £m (Unaudited)	6 months to 30 June 2019 £m (Unaudited)	Year ended 31 December 2019 £m (Audited)
(Loss)/profit for the period/year	(5.2)	16.2	32.0
Items that will not be reclassified subsequently to profit and loss:			
Actuarial (loss)/gain on retirement benefit obligations	(0.4)	0.6	0.3
Tax on retirement benefit obligations	0.2	(0.1)	(0.1)
Items that may be reclassified subsequently to profit and loss:			
(Loss)/gain on assets at fair value through other comprehensive income	(0.1)	0.8	0.6
Tax on assets at fair value through other comprehensive income	-	(0.2)	(0.1)
Total comprehensive income for the period/year	(5.5)	17.3	32.7

Condensed consolidated statement of financial position
Group interim results as at 30 June 2020

	Notes	30 June 2020 £m (Unaudited)	30 June 2019 £m (Unaudited)	31 December 2019 £m (Audited)
Assets				
Liquid assets:				
Cash in hand and balances with the Bank of England		797.8	830.5	1,201.9
Loans and advances to credit institutions		291.8	218.5	202.6
Debt securities		115.5	139.0	165.1
		1,205.1	1,188.0	1,569.6
Derivative financial instruments		27.9	22.1	21.3
Loans and advances to customers:				
Loans fully secured on residential property		8,881.1	8,521.1	8,721.7
Other loans		316.6	294.5	311.4
	10	9,197.7	8,815.6	9,033.1
Intangible fixed assets		23.0	11.4	17.5
Property, plant and equipment		37.6	34.1	34.8
Investment properties		6.7	7.0	6.9
Current tax assets		1.5	-	-
Deferred tax assets		3.3	2.2	1.8
Other assets		4.0	6.6	3.9
Retirement benefit obligations	8	1.0	-	-
Prepayments and accrued income		7.8	5.4	6.9
Total assets		10,515.6	10,092.4	10,695.8
Liabilities				
Shares		7,594.7	7,165.8	7,588.5
Deposits and debt securities:				
Amounts owed to credit institutions		1,055.6	1,139.3	1,072.5
Amounts owed to other customers		102.7	133.6	197.9
Debt securities in issue		1,041.1	933.4	1,107.7
		2,199.4	2,206.3	2,378.1
Derivative financial instruments		116.7	56.4	50.4
Current tax liabilities		-	2.7	2.8
Other liabilities		14.1	14.2	14.0
Provisions for liabilities	11	3.7	4.8	4.4
Accruals and deferred income		8.3	9.4	11.8
Deferred tax liabilities		0.8	0.9	1.2
Retirement benefit obligations	8	-	1.4	-
Subscribed capital		-	62.5	61.2
Total liabilities		9,937.7	9,524.4	10,112.4
General reserve		576.7	566.8	582.1
Other reserves		1.2	1.2	1.3
Total equity and liabilities		10,515.6	10,092.4	10,695.8

Condensed consolidated statement of changes in Members' interests
Group interim results for six months to 30 June 2020

	Six months to 30 June 2020 (Unaudited)		
	General Reserve £m	Fair Value through OCI reserve £m	Total equity attributable to Members £m
Balance at 1 January 2020	582.1	1.3	583.4
Comprehensive income for the period	(5.4)	(0.1)	(5.5)
At 30 June 2020	576.7	1.2	577.9

	Six months to 30 June 2019 (Unaudited)		
	General Reserve £m	Fair Value through OCI reserve £m	Total equity attributable to Members £m
At 1 January 2019	550.1	0.6	550.7
Comprehensive income for the period	16.7	0.6	17.3
At 30 June 2019	566.8	1.2	568.0

All items dealt with in arriving at the profit for the period, and the preceding financial periods, relate to continuing operations. The accounting policies and notes on pages 15 to 28 form part of these accounts.

Condensed consolidated statement of cash flows
Group interim results for six months to 30 June 2020

