Annual Report and Accounts 2022

Building your future

Principality
Building Society
Cymdeithas Adeiladu

Where home matters
principality.co.uk

2022 highlights

First Time Buyers helped
2021: 2,954
4,587

Net Promoter Score
2021: 80.5
81.6

Common Equity Tier 1 ratio
26.5%
2021: 34%

Great Place To Work®
Certified
OCT 2021-OCT 2022
UK
86%
engagement score
2021: 87%

49.3 million
Statutory profit before tax
2021: 64m

Mortgages funded by savers
92.3%
2021: 89.4%

£19m
committed to the Green Commercial Development Fund

28,000
children supported via financial education initiatives
2021: 3,900

£0.7m
donated to charity
2021: £0.6m

The above measures, apart from statutory profit before tax, are alternative performance measures (APMs). Further information on these APMs can be found in the Strategic Report, with definitions included within the glossary.

Welcome

Strategic Report

Chair's Review of the Year

To all our Members and customers, welcome to our annual report and accounts for 2022. In these tough economic times, our role as a mutual building society is to positively support our customers, colleagues, communities and society. I'm pleased to say that once again we have helped thousands of people find a home and have looked after our savers with competitive interest rates, so you can save for a more secure future.

The Board has developed and set a strategy for the next decade with three key areas of focus: Better Homes, Secure Futures and Fairer Society. These are the foundations upon which our success has been built this year and they will drive us to deliver even more positive impact and reach in the future. You can read more about these from page 10.

Our results are not just measured in financial performance, but also in the ways we make a positive impact on society and this feels especially important at the present time. You will hear about the great ways we have had an impact on financial education, our charitable support, plus how we have helped our Members who depend upon using cash and visiting us in person, by keeping open our branches as we see other financial providers around the country close theirs.

Pictured: Sally Jones-Evans, Chair

I want to thank our amazing colleagues on behalf of you all for their passion, enthusiasm, and dedication to provide award-winning customer service despite another challenging year. Recognition should also go to Julie-Ann and her Executive leadership team who have steadied the organisation through turbulent economic conditions, and led by example as we took the first steps to bring this new strategy, focused on our social impact and purpose, alive for our Members and communities.

Board changes

This year we said goodbye to Nigel Annett and David Rigney as Non-Executive Directors (NEDs) after nine and seven years respectively, and to Tom Denman, our former Chief Financial Officer (CFO) who moved on to pastures new. We wish them all well in the future and thank them for their hard work on your behalf.

Joining the Board as a NED is Ian Greenstreet, who has wide ranging experience in financial services with particular expertise in risk and financial matters, as well as digital transformation experience. Iain Mansfield, our former Chief Operating Officer (COO) who was already an Executive Director on the Board was appointed into the CFO role.

We have also broken new ground by creating two Non-Executive Board associate roles as part of our desire to give greater development opportunities to individuals who want to gain experience for future Board postions and provide a pipeline of talent for future substantive board roles. Natalie Jakomis and Sandra Skeete are the first ever Board associates in Principality's history and bring to us their current deep expertise in data science and the housing sector respectively.

All these appointments are made with a vision to make your Society a modern, effective business now and for future generations, with a diversity of knowledge, skills, business, life and leadership experience, and thinking styles around the Board.

Thank you

Before you read on, I want to thank you, our loyal Members, for the fantastic support you have shown us yet again this year. I am proud of what we all do to run this Society on your behalf, to keep it safe and secure, and to invest to make it relevant in the future. I do hope you enjoy reading more about this in the following pages.

Sally Jones-Evans
Chair
17 February 2023

Chief Executive's Review of the Year

Framing the future of your business

From the first moments I took over as Chief Executive Officer (CEO) at Principality, I could see an urgent need to focus on being much more ambitious, clear about what we were going to stand for and do a better job of helping more people across the UK to own their own home and be more financially resilient.

There are a number of issues that are staring us in the face as Members and communities feel the pressure of the cost of living crisis. Right now, many businesses have been thrust into the perhaps unfamiliar position of having to act in the interests of society but as a mutual building society, it is something that comes naturally to us.

Our commitment to keep our branches open until at least the end of 2025 is a prime example of this. We have the biggest branch presence of any financial services provider on the high streets of Wales, whilst continuing to develop our technology to become easier to do business with, be quicker and more efficient.

You can read about all the excellent work we have done to make a positive impact on society on page 23 which explains our wholehearted plans to commit to this as a mutual for many years to come. It is what we were set up to do more than 160 years ago and our purpose is stronger than ever before in these difficult times.

Pictured: Julie-Ann Haines, Chief Executive Officer

There is a growing expectation that firms make long-term commitments to sustainable finance, and build environmental, social and governance considerations more comprehensively into their structure. We have a lot to do, but are already taking positive steps and I am proud of our progress. You can find out what we have done this year on page 24.

Performance highlights

As a building society owned by you, our Members, we are not under pressure to meet the short-term needs of shareholders. Our aim is to focus on the long-term and invest to support you and as a result the future growth of the Society.

Our financial performance was strong in 2022, with underlying profits of £43.5m (2021 - £54.4m, see page 12) and profits before tax of £49.3m

(2021 - £64.0m). Our mortgage book grew by £208.5m in 2022 (2021: reduction of £142.4m), which exceeded our goal at the start of the year, despite the pressures of rising house prices on top of high inflation. So, you can be assured we have a strong balance sheet and capital to reinvest in the business for your benefit, to help us create better homes, help Members to financially secure their futures through savings, as well as trying to create a fairer society by having a positive impact on our communities.

You can find more information and an explanation of our performance from page 13 and how this has benefited you as a Member.

Over the past 18 months, we have reframed our strategy for the next 10 years and our focus is around three strategic pillars; Better Homes, Secure Futures and Fairer Society and the Board has agreed that we will continue to increase investment so we can have a bigger impact.

Better Homes highlights

As inflation has increased this year, we have worked hard to balance the differing needs of our mortgage and savings customers, passing on just 1.25% of the Bank of England's 3.25% base rate rises to our variable rate and discount mortgage Members.

Our key achievements included:

- 75,902 homeowners supported (2021 - 76,262)
- 4,587 first time buyers helped to buy a home (2021 - 2,954)
- 213 new homes built as a result of our commercial lending funding relationships (2021 - 160)
- £19m committed to providing loans to Green Commercial Development Fund (2021 - scheme launched)

Secure Futures highlights

Most of our Members who save with us have benefited from at least six rate increases, ensuring we are offering competitive returns for our savers as interest rates rise.

In 2022 we helped:

- Almost 400,000 savers with improved rates
- Supported over 28,000 young people (2021 - 3,900) via our financial education programmes to help them understand the importance of financial planning
- On average our savings rate paid to Members has increased more than the market with an average savings rate of 1.03% compared with the market of 0.56% (Source: CACI's CSDB, Stock, Weighted Average Interest Rate for December 2021 – November 2022).

Fairer Society highlights

As a consequence of our work on strategy and the challenges our communities and colleagues are facing, our key achievements are:

- £0.7m (2021 - £0.6m) distributed for positive social impact activity across our communities via donations to charity groups and financial education for young people
- Living Wage Employer accredited - meaning we pay colleagues the minimum real living wage, helping us to retain our award-winning teams
- Commitment to keeping our branches open at least until the end of 2025

Outlook

With unfavourable economic conditions expected to last until at least 2024, I want to reassure you that our business is strong and able to endure these difficult times. Now more than ever, we need to be courageous in our decision making. The challenges facing our Members, communities and colleagues in the face of the cost of living crisis means we need to strive to achieve more.

I am so excited about the opportunities that lay before us and how we can start to make an even bigger difference. We are here for our Members, colleagues and communities and I thank you on behalf of your Executive team for your loyalty and support.

Chief Executive Officer (CEO)
17 February 2023

Business Model and Strategy

for the year ended 31 December 2022

Our Purpose and Vision
As a mutual, we're owned by our Members, not shareholders. We're led by Member voices, respond to their needs and reinvest our profits for the benefit of our customers, colleagues, communities and wider society, ensuring we continue to be a responsible, sustainable and future focused business - just as we have for the past 162 years.

This is why we are reimagining the role of Principality, as we seek to have more of a positive impact on society and the lives of our customers and colleagues.

We believe that home is the heart of life, where plans, decisions and memories are made. Our purpose is to help everyone prosper in their homes at every stage of life.

Our vision is to help build a society of savers, where everyone has a place to call home and our ambition is to have more impact while ensuring our purpose is at the heart of everything we do.

Our Business Model
We've always operated ethically, responsibly and socially and now we must evolve to do so more sustainably, whilst amplifying our voice and accelerating our progress to deliver impact beyond our scale.

Our business model operates across three primary lines of business; retail mortgages, commercial lending and savings, whilst our distribution channels allow us to reach customers through branches, our broker network, over the phone and digitally. We're owned by and run for the benefit of our half a million Members – our savers and borrowers. We raise over 90% of our funds from Members' savings and deposit accounts, enabling us to provide loans to a broad range of customers, from first time buyers through to commercial landlords and investors. The difference between the income earned on these loans and the interest paid to savers generates net interest income for the Society. This is used for a number of purposes including enhancing our range of products and services, ensuring the mortgage and savings rates we offer across all of our products are competitive in the market, covering operational expenses and reinvesting in our business for the benefit of future generations.

We do this whilst continuing our journey to become a more progressive building society, establishing a more cohesive, impact-focused approach to our environmental and social activity and designing initiatives to align with our strategy. We're working towards being carbon neutral across our operations, building on our work to support future generations more effectively and ensuring we become an even more inclusive organisation - where everyone belongs.

Our Strategy

Our strategy helps us accelerate our purpose. It clearly sets out our focus around our retail mortgage, commercial lending and savings business, driving sustainable and impactful growth through customer focused products and services and delivering excellent customer experience. We aim to deliver this by:

- Improving customer experience and creating capacity to grow
- Developing our value proposition for all our customers
- Communicating clearly and with impact

This strategy drives our key activities and progress towards achieving our vision and is continually measured through a clear set of Key Performance Indicators aligned to our strategic outcomes:

Our ambition is to have impact beyond our scale, embracing and embedding our purpose across everything we do.

<table>
<tr><th>Purpose and Vision</th><th>Strategic pillars</th><th>Missions</th><th>Strategic ambition and KPIs (2030)</th><th>Strategic outcomes (2030)</th></tr>
<tr><td rowspan="8">Our purpose is to help everyone prosper in their homes at every stage of life</td><td rowspan="4">Better Homes</td><td rowspan="2">A more accessible housing market</td><td>£400m committed to RSL lending (Registered Social Landlord)</td><td rowspan="2">More people living in the home they desire</td></tr>
<tr><td>750 homes funded (p/a)</td></tr>
<tr><td rowspan="2">Making it easy</td><td>8,000 first time buyers (p/a)</td><td rowspan="2">More people having a home that meets their needs</td></tr>
<tr><td>Increasing our Net Promoter Score to 83</td></tr>
<tr><td rowspan="4">Secure Futures</td><td rowspan="2">More savers, saving more regularly</td><td rowspan="2">Support 130,000 of our customers to save regularly</td><td>More people actively saving to achieve their life goals</td></tr>
<tr><td rowspan="2">More people building financial resilience for life’s uncertainties</td></tr>
<tr><td rowspan="2">Meaningful opportunities for young people</td><td rowspan="2">500,000 young people to have access to opportunities</td></tr>
<tr><td>More young people prepared for the future</td></tr>
<tr><td rowspan="5">Our vision is to help build a financially resilient society of savers where everyone has a place to call home</td><td rowspan="5">Fairer Society</td><td rowspan="2">Tackling the big issues at a local level</td><td>Investing a minimum of 3% PBT into our communities annually</td><td rowspan="2">Thriving communities at the heart of a diverse and inclusive society</td></tr>
<tr><td>We will be reflective of society and the customers we serve</td></tr>
<tr><td>An employer for all</td><td>Net Zero across all operations</td><td>Deliver Carbon Net Zero by 2030</td></tr>
<tr><td rowspan="2">A journey to net zero</td><td>Support 5,000 customers to make home energy improvements</td><td rowspan="2">More sustainable homes that are low carbon and future proofed</td></tr>
<tr><td>90% of New Home Devs. funded > EPC B</td></tr>
</table>

Transforming our Society

Existing social and financial challenges have been intensified by the pandemic and a rise in the cost of living across our communities. Living in the homes we desire and saving for the futures we deserve has never been more difficult.