	6 months to 30 June 2020 £m (Unaudited)	6 months to 30 June 2019 £m (Unaudited)	Year ended 31 December 2019 £m (Audited)
Net cash flows from operating activities	(210.9)	177.9	406.8
Cash flows from investing activities			
Purchase of intangible assets	(6.1)	(6.9)	(13.0)
Purchase of property, plant and equipment	(5.1)	(3.8)	(7.6)
Purchase of investment securities	(43.8)	(109.6)	(200.3)
Proceeds from sale and maturity of investment securities	93.4	4.5	68.9
Net cash flows from investing activities	**38.4**	**(115.8)**	**(152.0)**
Cash flows from financing activities			
Interest paid on subscribed capital	(1.7)	(2.1)	(4.2)
Interest paid on debt securities in issue	(8.9)	(8.7)	(23.3)
Proceeds from issuance of debt securities in issue	1.8	-	431.7
Redemption of debt securities in issue	(72.9)	(80.9)	(332.4)
Repayments of lease liabilities	(0.7)	(1.0)	(1.7)
Repayment of subscribed capital	(60.0)	-	-
Net cash flows from financing activities	**(142.4)**	**(92.7)**	**70.1**
(Decrease)/increase in cash and cash equivalents	(314.9)	(30.6)	324.9
Cash and cash equivalents at beginning of period/year	1,404.5	1,079.6	1,079.6
Cash and cash equivalents at end of period/year	**1,089.6**	**1,049.0**	**1,404.5**
Represented by:			
Cash and balances with the Bank of England	797.8	830.5	1,201.9
Loans and advances to credit institutions repayable on demand	291.8	218.5	202.6
	1,089.6	1,049.0	1,404.5
Operating activities			
(Loss)/profit before taxation	(6.4)	19.8	39.6
Adjusted for:			
Depreciation and amortisation	4.0	3.6	7.3
Charge on defined benefit pension scheme	-	-	0.1
Impairment on loans and advances to customers	17.9	(2.1)	(4.1)
Change in fair values	(54.2)	(25.9)	(28.0)
Interest on debt securities in issue	8.3	8.5	24.5
Interest on subscribed capital	1.7	2.1	4.2
Non-cash items included in profit before tax	0.2	0.2	0.2
Changes in net operating assets			
Loans and advances to customers	(119.3)	(282.8)	(505.6)
Other operating assets	(0.7)	(3.1)	(2.2)
Derivative financial instruments	59.7	27.5	22.3
Shares	0.8	172.3	595.9
Deposits	(112.1)	264.4	261.9
Other operating liabilities	(4.3)	(1.8)	0.2
Contributions paid into defined benefit scheme	(1.5)	(2.0)	(3.7)
Taxation paid	(5.0)	(2.8)	(5.8)
Net cash flows from operating activities	**(210.9)**	**177.9**	**406.8**

Notes to the accounts
for the six months ended 30 June 2020

1. Basis of preparation

The condensed consolidated set of financial statements of the group for the half-year ended 30 June 2020 have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority and with International Accounting Standard (IAS) 34 Interim Financial Reporting, as adopted by the European Union. The annual financial statements of the group are prepared in accordance with IFRSs as adopted by the European Union. The accounting policies adopted are consistent with those of the previous financial year.

Going concern

The Directors have assessed the viability of the group, taking into account business strategy, principal risks, current economic conditions and the financial and operational impact on the group from the COVID-19 pandemic.

The approach taken is broadly consistent with that undertaken at the 2019 year-end; however, has also taken into account events since that date and the impacts already seen and expected to be seen, including but not limited to:

- operational changes resulting from the majority of head office colleagues moving to work from home;
- liquidity impacts arising from mortgage payment holidays and other forms of support for Commercial customers;
- outlook for the mortgage and savings markets in the UK and impacts on growth aspirations; and
- financial and capital impacts from the increased risk of loan losses which may arise if borrowers fall into arrears as a result of the economic impacts of the pandemic.

The Directors have considered the resilience of the group, taking account of its current position, the risks facing the business in severe but plausible scenarios and the effectiveness of any mitigating actions. The assessment has considered the potential impacts on the business model, future performance, capital adequacy and liquidity. The group's financial forecasts have been refreshed and make certain assumptions about the expected impact of the pandemic on the macroeconomic environment, the performance of the group's lending portfolios and the availability of funding.

The group's most recent Internal Capital Adequacy Assessment Process (ICAAP) has recently been finalised and the Internal Liquidity Adequacy Assessment Process (ILAAP) is well advanced. Both are completed annually and use scenarios determined by the Bank of England together with internal scenarios which reflect the specific nature of the group's business. Included within these scenarios are substantial falls in residential and commercial property prices, increases in unemployment, changes to interest rates and reduced funding availability within wholesale and retail markets.

Having considered the plans and forecasts for the group, the Directors remain satisfied that the group has adequate resources and no material uncertainties that lead to significant doubt about 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.

New and amended standards adopted by the group

Amendments to existing standards, IAS 1, IAS 8 and IFRS 3, effective from 1 January 2020, did not have any impact on the group's accounting policies and did not require retrospective adjustments. Amendments to IFRS 9, IAS 39 and IFRS 7: Interest Rate Benchmark Reform, were early adopted for the year ended 31 December 2019 and the policies and approach adopted are as disclosed in the 2019 Annual Report and Accounts.

Notes to the accounts
for the six months ended 30 June 2020

1. Basis of preparation (continued)

Impact of standards issued but not yet applied

There are no material impacts expected from issued standards and amendments to existing standards that are not yet applicable.

Judgements in applying accounting policies and critical accounting estimates

There are no significant judgements made in applying the group's accounting policies. The areas of critical accounting estimates remain consistent with those disclosed in the 2019 Annual Report and Accounts, being impairment provisions on loans and advances (note 14), retirement benefit obligations (note 8) and provisions for customer and regulatory complaints (note 11).

2. Business segments

The group operates three main business segments: retail financial services, commercial lending and secured personal lending.

Transactions between the business segments are on normal commercial terms and conditions.

	Six months to 30 June 2020 (Unaudited)			
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Total £m
Net interest income	39.1	8.2	4.8	52.1
Other income and charges	(2.2)	0.5	-	(1.7)
Net operating income	36.9	8.7	4.8	50.4
Operating expenses	(38.0)	(1.2)	(0.4)	(39.6)
Impairment provision for losses on loans and advances	(11.1)	(3.0)	(3.8)	(17.9)
Provision for other liabilities and charges	0.2	-	0.5	0.7
Operating (loss)/profit and loss before taxation	(12.0)	4.5	1.1	(6.4)
Taxation credit				1.2
Loss after taxation				(5.2)

	Six months to 30 June 2019 (Unaudited)			
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Total £m
Net interest income	43.8	7.1	5.3	56.2
Other income and charges	(0.1)	0.8	-	0.7
Net operating income	43.7	7.9	5.3	56.9
Operating expenses	(36.7)	(1.8)	(0.7)	(39.2)
Impairment provision for losses on loans and advances	(1.7)	2.3	1.5	2.1
Provision for other liabilities and charges	-	-	-	-
Operating profit and profit before taxation	5.3	8.4	6.1	19.8
Taxation expense				(3.6)
Profit after taxation				16.2

Notes to the accounts
for the six months ended 30 June 2020

2. Business segments (continued)

	Year ended 31 December 2019 (Audited)			
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Total £m
Net interest income	86.2	14.7	10.5	111.4
Other income and charges	2.4	1.7	0.1	4.2
Net operating income	88.6	16.4	10.6	115.6
Operating expenses	(75.2)	(3.6)	(1.3)	(80.1)
Impairment provision for losses on loans and advances	(2.3)	2.7	3.7	4.1
Operating profit and profit before taxation	11.1	15.5	13.0	39.6
Taxation expense				(7.6)
Profit after taxation				32.0

The group operates entirely within the UK, and therefore a geographical segment analysis is not presented.

	6 months to 30 June 2020 £m (Unaudited)	6 months to 30 June 2019 £m (Unaudited)	Year ended 31 December 2019 £m (Audited)
Total assets by business segments			
Retail financial services	9,495.1	9,068.1	9,665.9
Secured personal lending	156.9	207.9	179.6
Commercial lending	863.6	816.4	850.3
Total assets	10,515.6	10,092.4	10,695.8
Total liabilities and equity by business segment			
Retail financial services and Commercial lending	10,358.7	9,884.5	10,516.2
Secured personal lending	156.9	207.9	179.6
Total liabilities and equity	10,515.6	10,092.4	10,695.8

3. Interest receivable and similar income

	Group		
	6 months to 30 June 2020 £m (Unaudited)	6 months to 30 June 2019 £m (Unaudited)	Year ended 31 December 2019 £m (Audited)
On loans fully secured on residential property	112.8	109.7	221.3
On other loans	4.0	4.7	11.9
On debt securities	0.7	0.5	1.2
On other liquid assets	2.4	3.8	7.7
On derivative financial instruments	(12.7)	(3.8)	(8.2)
	107.2	114.9	233.9

Notes to the accounts
for the six months ended 30 June 2020

4. Interest payable and similar charges

	Group		
	6 months to 30 June 2020 £m (Unaudited)	6 months to 30 June 2019 £m (Unaudited)	Year ended 31 December 2019 £m (Audited)
On shares held by individuals	45.3	44.3	92.8
On deposits and debt securities	12.3	14.2	28.8
On subscribed capital	1.7	2.1	4.2
On lease liabilities	0.1	0.1	0.3
On derivative financial instruments	(4.3)	(2.0)	(3.6)
	55.1	58.7	122.5

5. Fees and commission receivable

	Group		
	6 months to 30 June 2020 £m (Unaudited)	6 months to 30 June 2019 £m (Unaudited)	Year ended 31 December 2019 £m (Audited)
Insurance and related financial service products	0.6	0.7	1.3
Mortgage related fees	1.3	1.6	3.5
Other fees and commission	-	0.1	0.1
	1.9	2.4	4.9

6. Other fair value gains and losses

	Group		
	6 months to 30 June 2020 £m (Unaudited)	6 months to 30 June 2019 £m (Unaudited)	Year ended 31 December 2019 £m (Audited)
Losses on derivatives in hedging relationships	(53.3)	(26.8)	(23.0)
(Losses)/gains on derivatives not in hedging relationships	(2.2)	(0.5)	1.9
Losses on derivatives	(55.5)	(27.3)	(21.1)
Gains on economic hedged items	5.0	3.2	5.9
Gains on hedged items attributable to hedged risk	47.6	22.7	15.0
Gains on hedged items	52.6	25.9	20.9
	(2.9)	(1.4)	(0.2)

Other fair value gains and losses represent the difference between changes in the fair values excluding interest flows of the hedging derivatives and the changes in the fair values excluding interest flows of the underlying hedged items.