The world we live in is changing rapidly, with technology playing an increasingly significant role in people's lives which in turn raises the expectations placed upon us. We remain committed to our branches on the high street but also recognise that we need to adapt to remain relevant and improve accessibility to our business digitally, and for this, investment in technology is vital to our future success. We have completed our keystone hybrid transformation programme, replatforming our mortgage and digital capability, but our technology journey continues with Member experience remaining at the heart of our decision making. As we improve our digital capability, we are dedicated to maintaining the same stand-out experience that Members currently receive, as we take steps to improve the quality of interactions with us across all of our channels.

Strategic Key Performance Indicators

We measure our performance through Strategic Key Performance Indicators (SKPI's) which are aligned to our strategic outcomes and ambitions to ensure Members can prosper in their homes at every stage of life.

2022 Strategic Key Performance Indicators (SKPIs)

Better Homes	Secure Futures	Fairer Society
• Total number of homeowners • Total number of first time buyers • Net Retail Mortgage growth/(reduction)	• Net Savings growth/(reduction)	• Total number of young people supported through financial education • Amount of funds distributed for social impact activity

Better Homes

SKPI	2022	2021
Total number of homeowners	75,425	76,262
Total number of first time buyers	4,587	2,954
Net Retail Mortgage growth/(reduction)	£208.5m	£(142.4)m

Secure Futures

SKPI	2022	2021
Net Savings growth/(reduction)	£175.2m	£(238.4)m

Fairer Society

SKPI	2022	2021
Total number of young people supported	28,867	3,900
Amount of funds distributed for social impact activity	£0.7m	£0.6m

The Strategic Key Performance Indicators, apart from statutory profit before tax, are alternative performance measures (APMs) which are internally used to inform key management decisions. Further information on these APMs can be found in this Strategic Report (definitions are included within the glossary).

	2022	2021
Financial Performance Measures		
Net Interest Margin	1.39%	1.17%
Statutory Profit Before Tax	£49.3m	£64.0m
Underlying Profit Before Tax[1]	£43.5m	£54.4m
Common Equity Tier 1[2]	26.5%	34.0%
Management Expense[3]	0.90%	0.84%
Stakeholder Experience		
Employee Engagement (annual)[4]	86.0	87.0
Customer Experience[5]	81.6	80.5
Broker Experience (6 month rolling average)[6]	67.6	–
Brand Consideration[7]	24.0	24.0

[1] *See page 13 for a reconicilation of underlying profit before tax.*
[2] *The reduction in CET1 is due to a post model adjustment that has been applied to reflect the anticipated changes as a result of the revised IRB model currently under development.*
[3] *See page 15 for a reconciliation of the movement in the management expense ratio.*
[4] *Source: Based on the Great Place to Work survey. The result is the percentage of employees who engaged and completed the survey.*
[5] *Source: Based on Maze survey customer data for the 12 months ended 31 December 2022.*
[6] *Source: Based on Maze survey broker data for the 12 months ended 31 December 2022. This is a new measure first reported in 2022.*
[7] *Brand consideration is a measure of how potential customers view Principality when choosing a financial services provider, and has remained consistent year on year.*

Financial Review

for the year ended 31 December 2022

Income statement overview

Continuing operations	2018 £m	2019 £m	2020 £m	2021 £m	2022 £m
Net interest income	119.6	111.4	108.6	129.1	153.9
Other income	5.6	4.4	2.7	3.0	4.8
Fair value (losses)/gains	(2.4)	(0.2)	(4.1)	9.6	5.8
Operating expenses	(81.5)	(80.1)	(79.9)	(93.1)	(100.2)
Impairment provisions (charge)/release	(0.6)	4.1	(9.1)	15.4	(14.8)
Other provisions	–	–	1.7	–	(0.2)
Statutory profit before tax	**40.7**	**39.6**	**19.9**	**64.0**	**49.3**

Statutory profit before tax for 2022 has decreased from the prior year to £49m (2021: £64m). This year has seen rising interest rates drive an increase in net interest income (NII) but the emergence of a cost of living crisis has driven up impairment, resulting in a £15m charge to provisions compared with a £15m release in 2021. Net interest income has increased significantly especially in the second half of the year.

Fair value gains in 2021 have continued into 2022, also as a result of the increases in the Bank of England base rate.

Underlying profit before tax, including impairment provisions, excludes fair value movements and reflects the true trading performance of the business was £43m (2021: £54m).

The table below details the adjustments made to statutory profit before tax to arrive at underlying profit before tax:

	2022 £m	2021 £m
Statutory profit before tax	49.3	64.0
Adjusted for: Fair value gains	(5.8)	(9.6)
Underlying profit before tax	43.5	54.4

The purpose of the underlying profit before tax 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 and inform decisions regarding variable remuneration.

The only difference between statutory and underlying profit before tax is fair value movement, which represent the change in value of certain assets and liabilities to reflect underlying market rates.

In 2022, a fair value gain was experienced due to rising interest rates, as rates rise unhedged swaps transacted at a lower rate typically increase in value.

These movements are primarily as a result of timing differences, which in any given year can be an overall loss or a gain; however, will reverse as the asset or liability approaches maturity and therefore trend to zero over time.

Return on assets, calculated as statutory profit after tax divided by average total assets (current year assets plus prior year assets divided by 2), has reduced compared with the prior year. This is driven by the reduction in profit due to the £15m impairment charge.

Return on assets %

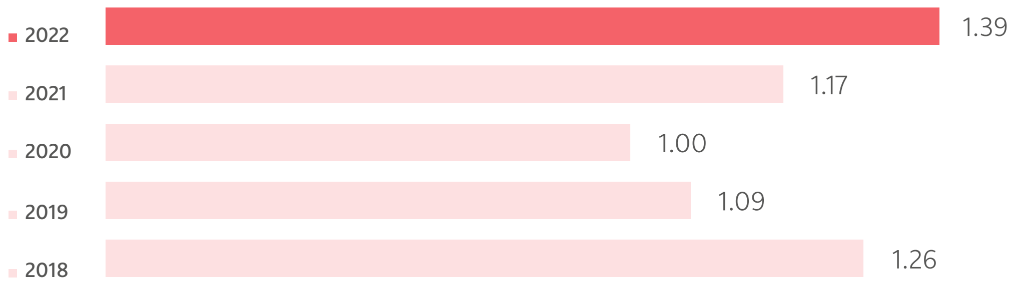
Net interest margin

Our net interest margin for the year was 1.39% (2021: 1.17%). This increase is primarily due to base rate increasing from 0.25% to 3.50% during the year. Despite the sharp rise in interest rates headline mortgage income is up by just £7m compared to the previous year due to the majority of customers being on fixed rate products. Interest receivable on mortgage swaps, which typically move directly in line with base rate is up £57m compared to the prior year with interest receivable on treasury assets up by £21m during the year.

Interest payable to savings customers has increased by £35m during the year and interest payable on wholesale deposits up by £26m.

Our lending continues to be primarily funded by Members' retail savings, with 92% (2021: 89%) of loans and advances to customers funded in this way. Interest rates paid on savings are impacted by the level of interest earned on mortgages.

Net interest margin %



Operating expenses

We recognise that operating efficiently is a significant factor in achieving optimal Member value, and as such operating expenses remain a key area of focus. Operating expenses increased in the year to £100m (2021: £93m).

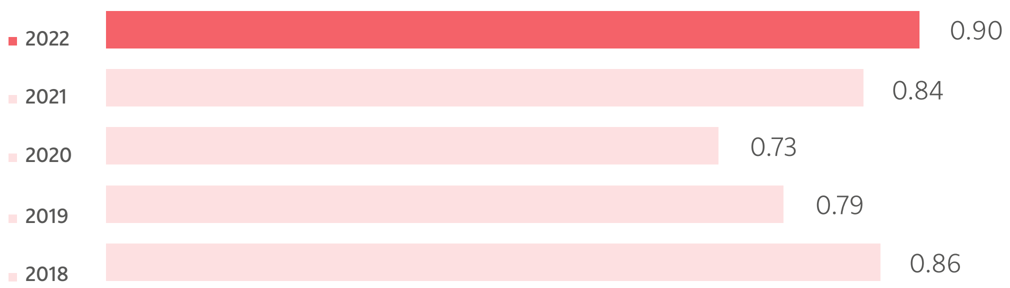
Staff costs increased by £4.6m following the response to the cost of living challenges faced by colleagues which saw the annual pay review brought forward from February 2023 to November 2022. Depreciation and amortisation is up by £4m as the new mortgage platform is now fully operational and the investment is being amortised. Other significant variances in the year include £0.7m of funds distributed for charitable causes, a £0.9m write off following the disposal of fixtures and fittings and the impairment of £0.4m of branch spend previously capitalised.

The year-on-year operating expenses comparison is set out in the table below:

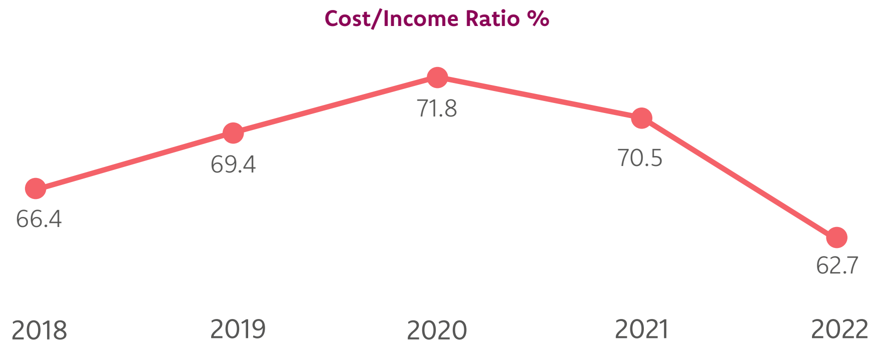
	2022 £m	2021 £m
Retail financial services	96.6	89.8
Commercial lending	2.8	2.6
Secured personal lending	0.8	0.7
Total operating expenses	100.2	93.1
Management expense ratio	0.90%	0.84%
Cost income ratio	62.7%	70.5%

The management expense ratio, which compares costs as a proportion of the average assets of the business, has increased due to the cost increases discussed above. The cost income ratio compares costs as a proportion of total income. This has reduced due to an increase in net interest income. These key cost ratios will remain an area of focus in 2023 and beyond.

Management expense ratio %



Between 2018 and 2020 the capitalisation of resource for the hybrid transformation programme as an intangible fixed asset contributed to the fall in the ratio. In 2021, the ratio increased due to amortisation of the intangible asset and the reasons for the 2022 cost increases discussed above. Our ambition is to reduce these costs over time.



Impairment provisions for losses on loans and advances

	2022 £m	2021 £m
Retail mortgage lending	7.1	(3.9)
Commercial lending	6.4	(9.2)
Secured personal lending	0.8	(2.4)
Treasury assets	0.5	0.1
Total charge/(release)	14.8	(15.4)

Impairment charges totalled £15m in 2022 compared with a £15m release in 2021.

The group continues to have a low overall level of arrears, reflecting our prudent lending criteria, credit quality and underwriting standards. The sharp rise in interest rates has seen some Commercial lending customers fall into forbearance due to interest cover covenant breaches although none are currently in arrears. The charge for the year reflects the more pessimistic outlook for 2023 and 2024 as the country is expected to head into a recession. House prices have already started to fall with further reductions expected and unemployment is also expected to rise. Inflation has started to slow down although food inflation is continuing to rise. These considerations have been taken into account in determining the level of provisions to be held and mean that the business is well positioned to deal with the future economic uncertainty that exists. In addition to these factors the retail and office elements of the Commercial Lending portfolio remain an area of potential concern as the impact of inflation, rising interest rates and employees working from home have hampered a post pandemic recovery, and contributed to the income statement charge.