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for the six months ended 30 June 2020

7. Administrative expenses

	Group		
	6 months to 30 June 2020 £m (Unaudited)	6 months to 30 June 2019 £m (Unaudited)	Year ended 31 December 2019 £m (Audited)
Wages and salaries	18.3	18.5	37.2
Social security costs	2.0	1.9	4.0
Other pension costs	1.1	1.1	2.2
	21.4	21.5	43.4
Other administrative expenses	14.2	14.1	29.4
	35.6	35.6	72.8

8. Retirement benefit obligations

	Group		
	30 June 2020 £m (Unaudited)	30 June 2019 £m (Unaudited)	31 December 2019 £m (Audited)
Fair value of plan assets	79.9	71.7	74.3
Present value of funded and unfunded obligations	(78.9)	(73.1)	(74.3)
Pension scheme surplus/(deficit)	1.0	(1.4)	-

The pension scheme has moved from a deficit to a surplus position, primarily as a result of contributions of £1.5m paid by the Society during the period.

Significant actuarial assumptions in the determination of the defined benefit obligation are the discount rate, inflation rate and life expectancy. The sensitivity analysis below represents the net impact on the scheme liabilities of a 0.5% increase or decrease in each assumption.

	Group	
	Increase 0.5% £m	Decrease 0.5% £m
Discount rate	(5.5)	6.1
Inflation	5.3	(4.8)
Life expectancy (+1 year/ -1 year)	3.3	(3.3)

Notes to the accounts
for the six months ended 30 June 2020

9. Taxation

Taxation for the group for the 6 months to 30 June 2020 is charged at 18.8% (30 June 2019: 18.2%), representing the best estimate of the annual effective tax rate expected for the full year, applied to the forecast pre-tax income for the year and pro-rated for the six-month period. The effective statutory rate of of corporation tax for the year ending December 2020 is 19.0%.

The actual tax charge for the period differs from that calculated using the statutory rate of corporation tax in the UK as follows:

	Group		
	6 months to 30 June 2020 £m (Unaudited)	6 months to 30 June 2019 £m (Unaudited)	Year ended 31 December 2019 £m (Audited)
(Loss)/profit before tax	(6.4)	19.8	39.6
(Loss)/profit multiplied by the standard rate of corporation tax at 19.00% (2019: 19.00%)	(1.2)	3.8	7.5
Effects of:			
Expenses not deductible for tax purposes	(0.1)	-	0.3
Other	0.1	(0.2)	(0.2)
Tax (credit)/charge	(1.2)	3.6	7.6

10. Loans and advances to customers

	Group		
	30 June 2020 £m (Unaudited)	30 June 2019 £m (Unaudited)	31 December 2019 £m (Audited)
Fully secured on residential property	8,810.3	8,490.3	8,695.2
Fully secured on land	316.6	294.5	311.4
	9,126.9	8,784.8	9,006.6
Provision for impairment losses	(43.3)	(29.7)	(25.5)
Unamortised loan origination fees	18.6	20.8	19.7
Fair value adjustment for hedged risk	95.5	39.7	32.3
	9,197.7	8,815.6	9,033.1

11. Provisions for liabilities

	Group		
	30 June 2020 £m (Unaudited)	30 June 2019 £m (Unaudited)	31 December 2019 £m (Audited)
At beginning of the period/year	4.4	5.1	5.1
Charge/(release) for the period/year	(0.7)	-	0.2
Utilisation	-	(0.3)	(0.9)
At end of the period/year	3.7	4.8	4.4

Notes to the accounts
for the six months ended 30 June 2020

11. Provisions for liabilities (continued)

The group continues to hold provisions in respect of various customer claims. The provision reflects management's best estimate of the costs required to settle its remaining obligations and takes account of expected customer behaviour, costs incurred with associated legal claims and an updated assessment of the remaining exposure population. The majority of the provision is expected to be utilised over the next three to five years.

Although a significant degree of uncertainty remains with regard to the ultimate cost of settling customer claims, the provision balance is expected to be sufficient to meet any remaining obligations. The provision will continue to be monitored and customer trends and behaviours analysed to ensure the provision remains appropriate.

12. Related party transactions

The group had no related party transactions outside the normal course of the business during the six months to 30 June 2020. Transactions for this period are similar to those for the year to 31 December 2019, details of which can be found in note 34 of the 2019 Annual Report and Accounts.

13. Financial instruments

Carrying values and fair values

The table below compares carrying values and fair values of the group's financial instruments by category.

	30 June 2020		31 December 2019	
	Carrying Value £m (Unaudited)	Fair Value £m (Unaudited)	Carrying Value £m (Audited)	Fair Value £m (Audited)
Total assets				
Cash in hand and balances with Bank of England	797.8	797.8	1,201.9	1,201.9
Loans and advances to credit institutions	291.8	291.8	202.6	202.6
Debt securities	115.5	115.5	165.1	165.1
Derivative financial instruments	27.9	27.9	21.3	21.3
Loans and advances to customers	9,197.7	9,442.6	9,033.1	9,341.2
	10,430.7	10,675.6	10,624.0	10,932.1
Total liabilities				
Shares	7,594.7	7,636.6	7,588.5	7,625.0
Amounts owed to credit institutions	1,055.6	1,055.6	1,072.5	1,072.5
Amounts owed to other customers	102.7	102.7	197.9	197.9
Debt securities in issue	1,041.1	1,046.1	1,107.7	1,112.7
Derivative financial instruments	116.7	116.6	50.4	50.4
Subscribed capital	-	-	61.2	60.6
	9,910.8	9,957.6	10,078.2	10,119.1

Further details on the methods and assumptions which have been applied in determining fair value are set out in note 30 of the 2019 Annual Report and Accounts.