The total loan loss impairment provisions held on the statement of financial position were as follows:

	2022 £m	2021 £m
Retail mortgage lending	15.4	8.3
Commercial lending	12.8	6.4
Secured personal lending	3.7	3.1
Total	**31.9**	**17.8**

Provisions for liabilities

Regulatory provisions have been made in respect of various customer claims. At 31 December 2022, the group held a provision of £2.8m (2021: £2.7m). This reflects management's best estimate of the costs required to settle its remaining obligations and takes account of expected customer behaviour, costs expected to be incurred, and an assessment of the exposure population.

The provision is monitored on an ongoing basis with customer trends and behaviour analysed to ensure the level of provision held is appropriate.

Further information on the level of provisions and the uncertainties therein can be found in notes 20 and 29.

Taxation

The effective tax rate for the group was 24% (2021: 24%) which is above the statutory rate of 19% (2021: 19%) due to the impact on the value of deferred tax liabilities following the decision to increase the rate of corporation tax to 25% from April 2023.

A reconciliation of the effective rate to the statutory rate is provided in note 13.

Statement of Financial Position

Total assets have increased to £11,257m (31 December 2021: £10,908m), as a result of growth in our retail lending book to £8,241m (31 December 2021: £8,033m) following the successful embedding of our new mortgage system.

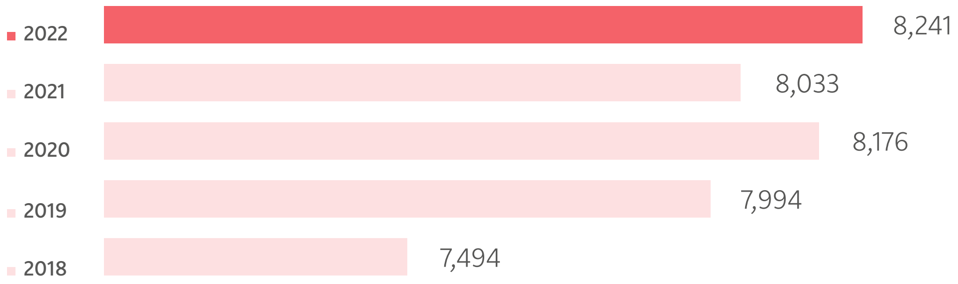
Total loans and advances have reduced within the table below due to movements in the underlying asset fair value position of hedged mortgage assets, this is an accouting adjustment that does not relate to movements in the size of the actual mortgage book. The Commercial lending book reduced to £762m (31 December 2021: £776m), mainly due to expected repayments within the period.

	2018 £m	2019 £m	2020 £m	2021 £m	2022 £m
Liquid assets	1,112.5	1,569.6	1,807.9	1,887.8	2,004.2
Loans and advances to customers	8,498.7	9,033.1	9,204.9	8,883.3	8,795.0
Other assets	76.2	93.1	108.1	136.8	458.1
Total assets	**9,687.4**	**10,695.8**	**11,120.9**	**10,907.9**	**11,257.3**
Retail savings	6,989.8	7,588.5	8,187.5	7,943.7	8,113.6
Wholesale funding	2,019.4	2,378.1	2,200.1	2,262.3	2,361.2
Other liabilities	127.5	145.8	138.7	55.6	103.6
Total liabilities	**9,136.7**	**10,112.4**	**10,526.3**	**10,261.6**	**10,578.4**
Reserves	550.7	583.4	594.6	646.3	678.9
Total liabilities and equity	**9,687.4**	**10,695.8**	**11,120.9**	**10,907.9**	**11,257.3**

Loans and advances to customers

We have continued to focus on our core business of prime lending against residential and commercial property. We have completed the implementation of a new mortgage system, which will provide benefits to both brokers and customers. There has been a net increase in loans and advances to customers of £166m (2021: decrease of £208m) to £9,084m (2021: £8,918m) partly due the full implementation of our new mortgage platform offset by the planned reduction in secured personal lending (Nemo) and expected repayments in the commercial portfolio. Net retail mortgage lending in the year, which is the increase in the mortgage book excluding accounting adjustments, increased by £209m (2021: £142m reduction). Gross retail mortgage lending, which is the total balance of new mortgages completed in the year excluding redemptions, was £1,525m (2021: £1,108m).

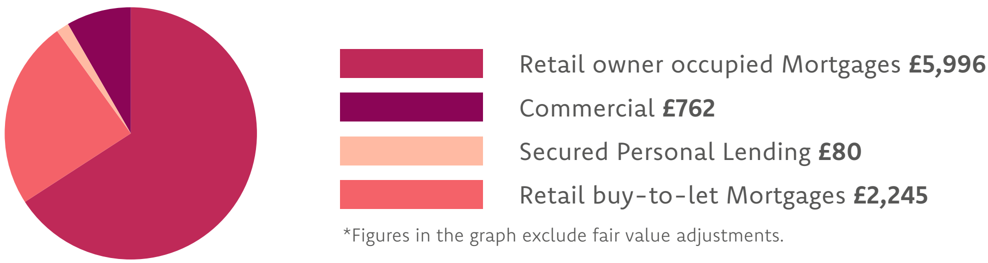
Retail loans and advances to customers £



The retail mortgage book remains the largest portfolio of the business at £8,241m (2021: £8,033m). This includes both lending to homeowners and a buy-to-let portfolio of £2,245m (2021: £2,267m). The support for both residential and buy-to-let borrowers helps provide a broad range of products to both current and any future Members. All buy-to-let lending is assessed against stringent interest cover and loan-to-value criteria.

We also hold a secured personal lending portfolio of £80m (2021: £108m), secured against residential property by a second charge. This business is in run off with balances reducing by £28m (2021: £33m reduction) in the year.

Loans & advances to customers by portfolio (£m)*



*Figures in the graph exclude fair value adjustments.

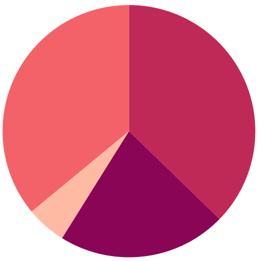
Our retail mortgage and secured personal lending portfolios reflect the prudent nature of our lending policies, with 88% (2021: 83%) of exposures having a balance to indexed valuation of less than 75% and 97% (2021: 97%) less than 90%. The exposures are well spread by geographical area within the UK, albeit with a larger share of lending in Wales, which by value makes up only 29% of lending (2021: 30%) in the retail mortgage and secured personal lending portfolios.

The strong credit quality of loans issued is reflected in the low value and volume of the arrears against first and second charge residential lending. The percentage of retail mortgage lending cases fully secured by a first charge currently with arrears of more than three months is 0.5% (2021: 0.5%) which compares favourably with the industry average of 0.8%*. This marginal increase to 397 (2021: 384) is due to the removal of government support provided as a consequence of the pandemic in 2021. There was a modest increase in the number of properties taken into possession during the year to 16 (2021: 10), as a result of the rising interst rate environment and cost of living pressures.

The Society provides loans secured on commercial property across England and Wales, with 46% (2021: 47%) of lending situated in Wales. The Commercial Lending portfolio is made up of lending against both residential property and registered social landlords of 63% (2021: 65%) and commercial property exposures representing 37% (2021: 35%) of balances.

The Commercial Lending portfolio had no exposures greater than three months in arrears at the year-end (2021: one with a balance of £0.2m). The sharp rise in interest rates has seen some Commercial Lending customers fall into forbearance due to interest cover covenant breaches although none are currently in arrears. Focus is maintained on all borrowers 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.

Commercial loans & advances by sector (£m)



Commercial **£284**
Housing association **£165**
Residential development **£37**
Residential investment **£276**

*UK Finance arrears and possession data at 10 November 2022.

Defined benefit pension scheme

The Society operates a defined benefit pension scheme, which is closed to new entrants and to further accrual. During the year, the pension scheme surplus (the difference between the scheme assets and scheme liabilities on an accounting basis) switched to become a deficit of £0.9m (2021: £3.2m surplus), due to lower than expected asset returns and higher than expected inflation.

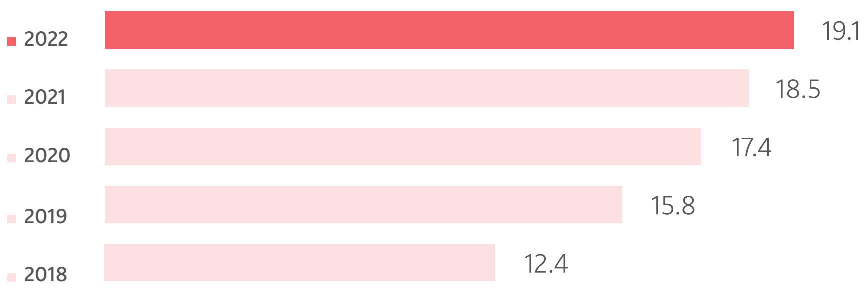
The scheme is subject to a triennial valuation by the scheme's independent actuary. The most recent valuation, with a reference date of 30 September 2019, was completed as planned during 2020. The next valuation is currently underway with a reference date of 30 September 2022 and is due to be completed later in 2023.

The Society continues to work closely with the Trustees of the scheme to ensure the investment plan for the scheme assets is effective in both generating returns and mitigating risks, and thereby ensuring that the pension risk to the Society is appropriately managed.

Liquidity ratio

We hold liquid assets to ensure we have sufficient access to funds to meet our financial obligations in both normal and stressed scenarios. We continue to maintain a robust liquidity position, with the liquidity ratio at the year end of 19% (2021: 19%) as a proportion of shares, deposits and loans (SDL). Liquidity levels at the end of the year were higher than the previous year following the latest successful Residential Mortgage Backed Security (RMBS) issuance in September.

Liquidity ratio %



Our liquidity is made up of cash and balances with the Bank of England and loans and advances to credit institutions. Included within liquidity is cash held in respect of collateral deposit posted by counterparties. The increase in rates has resulted in cash held in respect of collateral deposits increasing by £276m during the year.

The Liquid Asset Buffer as defined by the Prudential Regulatory Authority (PRA) includes highly liquid assets, typically central bank and sovereign exposures. At the year end, the proportion of the group's available liquidity which was buffer eligible was 86% (2021: 91%). Of the total liquid assets, none (2021: none) were less than A rated under Fitch credit ratings.

The PRA monitors liquidity using the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR), measures introduced as part of the CRD IV regulatory changes. The group's LCR, a measure of our ability to withstand a short-term liquidity stress, was 246% at the year end (2021: 294%), well above the regulatory requirement. The NSFR is a longer-term stable funding metric, which measures the sustainability of the group's long-term funding. Our NSFR is in excess of 100%, and we have sufficient stable funding to meet the new requirement.

We are a participant in the Bank of England's Term Funding Scheme, and also have access to contingent liquidity through the Bank of England's Sterling Monetary Framework.

Liquid assets are set out in the table below:

	2022 £m	2021 £m
Cash and balances with the Bank of England	1,566.9	1,645.8
Securities issued by the UK Government and Multilateral Development Banks	48.0	50.2
Total Buffer Eligible Assets	**1,614.9**	**1,696.0**
Loans and advances to credit institutions and other debt securities	389.3	191.9
Total	**2,004.2**	**1,887.9**

Loans and advances to credit institutions are made up of collateral deposits and investments into covered bonds and RMBS issuances. The increase in the year is due to increases in collateral deposits and covered bonds investments.

Funding

Members' savings are, and will remain, the most important part of the Society's funding base. However, given the highly competitive nature of the mortgage market and the lower relative cost of wholesale funding sources, it is important that we maintain an appropriate balance between retail and wholesale funding.

Funds are raised from a variety of sources in order to meet the strategic objective of maintaining a diversified funding mix. The largest component is retail savings, which at £8,114m (2021: £7,944m) represent 92% (2021: 89%) of all mortgage and loan balances. Retail savings balances have increased by £170m in the year (2021: £238m decrease), as the retail book returned to growth.

In January 2022, Friary No. 4 Plc matured, this was replaced in September 2022 with Friary No. 7 which raised £450m of funding (including £100m of retained notes). The total value of external RMBS notes outstanding at the end of the year was £527m (2021: £398m).