Notes to the accounts
for the six months ended 30 June 2020

13. Financial instruments (continued)

Assets and liabilities measured at fair value

	30 June 2020 (Unaudited)			
	£m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	27.9	-	16.6	11.3
Financial assets at fair value through other comprehensive income:				
Debt securities	115.5	115.5	-	-
Total	143.4	115.5	16.6	11.3
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	8.2	-	8.2	-
Derivative financial instruments	116.6	-	105.4	11.2
Total	124.8	-	113.6	11.2

	30 June 2019 (Unaudited)			
	£m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	22.1	-	14.6	7.5
Financial assets at fair value through other comprehensive income:				
Debt securities	139.0	139.0	-	-
Total	161.1	139.0	14.6	7.5
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	15.1	-	15.1	-
Derivative financial instruments	56.4	-	48.9	7.5
Total	71.5	-	64.0	7.5

	31 December 2019 (Audited)			
	£m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	21.3	-	13.7	7.6
Financial assets at fair value through other comprehensive income:				
Debt securities	165.1	165.1	-	-
Total	186.4	165.1	13.7	7.6
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	1.9	-	1.9	-
Debt securities in issue	1.7	1.7		
Derivative financial instruments	50.4	-	42.8	7.6
Total	54.0	1.7	44.7	7.6

The tables above provide an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3 based on the degree to which the fair value is observable. This is detailed on the following page.

Notes to the accounts
for the six months ended 30 June 2020

13. Financial instruments (continued)

Hierarchy for fair value disclosures

Level	
1.	Quoted prices (unadjusted) in active markets for identical assets or liabilities.
2.	Inputs other than quoted prices included within level 1 that are observable for the asset or liability either directly or indirectly (i.e derived from prices).
3.	Inputs for the asset or liability that are not based on observable market data.

The items included within level 3 are interest rate swaps, the notional amounts for which track the amortisation profile of the mortgage assets within the Retail Mortgage Backed Securities (RMBS) structures. The valuations are calculated using present value calculations based on market interest rate curves and projected mortgage prepayment amounts. The unobservable inputs relate to the projection of the notional amounts of the swaps, which change over time to match the balance of the underlying mortgage portfolio.

14. Credit risk

The table below shows the group's estimated maximum exposure to credit risk for all financial assets.

i) Loans and advances to customers

The group's exposure to credit risk relating to loans and advances to customers can be broken down by security as follows:

	Group		
	30 June 2020 £m (Unaudited)	30 June 2019 £m (Unaudited)	31 December 2019 £m (Audited)
In respect of loans and advances to customers:			
Secured by a first charge on residential property	8,649.0	8,281.9	8,514.5
Secured by a first charge on land	316.6	294.5	311.4
Secured by a second charge on residential property	161.3	208.5	180.7
	9,126.9	8,784.9	9,006.6
Provisions for impairment losses	(43.3)	(29.7)	(25.5)
Effective interest rate adjustments	18.6	20.7	19.7
Fair value adjustments	95.5	39.7	32.3
	9,197.7	8,815.6	9,033.1

The group's exposure to credit risk relating to loans and advances to customers by business segment split by stage in accordance with IFRS 9 is as follows:

	Retail Financial Services		Commercial Lending		Secured Personal Lending	
Stage	30 June 2020 £m (Unaudited)	31 December 2019 £m (Audited)	30 June 2020 £m (Unaudited)	31 December 2019 £m (Audited)	30 June 2020 £m (Unaudited)	31 December 2019 £m (Audited)
1	7,472.0	7,404.8	743.3	763.5	117.7	135.6
2	605.8	620.8	96.0	70.9	32.1	34.9
3	39.0	39.0	9.5	4.9	11.5	10.2
	8,116.8	7,986.6	848.8	839.3	161.3	180.7

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for the six months ended 30 June 2020

14. Credit risk (continued)

The group's expected credit losses split by stage in accordance with IFRS 9 and by business segment is as follows:

	6 months to 30 June 2020 £m (Unaudited)	6 months to 30 June 2019 £m (Unaudited)	Year ended 31 December 2019 £m (Audited)
Retail financial services	21.9	10.8	11.0
Secured personal lending	10.4	8.6	6.5
Commercial lending	11.0	10.3	8.0
	43.3	29.7	25.5

The group's split of loans by stage in accordance with IFRS 9 and by business segment is as follows:

Retail Financial Services and Secured Personal Lending

Stage	6 months to 30 June 2020 £m (Unaudited)	6 months to 30 June 2019 £m (Unaudited)	Year ended 31 December 2019 £m (Audited)
1	90%	90%	91%
2	9%	9%	8%
3	1%	1%	1%
	100%	100%	100%

Commercial Lending

Stage	6 months to 30 June 2020 £m (Unaudited)	6 months to 30 June 2019 £m (Unaudited)	Year ended 31 December 2019 £m (Audited)
1	90%	90%	92%
2	8%	9%	6%
3	2%	1%	2%
	100%	100%	100%

The average index-linked loan balance to value (BTV), in respect of the group's loans secured by a first or second charge on residential property, is 53.0% (31 December 2019: 52.3%).

The percentage of retail lending cases fully secured by a first charge, currently with arrears greater than three months, is 0.42% (31 December 2019: 0.42%).

Residential lending cases fully secured by a first charge which were six months or more in arrears had arrears balances of £1.0m (31 December 2019: £0.8m) with 223 (31 December 2019: 164) cases.

14. Credit risk (continued)

The percentage of secured personal loans currently in arrears by two months or more by number is 6.8% (31 December 2019: 4.72%), which by value is 7.1% (31 December 2019: 5.92%).

The critical accounting estimates applied in determining expected credit loss provisions are:

- determining criteria for identifying a significant increase in credit risk;
- choosing appropriate models and assumptions for the measurement of expected credit losses; and
- establishing the number and relative weightings of forward-looking economic scenarios.

Sensitivity analysis has been performed on the staging criteria and probability of default (PD) models used to determine expected credit loss provisions. A 20% variance has been selected as this is deemed to be a reasonable variation which could occur over a 12 month period in the current economic environment. The impact of a 20% increase or reduction in the volume of loans in stage 2 is as follows:

Stage	Retail financial services £m	Secured personal lending £m	Commercial lending £m
Stage 1 to Stage 2	2.8	0.8	0.2
Stage 2 to Stage 1	(2.2)	(0.6)	(0.2)

The impact of a 20% change in the PD rates is as follows:

Retail financial services £m	Secured personal lending £m	Commercial lending £m
4.0	2.0	1.6

Forward looking economic scenarios

Forecasts of economic variables together with probability weightings are supplied by an external provider. Economic scenarios have been selected which take account of a range of possible economic outcomes. The scenarios, together with the weightings and average values of the key variables over the four years to 2023 are set out below:

Scenario	Weighting at 30 June 2020 %	2020 Scenario				Weighting at 31 Dec 2019 %	2019 Scenario			
		2020 %	2021 %	2022 %	2023 %		2020 %	2021 %	2022 %	2023 %
HPI										
Base	32.5	(14.6)	(4.9)	5.8	10.5	45.0	1.4	0.6	1.1	1.1
Upside	30.0	(12.1)	1.3	7.2	8.7	0.0	5.8	5.9	2.2	0.1
Downside	20.0	(16.7)	(9.5)	5.0	11.8	25.0	(1.0)	(3.1)	0.9	2.3
Severe Downside	7.0	(20.9)	(18.3)	(0.9)	9.4	15.0	(6.3)	(11.8)	(4.5)	2.2
Stagflation	10.5	(15.7)	(9.1)	(2.1)	8.7	15.0	(1.2)	(4.8)	(3.8)	2.0

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14. Credit risk (continued)

Scenario	Weighting at 30 June 2020 %	2020 Scenario				Weighting at 31 Dec 2019 %	2019 Scenario			
		2020 %	2021 %	2022 %	2023 %		2020 %	2021 %	2022 %	2023 %
Unemployment										
Base	32.5	4.6	0.0	(0.5)	(0.9)	45.0	0.2	0.2	0.2	0.1
Upside	30.0	3.8	(0.9)	(0.4)	(0.7)	0.0	(0.7)	(0.3)	0.3	0.4
Downside	20.0	5.2	0.4	(0.7)	(1.2)	25.0	1.0	0.4	0.0	(0.1)
Severe Downside	7.0	6.6	1.2	(0.1)	(1.1)	15.0	2.0	1.7	0.4	(0.1)
Stagflation	10.5	4.8	1.2	0.3	(1.1)	15.0	0.7	1.5	0.7	0.0

Scenario	Weighting at 30 June 2020 %	2020 Scenario				Weighting at 31 Dec 2019 %	2019 Scenario			
		2020 %	2021 %	2022 %	2023 %		2020 %	2021 %	2022 %	2023 %
GDP										
Base	32.5	(7.6)	4.3	7.5	5.4	45.0	3.3	3.2	3.5	3.6
Upside	30.0	(4.0)	5.7	8.4	5.9	0.0	8.2	3.9	3.5	3.5
Downside	20.0	(10.8)	4.5	7.0	5.6	25.0	(0.1)	2.2	3.9	4.4
Severe Downside	7.0	(12.8)	0.2	6.2	4.6	15.0	(5.7)	(1.2)	2.5	4.7
Stagflation	10.5	(6.9)	3.2	5.8	5.1	15.0	2.1	1.0	2.2	4.5

In determining ECLs at 30 June 2020, the group has followed the Prudential Regulation Authority (PRA) guidance and concluded that mortgage payment holidays arising from COVID-19 should not be treated either as a forbearance measure or as automatically triggering a significant increase in credit risk.