During the year, the Society maintained its credit ratings on its long-term and short-term debt with both Moody's and Fitch. The group's current credit ratings are set out in the table below:

	Short-term	Long-term	Outlook
Moody's	P-2	Baa2	Stable
Fitch	F2	BBB+	Stable

Asset encumbrance

We use our assets as collateral to support the raising of secured funding, primarily as part of the RMBS issuances or pledged under the terms of Bank of England funding schemes. At the end of the year, 22% (2021: 22%) of the group's assets were encumbered, representing £2,109m (2021: £2,219m) of residential mortgage assets and £274m (2021: £149m) of other assets.

Capital

We hold capital to protect Members' deposits by providing a buffer against unexpected losses. The amount of capital required is assessed in relation to our overall risk appetite, the material risks to which the business is exposed and the management strategies employed to manage those risks. At 31 December 2022, capital comprises the group's general reserve, adjusted in line with regulatory rules, which qualifies as Common Equity Tier 1 capital, the very highest quality of capital.

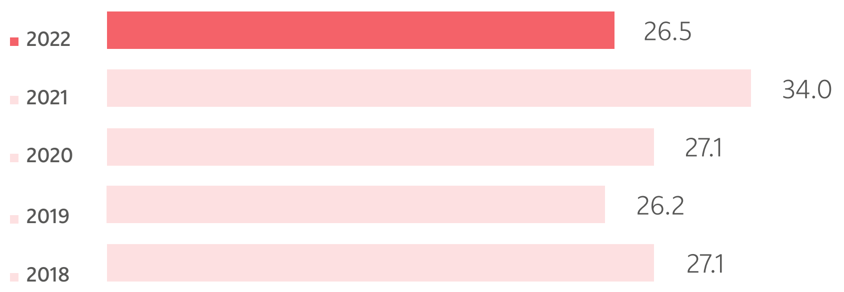
Our primary measure in assessing capital adequacy is the Common Equity Tier 1 (CET1) ratio, which expresses the highest quality capital as a proportion of the sum of the risk weighted assets of the group. The risk weighting for each asset is calculated either through the use of internal models or through standardised calculations dependent on regulatory permissions for each portfolio of assets.

Our CET1 ratio has decreased to 26.5% in the year (2021: 34.0%). The profits in the year and house price increases caused an increase to the ratio, however, this was offset by an anticipated Post Model Adjustment (PMA) applied in respect of the retail Internal Ratings Based (IRB) model redevelopment. The PMA is a result of regulatory changes which came into effect on 1 January 2022. The model redevelopment is in an advanced stage with consultation ongoing with the PRA. The PMA applied is based on the expected capital requirement following model completion.

The ratio remains strong and our profitability during the year means that we are continuing to generate sufficient capital through our financial performance to support our future lending to households and businesses.

Our solvency ratio, the ratio of total capital to risk weighted assets, is consistent with our CET1 ratio, at 26.5% (2021: 34.0%).

CET1 %



A further measure of capital strength is the PRA Leverage ratio, a measure of Tier 1 capital held against total (non-risk-weighted) assets, including certain off-balance sheet commitments. At the end of the year, our PRA Leverage ratio was 6.5% (2021: 6.5%). The ratio disclosed in the 31 December 2021 financial statements was the EBA Leverage ratio, which was 5.6%.

Supporting our Members, Colleagues and Communities

for the year ended 31 December 2022

Communities
Principality has an ambition to set aside up to 3% of its profit before tax for projects with social purpose.

This includes:

- The launch of our Future Generations Fund which saw us donate £125,000, split between 25 charities who are helping younger people across Wales
- 28,000 young people supported via our financial education, careers partnerships and activities
- £100,000 donated to the London Institute of Banking and Finance qualification has helped over 50 schools and learning centres across Wales and England
- 2,700 students gained recognised financial education qualifications
- £163,000 fundraised or donated to our charity partners Tŷ Hafan and Hope House Tŷ Gobaith

Members and sponsorship
We currently have almost 1,500 Members on our Member Pulse panel and their feedback has led to:

- Children accounts' review and consultation on 'new' products
- How we can best support them during the cost of living crisis

Through our partnership with the Welsh Rugby Union (WRU) and sponsorship of Principality Stadium, supporting community rugby has been a key priority for us in 2022. We celebrated the incredible efforts of Clubhouse Champions across Wales by creating The Unofficial Squad during this year's Guinness Six Nations; shone a spotlight on grassroots rugby with Nigel Owens at 'Road to Principality'; and celebrated the important role that rugby clubhouses play in communities during this year's Autumn Nations Series through a series of murals, expertly painted on clubhouse walls.

There was something for everyone at Principality Stadium this year and we're delighted to have been able to give away more than 1,000 tickets to Members to experience these fantastic events.

Colleagues
Living Wage Employer
Principality prides itself as a mutual, Member-owned building society, in having a positive impact on society, and this includes looking after the health and wellbeing of our colleagues who do so much to improve the communities in which they live and work. They continue to go above and beyond to provide excellent customer service for our Members, in order to help build a financially resilient society of savers and to help people buy and stay in their homes. In 2022, we reaffirmed our commitment to paying the real Living Wage to our colleagues by becoming an accredited employer by the Living Wage Foundation. In response to the cost of living crisis, we sought to provide our colleagues with a meaningful rise against the current high inflation environment, focused on providing greater support to our lower paid colleagues.

Diversity and Inclusion

At Principality, having a diverse workforce that is representative of society is crucial to our success and we work hard to promote an inclusive culture where everyone feels they belong and can be their authentic selves. In 2022, we're proud to have signed the Race at Work Charter and we celebrate the richness of different cultural heritages. We have a variety of flourishing colleague network groups, devoted to a range of areas of interest, all of which have been created by colleagues to provide an open and honest forum for discussion as well as a place to share advice and guidance and offer support to one another.

Colleague Engagement

Colleague engagement remains high, and we achieved 9th place in the Super Large category of the Great Place to Work™ Best Workplaces for 2022. We were delighted to also be ranked first place in the Super Large Organisation List in the 2022 UK's Best Workplaces™ for Women. We remain committed to enhancing our colleagues' voice across the Society, utilising our Colleague Forum to understand the key drivers for our workforce. We have also partnered with a new, proactive engagement platform for the coming year to enable us to gain greater understanding of the key metrics around colleague engagement.

Environmental Sustainability

We calculated our 2021 carbon footprint using the data that was available at the time and for the first time we offset our operational emissions to become a carbon neutral organisation. This involved buying carbon credits. We did the same again for our 2022 operational emissions and intend to do the same each year until we reach net zero.

In 2022, we worked with ClimatePartner to understand how we can improve our data capture and accuracy to ensure that our emissions figures are as accurate as possible and we'll be working on their recommendations in 2023. We're using this data to help refine our plans to achieve net zero carbon emissions, to feed into our wider social impact strategy, and to give us a better understanding of where we need to focus our resources.

What's next?

We recognise that to make a material reduction in our carbon footprint and achieve our net zero ambitions we're going to need to make big changes to our systems and processes. Realistically, some of these things may take years to implement before we start seeing the benefits.

One example is the need to update our systems so that we can capture customer communication preferences and then act on them. This should help us reduce the amount of paper we send and we'll be making 'paperless by design' a key principle, requiring sustainability to be considered as part of all internal business cases. We're also working on embedding sustainability into the procurement process and our value chain to ensure that our suppliers are as committed to reducing their emissions as we are.

Risk Overview

for the year ended 31 December 2022

Our business is exposed to a diverse range of risks in the execution of our strategy and in undertaking our day-to-day activities. These risks are mitigated to an extent by the straightforward nature of our business model and the products we offer. Our culture and risk management philosophy reflects a strong awareness of the current and emerging risk landscape, which could affect the delivery of our strategy. We operate solely within the UK and take risks only where they can be fully understood, monitored and controlled.

We manage risks by:

- operating a single integrated business model underpinned by strong risk governance
- adopting a risk management framework, which covers all risks and is supported by a clearly defined 'three lines of defence' model
- monitoring and managing risks within risk appetite as set by the Board; and
- ensuring we maintain sufficient capital and liquidity to enable the business to survive a combination of severe but plausible market and firm specific stresses

Principal risks
The key risks to which we are exposed are outlined below. These are fundamentally unchanged from those reported in the prior year, but in many respects their potential impact on the inherent risk profile of the business remains elevated as a consequence of the challenges and uncertainty arising from the cost of living crisis:

Business risk	Credit risk	Liquidity and funding risk	Market 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 risk that borrowers or counterparties do not meet their financial obligations as they fall due.	The 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.	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.
Operational risk	**Solvency risk**	**Conduct risk**	**Legal and regulatory risk**
The risk of loss arising from inadequate or failed internal processes, systems, human error or from external events.	The risk that the Society does not maintain sufficient capital resources in excess of minimum regulatory requirements.	The risk that the Society does not treat its customers fairly resulting in inappropriate or unfair outcomes.	The risk that the Society does not comply with legislation and regulation.

a) Business risk

We consider strategic risk, the risk to the delivery of the Society's Corporate Plan, to be the principal business risk. Whilst all business areas are responsible for managing their own risks, management of strategic risk is primarily the responsibility of the Board and the Board Risk Committee whose remit encompasses all risk categories on a Society wide basis.

(i) Market background and uncertainties

Competition in mortgage and savings markets from 'Challenger' and mainstream UK banks is increasing as they focus on service delivery and non-investment banking activities. We are focusing on efficiency and cost control through our continuous improvement programme, but cost pressures will continue to arise from the pace and complexity of regulatory change, required levels of investment in technology and organic growth. Global inflationary pressures and the resultant fiscal and monetary policy decisions have the potential for significant near-term impacts on the core markets in which we operate, but we also recognise the implications for our longer-term business strategy as Member and customer behaviour and preference evolves in response to the availability of digital technology.

(ii) Risk mitigation

The Board maintains a robust strategic planning process which is subject to oversight by the risk function and supported by a capital and liquidity stress testing programme. Consolidated business performance and risk reporting are provided to the Board and senior risk committees whose remit encompasses the oversight of all risk categories and an assessment of emerging strategic risks.

b) Credit risk

Credit risk arises primarily from loans to retail and commercial customers and from the investments held by the Society's Treasury function.

(i) Market background and uncertainties

Throughout the year, following the end of COVID-19 restrictions, the UK economy has seen a period of consistent growth. As government support schemes have been brought to an end, economic activity has begun to recover with unemployment remaining low. The housing market has remained buoyant, and a surplus of demand has led to house prices recording a year on year increase.

The lasting impact of COVID-19 on global supply chains, combined with other factors such as the war in Ukraine, has resulted in a high inflation near term economic outlook, which is likely to place pressure on the finances of both consumers and businesses. It seems inevitable that the fiscal and monetary policy response to higher inflation will further impact mortgage affordability, which is likely to lead to a slow down or even reversal in house price inflation. Our plans are based on cautious, realistic assumptions and are tested against a range of economic scenarios, including those that recognise the risk of a severe, but plausible, recession.

(ii) Risk mitigation

The quality of individual lending decisions and subsequent management and control of mortgage exposures, together with the application of a credit policy that reflects our risk appetite, have a direct impact on the success of our strategy. Each business area: residential lending, commercial lending and treasury, has a Credit Risk Policy Statement setting out the Board's risk appetite including structures and responsibilities, definitions of risk and risk measurement and approach to monitoring.

Day-to-day management of credit risk is undertaken by specialist teams using credit risk management techniques to measure, mitigate and manage credit risk in a manner consistent with risk appetite. Credit risk portfolios are subject to regular stress testing to simulate outcomes from specific test scenarios that lead to assessment of the potential impact on capital requirements and mortgage loss provisions.

(iii) Retail credit risk

We continue to focus on the underlying quality of new lending in prime residential and buy to let mortgages, ensuring that the mix of overall portfolio exposures remains within our risk appetite. We continue to underwrite all mortgage applications individually, thus ensuring that our assessment of credit worthiness and affordability takes account of the unusual circumstances in which some applicants have found themselves.

As pressures on household finances build, our affordability assessment continues to include an estimate of essential expenditure. An interest rate stress test is applied to ensure that the proposed mortgage is affordable in the event of further increases in interest rates. A substantial proportion of our customers benefit from fixed rate products, which provide protection against interest rate increases whilst they are in their fixed rate period.

New retail lending is restricted to advances secured against properties in England and Wales. Our second charge lending business, Nemo Personal Finance Ltd, ceased originating new loans in 2016.

The concentration in the UK market could be exacerbated by overexposure to one geographical location or reliance on particular product types within the portfolio. We manage this risk by monitoring the geographical distribution of lending and by setting new lending risk limits in specific segments of the mortgage market. Regular stress testing is undertaken, which seeks to establish the extent to which losses may emerge under a range of scenarios and primarily consider the impact of economic events on rates of default.

Our collections and recoveries functions aim to provide a responsive and effective operation for the arrears management process. Arrears rates on residential mortgages remain low following the ending of government support schemes and payment deferrals introduced in response to the COVID-19 pandemic. For borrowers who anticipate or are experiencing financial difficulty, we encourage early two-way communication, with the aim of seeking commitment to maintain payment obligations, typically through repayment plans. Forbearance measures are tailored to individual circumstances so that repossession of a property is normally only sought where all reasonable efforts to regularise matters have failed, or the mortgage is considered unsustainable in the longer term.

(iv) Commercial credit risk

Commercial risk appetite is regularly reviewed in the light of changing economic and market conditions, and is subject to a formal annual review. We remain cautious with regard to commercial lending and continue to adopt a strategy of maintaining long-term relationships. Commercial lending continues to operate within a framework of conservative lending criteria, principally focusing on the underlying income stream and debt servicing cover, as well recognising property value. We have continued to assess individually new opportunities to lend, whilst seeking to limit our exposure to areas of the commercial lending market that we feel will be more exposed to fluctuations in the UK economic performance.

Concentration risk within the commercial portfolio is controlled and monitored via a series of credit exposure limits. Commercial lending relationships are subject to regular reviews to ensure that facilities are performing in accordance with the terms of original sanction. Watch-list procedures are in place that grade borrowers in line with the perceived severity of the risk and are designed to identify cases of potential cause for concern to facilitate early risk mitigation, or forbearance activity where appropriate. When accounts are in default, careful consideration is given to the most appropriate resolution strategy. In particular, the commercial lending operation will engage in extensive dialogue with customers and advisors, and enlist external professional support where required to ensure that the optimal approach is chosen, taking account of the needs of all stakeholders.

Responsibility for the overall quality of the lending book and the adequacy of credit procedures and controls rests, with the commercial lending division with oversight provided by the Society's Credit Risk function, Credit Risk Committee and Board Risk Committee.

(v) Treasury credit risk

Treasury credit risk arises from the investments held to meet liquidity requirements and is managed by the Treasury function within policy limits. Treasury counterparty lines of credit are reviewed on a weekly basis by the Finance Committee. Changes to lines and limits are approved by the Board Risk Committee within a framework prescribed by the Board.

c) Liquidity and funding risk

Determining the appropriate mix and amount of liquidity and funding to hold is a key decision for the Board, which recognises that we must remain a safe and attractive home for Members' retail deposits in addition to providing adequate levels of profitability.

(i) Market background and uncertainties

Global inflationary pressures and related fiscal and monetary policy responses have resulted in significant market volatility throughout 2022, which has the potential to continue in the near term.

As the Bank of England attempts to control inflation through base rate increases, there remains the possibility that changes in customer behaviour, masked by a prolonged period of consistently low interest rates, could result in changing funding and liquidity requirements.

(ii) Risk mitigation

The day-to-day management of liquidity is the responsibility of the Treasury function. The Finance Committee exercises control over levels of liquidity through the operation of strict liquidity policies and close monitoring, receiving weekly reports on current and projected liquidity positions.

The Board determines the level of liquid resources required to support the Society's strategy through undertaking an annual Internal Liquidity Adequacy Assessment Process (ILAAP) as part of the development of the Society's Corporate Plan. Stress tests consider a range of severe but plausible scenarios and their impact on the Society, particularly with respect to retail saving outflows. The Board approved the most recent ILAAP in June 2022.

The Society has a diverse funding base, with a strong track record of attracting and retaining retail funds through its range of retail product offerings, while maintaining a presence in the wholesale market, supported by external credit ratings. As part of its funding strategy, the Society issued £450m of Retail Mortgage Backed Securities in September 2022 (including £100m of retained notes), helping to maintain its strong liquidity and funding position.

d) Market risk

The Treasury function is responsible for managing our exposure to all aspects of market risk within the operational limits set out in the Treasury Policy Statement. Oversight is provided by the Financial Risk function, Finance Committee, Executive and Board Risk Committees.

The Society's defined benefit pension scheme is also subject to market risk, which is managed by the Scheme's Trustees.

Currency risk is not considered to be material as almost all transactions are conducted in Sterling.

(i) Interest rate risk

Interest rate risk principally arises from the imperfect matching of interest rates between different financial instruments. The provision of fixed rate lending products with various interest rate features and maturity profiles, supported by variable retail savings and wholesale funding, creates interest rate risk exposures. Another form of interest rate risk arises from the imperfect correlation between re-pricing of interest rates on different assets and liabilities, referred to as basis risk.

(ii) Market background and uncertainties

The Bank of England's Monetary Policy Committee has consistently increased base rate throughout 2022 to address global inflationary pressures, increasing rates from the historic low of 0.1% during COVID-19 to 3.5% as at December 2022. The November rate increase of 75 basis points (bps) is the highest single increase since 1989 and financial markets are pricing in further rate increases in 2023.

(iii) Risk mitigation

Interest rate risk is subject to continual review and management within the risk appetite set by the Board. Risks relating to specific products are mitigated through appropriate related product terms and conditions, offer procedures, and close analysis of the mortgage pipeline and early redemption behaviour. Derivative instruments are used to manage various aspects of interest rate risk, including the net basis positions where appropriate, and in accordance with the terms of the Building Societies Act 1986.

On a monthly basis, the Finance Committee considers the impact of a number of interest rate risk and basis risk stress tests on the balance sheet, using both earnings and value measures. In addition, our Executive and Board Risk Committees review options and strategies available to manage the impact of any potential future changes in interest rates. Our forecasts and plans take account of the risk of interest rate changes and are stressed accordingly.

We continue to ensure that we maintain a significant proportion of discretionary variable rate savings and mortgages on our balance sheet, which provides flexibility to manage the impacts of a change in Bank of England base rate.

We have a series of Board approved limits that ensure the impact of a change in base or market interest rates has limited effects on both the net interest income generated and the economic value of the balance sheet.

The Society completed a smooth transition of LIBOR-linked commercial loans and associated derivative positions in line with regulatory expectations in early 2022.

e) Operational risk

We assess our exposure to and management of operational risks by reference to eight categories:

Risk category	Brief definition
Change management	The risk of non-delivery of strategic change programme objectives or disruption to business as usual activity resulting from the implementation of change.
Financial crime	The risk of loss to the business arising from activities which circumvent controls, the unauthorised use of assets, services or illegal activities.
Financial management	The risk of losses or reputational damage arising from weak financial management or inadequate management information to support decision-making.
Data management	The risk of losses or reputational damage arising from the mismanagement of personal data or poor quality data.
Business Continuity	The risk associated with our ability to maintain our operation in the event of a major disruption.
Information & Cyber Security	Risk of service disruption, reputational damage and/or operational losses due to unauthorised access, use, disclosure, modification or destruction of our information assets.
Information Technology	Risk of service disruption arising from non-cyber related incidents.
Physical Assets	The risk that business premises are unfit or unsecure, resulting in workplace unavailability and/or security issues.
People	The risk of failure to maintain and develop the appropriate level of skilled resource, maintain employee relations, provide a safe environment in line with legislative requirements and comply with ethical, diversity and discrimination laws.
Health and Safety	Risks to health and safety of staff and customers.
Supplier and procurement	The risk of loss arising from the failure of a key supplier or outsourcing arrangements or in the failure of third party service providers to meet agreed target levels of service.

(i) Market background and uncertainties

The external environment continues to evolve with challenges arising from technological innovation, increased customer expectations and emerging regulatory standards. The sector as a whole has become exposed to increased levels of operational risk, with greater reliance placed upon the resilience and security of technology platforms and staff capability. Notwithstanding recent and substantial investments by financial institutions in technological solutions aimed at combating the more sophisticated financial crime and cyber threats, there is a continuing trend of financial deception targeting consumers directly. We continue to strengthen our control environment to protect those who are most vulnerable to financial abuse, and work collaboratively with industry partners to further improve controls and enhance both staff and customer education.

We recognize that failure to keep pace with developments in technology could introduce risk to the stability, security and resilience of technology systems. As a result, we continue to invest in upgrading our IT estate. Undertaking any change programme carries risk, as new systems and processes are introduced and integrated with existing ones. We have a strong focus on change governance and programme management to minimise these risks.

Attracting and retaining colleagues remain key priorities as the recruitment market presents challenges across multiple functions. We recognize the challenges ahead and continue to invest in this area.

(ii) Risk mitigation

We manage our exposure to operational risk by assessing the nature of external incidents, information sharing with peer organizations and by the review of internal risk events analysed by reference to the operational risk categories described above. In addition to any direct loss attributable to risks in these categories, the reputational impact of such an event may damage the Society leading to secondary impacts.

Our operational risk management framework sets out the strategy to identify, assess and manage operational risk, with senior management having responsibility for understanding the nature and extent of the impact on each business area, and for embedding appropriate controls to mitigate those risks. The framework is updated periodically to take account of changes in business profile, new product development, the external operating environment and best practice guidance, and is based on both quantitative and qualitative considerations.

The crystallization of operational risks is captured through the recording of risk events including those that result in financial losses or near misses. The analysis of events is used to identify any potential systemic weaknesses in operational processes. The Internal Capital Adequacy Assessment Process (ICAAP) considers an appropriate amount of capital to be held for operational failures.

f) Solvency risk

Capital is held to protect depositors, by ensuring that there will be sufficient assets to repay liabilities even in the event of unexpected losses. When assessing the adequacy of available capital, the Board considers the material and inherent risks to which we are exposed and the need for capital to be available to support the growth of the business.

(i) Market background and uncertainties

The implementation of Basel III has resulted in a UK financial system that is much better capitalised than prior to the 2007 Financial Crisis and the regulatory landscape continues to evolve as Basel 3.1 is adopted, and focus on climate related financial risks increases.

The UK economic outlook remains uncertain as global inflationary pressures and the resultant fiscal and monetary policy decisions will impact mortgage affordability, unemployment and house prices in the near-term and beyond.

(ii) Risk mitigation

Solvency risk is subject to regular review and is managed within the risk appetite set by the Board. The Board determines the level of capital resources required to support the Society's strategy through undertaking an annual ICAAP as part of the development of the Society's Corporate Plan. Stress tests consider a range of severe but plausible scenarios and their impact on the Society, ensuring that the Society holds sufficient capital to withstand an equivalent stress. The assessment process includes evaluation of financial risk exposure to physical (e.g. flood, coastal erosion) and transition risks (e.g. environmental legislation, customer demand) related to climate change. The Board approved the most recent ICAAP in August 2022.

(iii) Capital requirements

In 2013, we obtained permission to use the Internal Ratings Based (IRB) approach for calculating Pillar 1 capital requirements for our first charge retail and commercial lending portfolios. This approach allows us to calculate regulatory capital requirements using internally developed models that reflect the credit quality of our mortgage book and detailed understanding of our customer base and credit risk profile. For other exposures and risk areas, we follow the Standardised approach that uses capital risk weighting percentages set by the PRA. CRD IV set enhanced minimum capital requirements for firms and we expect at all times to meet these requirements.

In addition to Pillar 1 capital requirements, we hold capital within Pillar 2 for those risks not captured adequately in Pillar 1 and retain capital buffers that may be drawn down in periods of stress. Capital Requirements Directive IV (CRD) requires firms to hold supplementary capital buffers.