However, it is recognised that there will be a proportion of customers that will experience longer-term financial difficulties beyond this initial deferral period. This will impact their probability of default, either because they fall behind in their payments on their mortgage or unsecured borrowings, or through other factors impacting their credit score, which may not be evident in the short-term due to the widespread use of payment holidays across the industry.

In order to recognise this increased risk, a management overlay has been calculated, covering a portfolio of customers deemed most likely to experience a significant increase in credit risk. This overlay totalled £1.9m at 30 June 2020 and is held on a collective basis within stage 2, albeit the reported volume of loans in each stage has not been impacted.

The impact of each of the economic variables varies according to the portfolio. For example, retail mortgages and secured personal lending are most sensitive to house prices, whilst commercial lending is more sensitive to GDP.

The IFRS 9 models calculate expected credit losses for each scenario and then apply the weightings to generate the weighted output for each model. Sensitivity analysis has been performed on the impact of each economic scenario. The table below shows the range of ECL impact between the most optimistic and the most severe scenario. The ECL range is the difference between applying a 100% weighting to the most severe downturn scenario and the upside scenario.

Notes to the accounts
for the six months ended 30 June 2020

14. Credit risk (continued)

Portfolio	ECL Range £m
Retail financial services	25.3
Secured personal lending	6.4
Commercial lending	2.9

The tables below set out information on movements in impairment loss provisions on loans and advances to customers:

	Group			
	Stage 1 12 month ECL £m	Stage 2 Lifetime ECL £m	Stage 3 Lifetime ECL £m	Total £m
At 1 January 2020	3.7	15.8	6.1	25.6
Transfers:				
Stage 1 transfers	(0.3)	-	-	(0.3)
Stage 2 transfers	-	2.3	-	2.3
Stage 3 transfers	-	-	3.1	3.1
New loans	0.5	0.1	-	0.6
Settled loans	(0.2)	(0.9)	(0.6)	(1.6)
Changes in macro-economic forecasts	2.5	11.9	4.9	19.3
Changes in credit quality	(0.4)	(1.1)	(0.3)	(1.9)
Changes in loan model assumptions	(0.1)	(3.4)	(0.1)	(3.7)
Loss allowance at 30 June 2020	5.6	24.7	13.0	43.3

	Group			
	Stage 1 12 month ECL £m	Stage 2 Lifetime ECL £m	Stage 3 Lifetime ECL £m	Total £m
At 1 January 2019	3.1	17.0	10.4	30.5
Transfers:				
Stage 1 transfers	(0.3)	-	-	(0.3)
Stage 2 transfers	-	0.7	-	0.7
Stage 3 transfers	-	-	0.3	0.3
New loans	1.2	1.6	-	2.8
Settled loans	(0.5)	(1.1)	(4.2)	(5.8)
Changes in credit quality	0.3	(0.2)	(0.2)	(0.1)
Changes in loan model assumptions	(0.1)	(2.2)	(0.2)	(2.5)
Loss allowance at 31 December 2019	3.7	15.8	6.1	25.6

Notes to the accounts
for the six months ended 30 June 2020

14. Credit risk (continued)

ii) Commercial

Loans secured on commercial property are diversified by industry type with the largest exposure to one counterparty amounting to £29.6m (31 December 2019: £29.6m) or 3.5% (31 December 2019: 3.5%) of gross balances.

Asset quality remains strong with impaired balances of £9.5m (31 December 2019: £4.9m), or 1.1% of gross balances (31 December 2019: 0.6%).

iii) Treasury

The treasury risk function monitors exposure concentrations against a variety of criteria including counterparty and country limits, and all exposures are well spread across this risk assessment framework.

Provisions for expected credit losses in relation to treasury instruments of £0.7m were held at 30 June 2020 (31 December 2019: £0.9m).

Responsibility statement

We confirm that to the best of our knowledge:

(a) the condensed set of financial statements has been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU;

(b) the interim management report includes a fair review of the information required by DTR 4.2.7 (indication of important events during the first six months and the description of principal risks and uncertainties for the remaining six months of the year); and

(c) the interim management report includes information required by DTR 4.2.8 (indication of any related party transactions that have taken place or any changes in the related party transactions described in the last annual report).

By order of the Board,

R Michael Jones
Interim Chief Executive Officer
4 August 2020

Independent review report to Principality Building Society

We have been engaged by the Principality Building Society (the "Society") to review the condensed set of financial statements in the interim financial report for the six months ended 30th June 2020 which comprises the condensed consolidated income statement, condensed consolidated statement of other comprehensive income, condensed consolidated statement of financial position, condensed statement of changes in Member's interests, condensed consolidated statement of cash flows and related notes 1 to 14. We have read the other information contained in the interim financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

Directors' responsibilities

The interim financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the interim financial report in accordance with the Disclosure Guidance and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1, the annual financial statements of the Society are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this interim financial report has been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" as adopted by the European Union.