To meet Basel III Pillar 3 requirements, we publish further information about our exposures and risk management procedures and policies and align with Task Force on Climate-related Financial Disclosures (TCFD) principles. This will be published on our website (principality.co.uk) in April 2023.

g) Conduct risk

(i) Market background and uncertainties

The sustainability of our business model and achievement of our longer-term strategy are dependent upon the consistent and fair treatment of Members and customers. We have always been committed to ensuring that Members and customers are treated fairly. Furthermore, the current regulatory regime has resulted in increased scrutiny around the conduct of firms and their focus on delivering fair customer outcomes, with significant consequences for those firms that do not manage conduct risk effectively.

The Consumer Duty will be one of the biggest changes in regulation for over a decade and will require firms to demonstrate that their culture, activities and behaviours deliver good consumer outcomes. The scope of this regulation is wide-ranging and is seen as a key strategic enabler for positive change. Work continues internally to implement the requirements by July 2023.

(ii) Risk mitigation

Our framework for managing conduct risk broadens and develops our conduct picture, ensuring that it continues to remain relevant, whilst highlighting the direct link to our organisational strategy and reflecting a greater emphasis on our culture as a mutual organisation. The Conduct Strategy is designed to identify, manage and measure conduct risk by reference to four categories: Customer, Culture, Colleague and Regulatory Conduct. The Conduct Strategy also articulates the Board's risk appetite in relation to conduct risk. This is set out in the diagram opposite to show how we deliver the Conduct Strategy Framework:

<table>
<tr><th>Conduct strategy</th><th>Culture</th><th>Colleague</th><th>Customer</th><th>Regulatory conduct</th><th>Corporate strategy</th></tr>
<tr><td>Risk appetite</td><td colspan="4">“Principality is focused on doing the right things, being straightforward and investing our efforts in helping people to prosper in their homes at every stage in life. As such, we have no appetite for knowingly delivering unfair customer outcomes. We recognise however that very occasionally things can go wrong. Where we have not delivered a fair outcome for our customers, we take ownership to put matters right, keeping our customers informed of what we are doing and acting on lessons learned.”</td><td>Better Homes</td></tr>
<tr><td rowspan="3">Infrastructure</td><td colspan="2">Board Conduct Risk Appetites</td><td colspan="2">Third and Second Line Assurance</td><td rowspan="4">Secure Futures</td></tr>
<tr><td colspan="2">First Line QA and Outcome Testing</td><td colspan="2">Annual Training and Assessments, SM and CR</td></tr>
<tr><td colspan="2">Policies, Procedures, Treatment Standards and PRA’s</td><td colspan="2">FCA (6) Conduct Questions</td></tr>
<tr><td rowspan="3">Outcomes</td><td rowspan="3">An evolved values based Culture, diverse and inclusive, based on a robust conduct framework, supporting communities around us and a continuous improvement focus.</td><td rowspan="3">Empowered Colleagues, working in an evolved agile and flexible way, demonstrating Conduct Risk understanding and delivering regulatory and transformational change.</td><td rowspan="3">Customer centric service, with fair outcomes; embracing vulnerable customer’s needs and providing insight-led tailored products and propositions to support each stage of life.</td><td rowspan="3">Effective Regulatory Conduct controls supported by an operationally resiliant business with robust and effective risk management, providing safety for colleagues and customers.</td></tr>
<tr><td rowspan="4">Fairer Society</td></tr>
<tr></tr>
<tr><td rowspan="2">Focus areas and measures</td><td colspan="2">12-18 months focused priorities</td><td colspan="2" rowspan="2">To be reviewed on an annual basis</td></tr>
<tr><td colspan="2">Conduct dashboard MI</td></tr>
</table>

Key conduct metrics, which align to our conduct risk appetite, are reported on a monthly basis to relevant committees and the Board. In addition, outcome testing enables an assessment of the extent to which we achieve our aim of consistently delivering fair outcomes for Members and customers. Regular feedback from Members and customers is also obtained.

Our Compliance and Conduct function advises on the management of conduct risks and oversees the effectiveness of controls in place to manage the risk of unfair customer outcomes.

The Compliance and Conduct Policy sets out high level expectations in relation to the management of conduct risk and this is supported by a suite of eleven customer treatment standards, which cover specific areas of conduct such as the treatment of vulnerable customers, handling of complaints, servicing and the provision of help to customers in financial difficulty.

h) Legal and Regulatory risk

(i) Market background and uncertainties

The following matters pose potential risks to the achievement of our strategy:

- Unknown legacy conduct issues may emerge. Regulation relating to the fair treatment of Members and customers continues to be a focus for the financial services industry, and the interpretation of fair treatment evolves over time and is influenced by developing case law
- The regulatory landscape continues to evolve and may lead to as yet unidentified risks. As a member and customer focused business operating in highly regulated markets, we are subject to complaints in the ordinary course of business. In addition, at a sector level, the incidence of regulatory reviews, challenges and investigations remains elevated. Regulatory expectations in respect of conduct standards increase the risk of future sanctions, fines or customer redress

Our business model and strong Member focus ensures that we are well placed to meet current and emerging requirements.

(ii) Risk mitigation

We have developed processes to monitor and record legal and regulatory pronouncements and notifications. These are assessed by the relevant internal subject-matter experts and, where appropriate, action plans are developed to ensure compliance by the required deadline. The register of pronouncements and notifications is reviewed on a regular basis to ensure that a coordinated approach is adopted to ensure compliance.

We manage implementation of regulatory changes through dedicated prioritised programmes that are closely monitored by the Board to ensure appropriate compliance.

All principal risks have the potential to affect more than one specific risk category and could have a significant impact on the business model if these were to crystallise concurrently. In particular, increased regulatory demands could significantly change capital or liquidity requirements which may, in extreme circumstances, threaten the viability of our business model.

Emerging/evolving risks

Alongside the principal risks detailed previously, our exposure to emerging and evolving risks is closely monitored through a formal governance structure that includes measuring performance against key risk indicators.

Regular horizon scanning activity is undertaken to identify any new or emerging risks that could threaten the long-term viability of the business. We also consider the outputs of stress testing and conduct regular reviews of strategic risks that could have a material impact on our business model. The most significant emerging and evolving risks to our strategy are detailed in the table opposite, together with actions being taken to mitigate those risks:

Risk	Mitigating Actions
Macroeconomic and geopolitical environment Current uncertainty in the macroeconomic environment is being driven by a number of factors, the most significant of which is the global inflationary pressure caused by geopolitical tensions and supply chain issues. The fiscal and monetary policy response to higher inflation will place further pressure on mortgage affordability, which is likely to lead to a slow down or even reversal in house price inflation. When combined with a potential increase in unemployment, higher credit losses could materialise over the short to medium-term. Changes in customer behaviour, masked by a prolonged period of consistently low interest rates also have the potential to change funding and liquidity requirements.	We prepare medium-term financial plans on an annual basis which incorporate scenarios that reflect the impact of changes in the economic environment. Key macroeconomic indicators are closely monitored, the purpose of which is to alert management to signs of increasing headwinds in the economy. In addition, we have modelled different financial plans to reflect the potential impacts of different recovery trajectories and the impacts on the core markets in which we operate. These include, but are not limited to, stress test scenarios published by the Bank of England.
Competitive environment The nature of, and demand for, financial services has altered significantly over recent years. In particular, this has been characterised by the development of innovative digital products offered by new entrants, as well as more established institutions. Acceptance and utilisation of digital technology appears to have increased significantly following COVID-19, with changes likely to result in continued competition in our core markets. Competitive pressures are expected to increase into the future, particularly as new propositions are developed utilising Open Banking technology.	Our investment programme is primarily intended to ensure that our core offering remains appropriate and relevant to our target market. The successful delivery of our plans will help mitigate the risks arising as a consequence of increased competition. Focus at Board level has increased in line with the perceived benefits and risks associated with delivery of our plans. The markets in which we operate are constantly monitored, to ensure the business can respond to changes in customer requirements.

Risk	Mitigating Actions
Climate change Climate change presents far-reaching impacts across all countries and industries. It will require a financial services industry that can manage the associated risks and support customers in making the shift towards a carbon neutral economy. The two key risks faced by financial services firms are: **Physical risk** (risk from increased severity and frequency of weather-related events) and **Transition risk** (risk from the adjustment towards a lower carbon economy). More focus is expected on climate change management as the regulator and consumers become more demanding of firms' green credentials.	We are in the process of ensuring climate consideration becomes embedded strategically within the business and have completed the initial analysis of the current book alongside potential outcomes from different scenarios. These form the basis of the targets we are establishing for the reduction of carbon in our operations, more details of which are provided in our TCFD published on our website (principality.co.uk). It is acknowledged that our response will develop as more data and regulatory guidance becomes available and the Society will closely monitor industry developments.
Cyber security The threat represented by cyber-attacks is expected to remain at an elevated level, taking into account the frequency and severity of reported attacks instigated against other financial services providers within both the UK and wider markets.	We continue to invest in our cyber risk management capability alongside the investment in our core product offering. We regularly assess this capability via a variety of means including third party penetration testing.
Operational resilience The nature and pace of technological change represent a risk to the continued resilience of the financial services sector. Our ability to maintain and further develop operational resilience and operational risk management capabilities is vital to ensure we can continue to provide Members with a secure, stable and competitive service. The move to hybrid working, initially as a consequence of the pandemic has affected the recruitment market, particularly in the supply of specialist/technical skills needed to support our investment programme.	Our medium term plans incorporate appropriate levels of investment in systems capability and underlying resilience. The Board Risk Committee maintains regular oversight of programme delivery and in ensuring the ongoing effectiveness of business level operational risk management capability and associated controls. Recruitment procedures and our employee offering are under review to ensure we remain competitive and attractive to prospective candidates, monitored through timely management information.

Approval of the Strategic Report

This Strategic Report has been approved by the Board of Directors and is signed on behalf of the Board by:

Iain Mansfield
Chief Financial Officer
17 February 2023

Governance

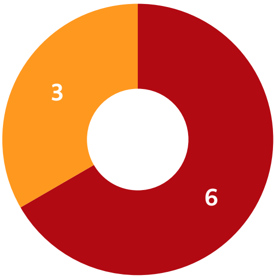
Corporate Governance Report

This section outlines how the Society is managed in the interests of its Members and highlights the role, constitution and governance of the Board and its Committees.

The Society's approach to corporate governance is based on the Principles and Provisions of the UK Corporate Governance Code ('UK Code'). Although the UK Code is primarily aimed at listed companies, the Society's Board is committed to operating in line with best practice standards of corporate governance. For this reason, and to meet the expectations of the Society's Members and other stakeholders, the Board chooses to comply with the UK Code, in so far as is possible and relevant to building societies. This report sets out how we have achieved this during 2022.

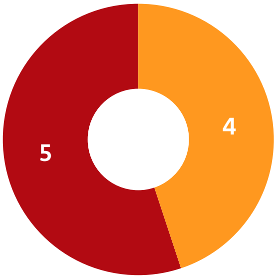
Board of Directors

Board composition



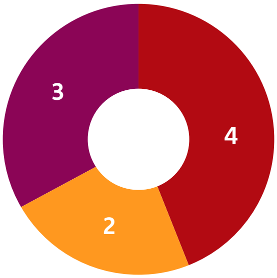
Non-Executive Directors
Executive Directors

Gender diversity



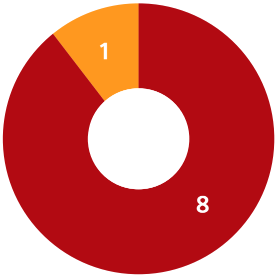
Male
Female

Tenure



0-3 years
3-6 years
6-9 years

Ethnicity diversity



White British
White and Black African

Committee Key: (In bold for Chair)

A	Audit	G	Governance and Nominations		
NRC	NED Remuneration	R	Risk	RC	Remuneration

Sally Jones-Evans
Chair, Non-Executive Director

G RC NRC

Joined the Board in February 2015, elected Chair in April 2021

Skills and experience

I spent 30 years in retail banking and general insurance during which I gained wide ranging experience in leading people through this change, mainly in areas directly serving customers. I believe that helps me to support the Executive Leadership team to shape the Society's ongoing change agenda.

Contribution to the Society's long-term sustainable success

I am responsible for leading the work of the Board, ensuring the Board operates effectively in setting the strategy, overseeing the performance and setting the risk appetites of the Society. I am also responsible for ensuring robust succession plans are in place, that the Society maintains the highest standards of corporate governance and that we have an open and transparent culture.

Other roles

I sit on the Boards of Hafren Dyfrdwy Ltd (a subsidiary of Severn Trent plc) and Delio Ltd, a fast growing Welsh fintech business. I have a special interest in tackling poverty and injustice and serve as a Trustee Director of Tearfund, the humanitarian and overseas development charity.

Julie-Ann Haines
Chief Executive Officer (CEO)

NRC

Joined the Board in May 2016

Skills and experience

I was appointed Chief Executive Officer in 2020, prior to that I had been the Society's Customer Director since 2012. Before joining Principality, I was a senior manager in sales, marketing and technology for companies such as Sainsbury's and HBOS. Working closely with customers has always been a critical part of what I do.

Contribution to the Society's long-term sustainable success

I am passionate about the Society, ensuring we build on our mutual ethos and values, rooted in our communities, providing fantastic customer experience and in meeting your needs. My role is to lead the Executive team to ensure we continue to deliver the Society's strategy for the long-term interests of our Members and ensure that the organisation runs smoothly day-to-day, supporting colleagues and building an inclusive and engaging culture.

Other roles

Member of the UK Finance Mid-Tier Strategic Advisory Committee. Member of the International Advisory Board of Cardiff Business School. Trustee of the Wales Millennium Centre.

Derek Howell
Senior Independent Non-Executive Director

A G R

Joined the Board in April 2014

Skills and experience

I hold a degree in mathematics and qualified as a Chartered Accountant with Price Waterhouse – subsequently Pricewaterhouse Coopers (PwC) where I initially worked in audit and eventually specialised in corporate recovery and insolvency work, becoming a partner in 1988. Following my retirement from the partnership, I continued to act as a consultant for PwC, solely in connection with the ongoing administration of Lehman Brothers until December 2021.

Contribution to the Society's long-term sustainable success

As Senior Independent Director, I act as a sounding board for the Chair, serve as an intermediary for other Directors, and am responsible for leading the annual review of the Chair's performance. As the Board appointed Whistleblowing Champion, I am also available to Members if they have concerns, which they have not been able to resolve through the normal channels, or for which such contact is inappropriate. I am responsible for helping the Board fulfil its oversight responsibilities in respect of matters relating to the integrity of financial and narrative statements, systems of risk management and internal control.

Other roles

A Trustee of the National Botanic Garden of Wales, Community Foundation Wales and Artes Mundi Prize Limited.

Jonathan Baum
Independent Non-Executive Director

A G R

Joined the Board in July 2021

Skills and experience

I have 30 years' experience in domestic and international banking within globally renowned organisations including Lloyds Banking Group, Barclays Bank plc and GE Capital. I was a Non-Executive Director for TransUnion UK and Vanquis Bank.

Contribution to the Society's long-term sustainable success

My experience across retail, business, wealth and asset finance sectors and in risk leadership roles enables me to have oversight of current and emerging risks that will ensure that the Society continues to be successful and sustainable for its Members.

Other roles

Advisory Role - Baum Advisory Ltd. Non-Executive Director of Lendable Ltd.

Claire Hafner
Independent Non-Executive Director

A G
R RC

Joined the Board in April 2018

Skills and experience

I am a qualified accountant (ACA) and have an MA in Languages and Economics. I trained and qualified at Ernst & Young in the financial services audit department followed by a further three years in corporate tax. During my career, I have performed a broad range of roles across multiple sectors including a term of six years as a Non-Executive Director of the West Bromwich Building Society.

Contribution to the Society's long-term sustainable success

My experience across the different sectors of financial services, payments, professional services, multimedia and telecoms enables me to contribute to the Society's change programme and to the Society's continuing success.

Other roles

Non-Executive Director of Glendrake Limited.

Debra Evans-Williams
Non-Executive Director

G RC

Joined the Board in September 2019

Skills and experience

During my career, I have held a range of Executive and Non-Executive Director positions and have also worked in a consultancy role with companies in the UK, Europe and the US. My previous experience includes five years spent at the Britannia Building Society, as well as senior roles at Tesco Compare and Confused.com.

Contribution to the Society's long-term sustainable success

My experience in the fintech/e-commerce arenas will enable me to make a positive contribution to the Society's ongoing digital transformation, which will support the continued delivery of stand-out experience for our Members.

Other roles

Non-Executive Director of Co-Op Insurance, Non-Executive Director of the Milford Haven Port Authority and Trustee of the Alacrity Foundation. I am also a proud ambassador for Tŷ Hafan. I am a member of the Society's Colleague Forum.

Ian Greenstreet
Independent Non-Executive Director

A G

Joined the Board in November 2022

Skills and experience

I am a qualified accountant (ACA) and investment banker with over 35 years' financial services experience (banks, insurance companies and fintech organisations). I am an experienced risk professional and worked as Chief Risk Officer at ABN Amro UK before undertaking several Board roles. I also co-founded and developed a successful disruptive fintech FX firm.

Contribution to the Society's long-term sustainable success

My experience will enable me to help the Board fulfil its oversight responsibilities in respect of matters relating to the integrity of financial and narrative statements, systems of risk management and internal control.

Other roles

CEO and Founder, Infinity Capital Partners Ltd, Board Director of United Bank of Africa, Director at Natwest Trustee and Depositary Services Limited.

Michael Jones
Chief Risk Officer (CRO)
Joined the Board in February 2013

Skills and experience

Having worked for the Society since 1997, I was appointed Head of Group Risk in 2005 and promoted to the role of Director of Group Risk (now Chief Risk Officer - CRO) in 2009. In December 2019, I was appointed Interim Chief Executive Officer (CEO) by the Board and undertook those duties until September 2020, at which point I moved back to my substantive role as CRO. I have spent over 40 years working in financial services, starting my career at Midland Bank and subsequently at HSBC, undertaking a number of managerial roles in both the retail and corporate banking divisions. I hold a degree in Economics, an MBA from Henley Management College, and I am an Associate Member of the Chartered Institute of Bankers.

Contribution to the Society's long-term sustainable success

As CRO, together with the CFO, I am responsible for ensuring the Society maintains a strong capital base, which will enable it to continue to grow and compete successfully over the long-term. I also have responsibility for the Society's second line of defence to ensure risk management is embedded throughout and aligns to the Society's risk appetite, purpose and objectives.

Other roles

Independent Member – Pobl Group Audit and Risk Committee.

Iain Mansfield
Chief Financial Officer (CFO)
Joined the Board in December 2019

Skills and experience

I was appointed Chief Financial Officer in July 2022. My remit extends across Commercial, Nemo, Architecture, Strategy, Corporate Property and Estates. I joined the Society in January 2015, initially as Finance Director for Nemo (Principality's second-charge loans subsidiary) before becoming Nemo's Managing Director. Prior to my current role, I was appointed Chief Operating Officer in October 2017 and joined the Board in December 2019. I am a Chartered Accountant, with more than 20 years' experience, across retail banking, as well as start-up and private equity owned financial services businesses in the UK.

Contribution to the Society's long-term sustainable success

My role is to ensure we plan and manage the Society's capital, liquidity and funding in the long-term interests of our Members and the sustainability of the Society.

The Role of the Board

The Board is the governing body of the Society and its responsibilities fall under a number of broad functions, which include, setting the overall strategy and risk appetite, leading the development of the Society's culture, operational performance and oversight and setting the corporate governance framework. One of its primary duties is to promote the long-term success of the Society, whilst acting in the best interests of both current and future Members. In doing so, the Board also has regard to its wider stakeholders.

The Board is responsible for:

- Formulating the Society's strategy, business model and monitoring progress against the agreed strategy
- Ensuring the sustainability of the Society's business model
- Approving significant projects with spend over £5m
- Maintaining a sound system of control and setting the Society's appetite for risk
- Ensuring that there is an appropriate culture in place across the Society, which aligns with its strategy and values
- Fostering transparency and honesty and ensuring that good standards of behaviour permeate throughout all levels of the Society
- Approving the Society's Whistleblowing Policy and its annual statement on the steps being taken to mitigate modern slavery and human trafficking risks to which the Society is exposed
- The proper conduct of all aspects of the Society's affairs
- Approving the Society's Remuneration Policy, upon the recommendation of the Remuneration Committee
- Ensuring that Board and Executive succession planning is in place and approving any key appointments

Board activity

To enable the Board to use its time effectively, a forward looking programme of meetings and a rolling Board agenda is maintained. There is sufficient flexibility in the Board's agenda to ensure that the Board can address emerging matters in a timely manner. The following table provides a sample of some of the matters the Board has considered during the year:

Responsibility	Key Activity
Standing Agenda Items	• Management information to facilitate the monitoring of Key Performance Indicators and Key Risk Indicators • Reports from the Chief Executive Officer, Chief Financial Officer and Chief Risk Officer and other Executives on performance and risk matters, including non-financial information • Reports from the Board Committee Chairs on key matters considered and decisions made at the last Committee meeting • Reports from the Board members on any meetings and interactions with stakeholders
Strategy	• Strategy and Business Model Review • Corporate Plan • Marketplace Developments • Macro-economic Assumptions • Transformation Programme
Financial Reporting and Performance	• Annual Report and Accounts and Interim Financial Statements • Long-term Viability Statement Review • Letter of Representation to the Auditors • Summary Financial Statements • Quarterly Performance Review • Budget and Quarterly Reforecasts
Risk Management	• ILAAP and ICAAP • Regulatory Matters • Climate Change Risks • Recovery and Resolution Plan • Approval of Risk Appetite and Tolerance • Information Security and Cyber Resilience • Operational Resilience and Outsourcing • Senior Manager Certification Regime and Responsibilities Map • Treasury Policy Statement • Wholesale Funding Decisions • Lending Policies

Responsibility	Key Activity
People, Culture and Remuneration	• Annual Colleague Survey (Great Place to Work Survey) and Interim Colleague Surveys • Culture, including People Programme and Diversity and Inclusion • Member and Stakeholder Engagement • Colleague Forum Updates • Remuneration Policy
Governance	• Approval of Board Committee Terms of Reference • Schedule of Matters Reserved to the Board • Board Effectiveness Review, including Action Plan • Annual General Meeting Notice and Proxy Form • Adoption of Part II to Schedule 10 of the Building Societies Act 1986 and Sections 68 and 69 of the Statements and Elections • Approval of Modern Slavery and Human Trafficking Statement • Whistleblowing Policy and Whistleblowing Champion's Report • Approval of Conflicts of Interest and Directors Outside Interests • Review of the framework governing the Delegation of Authority

Delegation of Authority

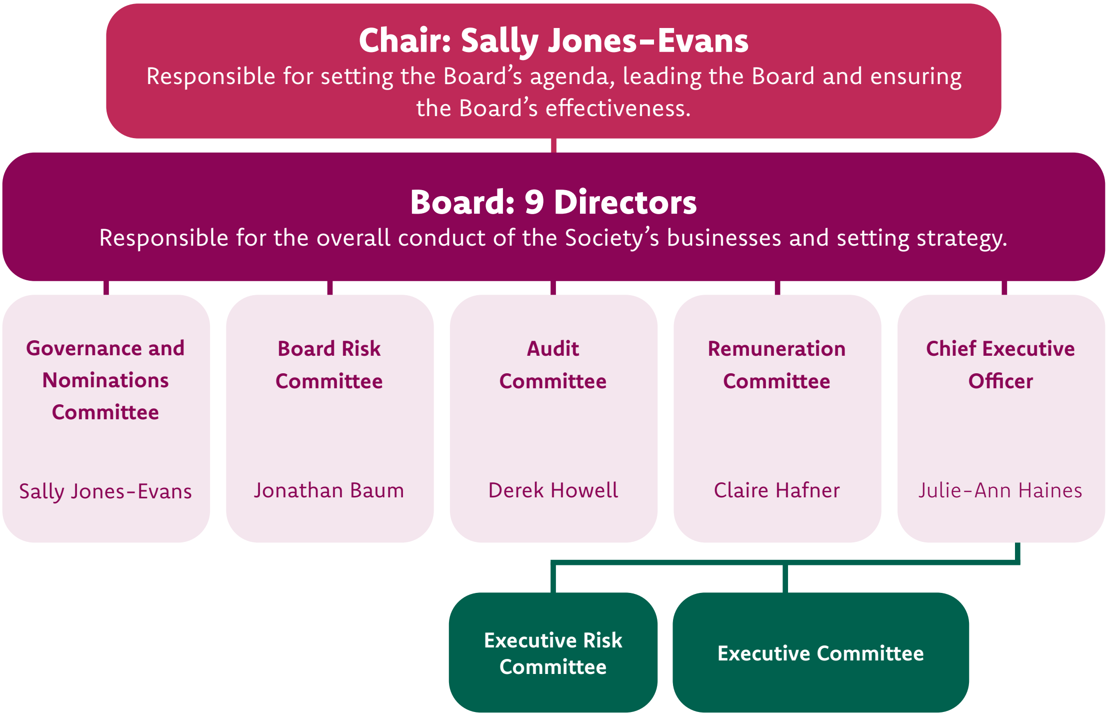
The Board recognises that ensuring a system of effective corporate governance is integral to the successful delivery of the Society's goals. In order to allow the Board to spend sufficient time on items of the most strategic importance, the Board delegates a number of oversight responsibilities to its Committees.