Our responsibility

Our responsibility is to express to the Society a conclusion on the condensed set of financial statements in the interim financial report based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Financial Reporting Council for use in the United Kingdom. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the interim financial report for the six months ended 30th June 2020 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure Guidance and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Independent review report to Principality Building Society (continued)

Use of our report

This report is made solely to the company in accordance with International Standard on Review Engagements (UK and Ireland) 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Financial Reporting Council. Our work has been undertaken so that we might state to the company those matters we are required to state to it in an independent review 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 company, for our review work, for this report, or for the conclusions we have formed.

Deloitte LLP
Statutory Auditor
Cardiff, UK
4 August 2020

Other information

The information for the period ended 30 June 2020 is unaudited and does not constitute accounts within the meaning of section 73 of the Building Societies Act 1986. The financial information for the year ended 31 December 2019 has been extracted from the Annual Report and Accounts for that year. The annual accounts for the year ended 31 December 2019 have been filed with the Financial Conduct Authority.

The auditor's report on the 2019 Annual Report and Accounts was not qualified and did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying the report.

A copy of the this Half Year Financial Report is placed on Principality Building Society's website. The Directors are responsible for the maintenance and integrity of the information on the website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Glossary

Arrears	A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan payment is overdue. Such a customer can also be said to be in a state of delinquency.
Brand consideration	Brand consideration measures whether a respondent would actively consider Principality as a potential provider when approaching a new purchase.
Commercial lending	Secured loans to a commercial borrower.
Contractual maturity	The final payment date of a loan or other financial instrument, at which point the entire remaining outstanding principal and interest is due to be repaid.
Common Equity Tier 1 capital	The highest quality form of capital as defined in the Capital Requirements Directive IV, comprising accumulated reserves and qualifying instruments after regulatory deductions.
Common Equity Tier 1 capital ratio	Common Equity Tier 1 capital as a proportion of risk-weighted assets.
Cost income ratio	A ratio that represents the proportion of management expenses (i.e. administrative expenses, depreciation and amortisation) to total income.
Credit risk	The risk of financial loss arising from a failure of a customer or counterparty to settle their financial and contractual obligations as they fall due.
Debt securities in issue	Transferable certificates of indebtedness including certificates of deposits, and fixed and floating rate notes.
Defined benefit pension scheme	A scheme that defines the benefit an employee will receive on retirement, depending on such factors as age, length of service and salary.
Financial Conduct Authority (FCA)	The statutory body responsible for conduct of business regulation and supervision of UK authorised firms from 1 April 2013. The FCA also has responsibility for protecting consumers and promoting healthy competition.
Internal Capital Adequacy Assessment Process (ICAAP)	The group's internal assessment of the levels of capital that need to be held by the Society to meet its regulatory capital requirements.
Internal Liquidity Adequacy Assessment Process (ILAAP)	The group's internal assessment of the levels of liquidity that need to be held by the Society to meet its regulatory liquidity requirements.
Leverage ratio	A ratio which measures Tier 1 capital against total on and off balance sheet assets.
Liquid assets	Cash or other assets that can be readily converted to cash without loss of value.
Liquidity Coverage Ratio (LCR)	A liquidity metric which aims to ensure that a firm maintains an adequate level of liquidity to meet its needs for a 30 calendar day time horizon under a severe stress scenario.
Loan To Value ratio (LTV)	A ratio showing outstanding loan balance as a percentage of the value of the security.
Management expense ratio	A ratio that measures cost as a proportion of mean assets.
Member	A person who has a share investment or a mortgage loan with the Society.

Glossary (continued)

Net interest income	The difference between the interest received on assets and the interest paid on liabilities.
Net interest margin	This ratio calculates the net interest income as a percentage of mean total assets.
Permanent Interest-Bearing Shares (PIBS)	Unsecured, Sterling denominated Additional Common Equity Tier 1 capital instruments repayable at the option of the Society.
Regulatory capital	Capital allowable under regulatory rules, less certain required regulatory adjustments and deductions.
Residential Mortgage Backed Securities (RMBS)	A category of asset backed security that represents interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).
Retail loans	Loans to individuals rather than institutions, including residential mortgage lending.
Shares	Money deposited by Members in a retail savings account with the Society and held as a liability in the statement of financial position.
Subscribed capital	See Permanent Interest-Bearing Shares (PIBS).

Getting in touch with us

Please refer to our website for the most up to date opening hours information.

ONLINE

Please stay safe, visit us at **www.principality.co.uk/coronavirus** or on our social channels **@principalitybs** for the latest updates.

VISIT

To minimise the spread of COVID-19, recommended precautions, such as social distancing, have been introduced in branches and we ask that Members please support us with this.

To find your nearest branch visit **www.principality.co.uk/branch**

CALL US

0330 333 4000•

This leaflet is available in large print, Braille and audio tape on request by calling 0330 333 4000•

• To help us maintain our service and security standards, telephone calls may be monitored and recorded.

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Principality
Building Society
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Where home matters
www.principality.co.uk