The delegation of a Board responsibility to a Committee is made on the basis that membership of each of the Committees comprises Non-Executive Directors with the most relevant skills, knowledge and experience required for that subject area. The responsibilities of each Committee of the Board are outlined within their respective terms of reference, which are subject to annual review by the Board and can be viewed on the Society's website: principality.co.uk. In addition, the Board also maintains a schedule of matters which are reserved for its decision which is also subject to annual review and is available on the website.

The Board oversees the work of each of the Committees by receiving regular reports from each Committee Chair on the key matters considered following each Committee meeting. In addition, each Committee carries out a review of its own effectiveness and reports on the outcome of this to the Board.

Board Composition

Under the Society's Rules, the Board must comprise no more than 14 and no less than seven Directors and, under the UK Code, at least half of the Board should comprise Non-Executive Directors. At 31 December 2022, the Society's Board comprised the Chair, five independent Non-Executive Directors and three Executive Directors. This composition is designed to be able to meet the needs of the business and allow for efficient operation of the Board's Committees.



During the year, two Non-Executive Board Associates (NEBA) joined the Board providing valuable insight and expertise from the technology and social housing sectors. The NEBAs attend the Board and provide advice and support based on their specific skills along with general input and challenge to the work of the Board and the Executive. They have no formal voting rights nor do they have any fiduciary duties. This is a first for the Society which also aims to improve diversity of thought around the Board table.

The Board Composition Policy is reviewed regularly. At its last review, the Board concluded that it remains satisfied that this policy continues to appropriately reflect the importance of building an inclusive culture, in which the whole organisation works together and where diversity is valued. More information on this topic is provided within the Governance and Nominations Committee report on pages 56 to 57.

The annual review of Board skills assessment has concluded that the Board has the skills and capabilities necessary to discharge its duties.

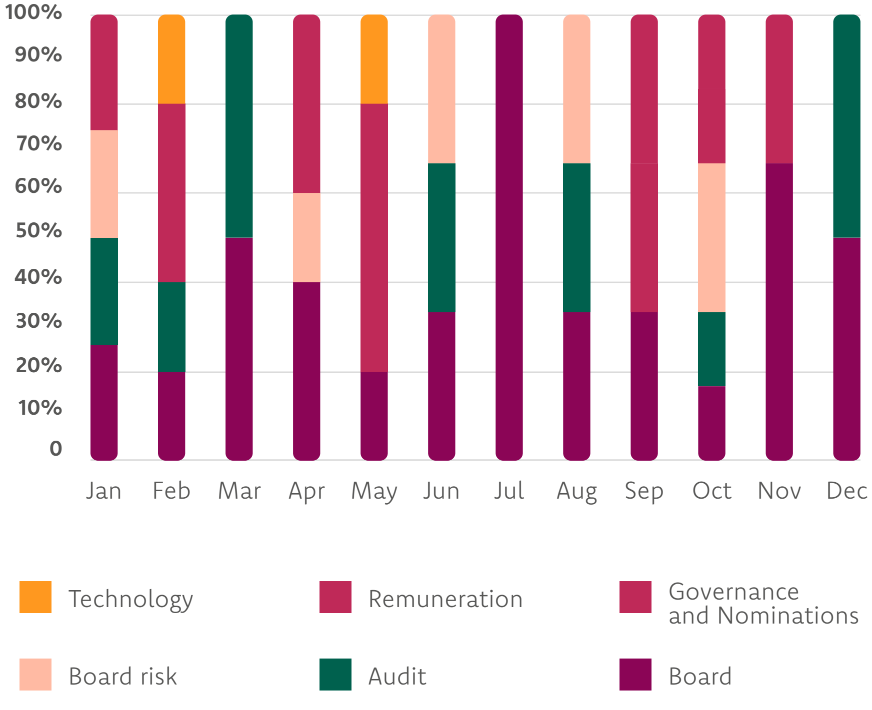
Non-Executive Directors

The Non-Executive Directors are expected to have a broad range of skills, knowledge and experience to exercise independent judgement on strategy, performance, risk management and corporate governance. In addition, the purpose of the Non-Executive role is to:

- Constructively challenge strategy proposals presented by the Chief Executive Officer and Executive Directors
- Scrutinise and challenge operational performance against the corporate plan
- Assess the integrity of the financial information and controls
- Assess the adequacy of the Society's risk management framework and systems of internal control
- Assess whether current and future resources are commensurate with the Society's objectives
- Determine the broad policy for executive remuneration; and
- Be satisfied that an appropriate culture is in place

Board Meetings

The Board and its committees have a regular cycle of meetings as set out below and hold ad-hoc meetings as required. Following learnings from the pandemic, the Board has continued to hold every other meeting as a virtual meeting. This has enabled the Board to meet more regularly and achieve cost efficiencies.



Time commitment

One of the key criteria which is taken into account when appointing a Non-Executive Director is whether they are able to commit sufficient time to the role with the Society. Time commitment of the Non-Executive Directors is reviewed by the Chair upon appointment and is monitored carefully by the Governance and Nominations Committee. Any additional roles that a Non-Executive Director wishes to take up following appointment requires the prior approval of the Board.

	Board	Audit	Board Risk	Remuneration	Technology[1]	Governance and Nominations
Sally Jones-Evans	13/13	-	-	5/5	-	5/5
Derek Howell	13/13	8/8	5/5	-	-	5/5
David Rigney[2]	3/3	3/3	1/1	-	1/1	1/1
Nigel Annett[3]	9/9	-	-	4/4	2/2	5/5
Claire Hafner	13/13	8/8	5/5	5/5	-	5/5
Debra Evans-Williams	12/13	-	-	4/5	2/2	4/5
Jonathan Baum	13/13	8/8	5/5	-	-	5/5
Julie-Ann Haines	13/13	-	-	-	-	-
Michael Jones	13/13	-	-	-	-	-
Tom Denman[4]	6/6	-	-	-	-	-
Iain Mansfield	13/13	-	-	-	-	-

[1] Technology Committee ended in May 2022.
[2] Resigned as Non-Executive Director in March 2022.
[3] Resigned as Non-Executive Director in October 2022.
[4] Resigned as Executive Director in July 2022.

Independence

The Board reviews the independence of its Non-Executive Directors annually. The UK Code outlines criteria for assessing the independence of a Non-Executive Director. A compromise of independence is presumed where Non-Executive Directors have been recent employees of the Society, held a material business relationship with the Society, received any additional fee other than their Director's fee, or have close family ties or significant links to the Society. In addition, the UK Code presumes that a Non-Executive Director who has served more than nine years on the Board is no longer independent. In light of this, the Board has concluded that all five Non-Executive Directors continue to remain independent.

At the time of Sally Jones-Evans' appointment as Chair, the Board was satisfied that she met the independence criteria as outlined within the UK Code. The Chair's role requires a substantial time commitment to the affairs of the Society. Consequently, the Chair is not expected to remain independent following appointment.

Senior Independent Director

Derek Howell is the Board appointed Senior Independent Director. This particular role is responsible for acting as a sounding board for the Chair, serving as an intermediary for other Directors, and being available to Members if they have concerns which they have not been able to resolve through the normal channels of the Chair, Chief Executive Officer or other Executive Directors, or for which such contact is inappropriate. Derek is stepping down in March 2023 after nine years on the Board. The Board have appointed Jonathan Baum to replace Derek Howell as Senior Independent Director when he steps down from the Board, subject to regulatory approval.

Chair and CEO

The offices of Chair and Chief Executive Officer are separate and held by different individuals. The Chair is not involved in the day-to-day management of the Society but is responsible for the following matters which are outlined within a role profile which is subject to review and approval by the Board:

- The leadership and operation of the Board, ensuring that it promotes high standards of corporate governance
- Leading the development of the Society's culture and standards
- Ensuring the effectiveness of the Board, its Committees and individual Directors are subject to annual evaluation
- Ensuring that the Society engages effectively with its key stakeholders
- Setting the agenda, style and tone of Board discussions
- Ensuring that Directors receive accurate, timely and clear information
- Developing the Board Succession Plan; and
- Ensuring that a comprehensive induction programme for new Non-Executive Directors and Board Associates joining the Board is maintained and that existing Non-Executive Directors receive the necessary ongoing training to be able to contribute fully to the Board

The Chief Executive Officer's primary responsibilities are the day-to-day management of the Society, the implementation of the Board approved strategies and policies, and chairing the Executive Committee. Her full responsibilities are also outlined within a role profile which is reviewed and approved by the Board. The Chair and the Chief Executive Officer maintain a close working relationship.

The Executive Committee oversees the day-to-day operations of the Society's business and formally meets every week. These meetings focus on topics relating to people, change, the market and performance, as well as reviewing matters which are due to be presented to the Board. The Executive Committee is composed of the Chief Executive Officer, two other Board members and four members of the Executive Leadership Team.

Appointments to the Board

Further details about the Non-Executive recruitment process can be found in the Report of the Governance and Nominations Committee.

Candidates to fill Non-Executive Director vacancies on the Board are sought in various ways, including through press advertisements and with the assistance of external search consultants. Candidates must meet the tests of fitness and propriety as prescribed by the FCA and must receive approval, where necessary, from the PRA and FCA before taking up their role. The Society's Rules require that all new Directors must stand for election at the Annual General Meeting in the year following their appointment to the Board. Members of the Society have the right to nominate candidates for election to the Board, subject to the Society's Rules and compliance with PRA and FCA requirements. No such nominations were received prior to the Society's 2022 AGM.

Culture

The Board is responsible for leading the development of the Society's culture. The Board is committed to ensuring that a diverse and inclusive culture is in place which enables all colleagues to feel accepted and valued. Fostering an appropriate culture encourages colleagues from all backgrounds to feel confident in their ability to achieve their best and is likely to improve retention rates.

Non-Executive Directors have devoted a significant amount of time to meeting Members and colleagues from across the business as a means of experiencing the culture of the business first hand. By visiting branches, offices and attending meetings of Colleague Forum and the

Annual General Meeting, Non-Executive Directors are able to hear from Members and a broad range of colleagues at all levels of the business to better understand matters which are of direct interest to them. The Board also gains insight into the culture within the business through reviewing the outcome of colleague surveys and information presented from a wide range of sources including the HR, compliance and conduct and internal audit teams.

Board information

The Board has full and timely access to all relevant information to enable it to discharge its duties effectively. The Chair is responsible for ensuring that all Directors are properly briefed on issues arising at Board meetings. The content of management information presented to the Board is reviewed regularly to ensure that it remains relevant to the Society's business model and operating environment, and to ensure it is sufficient to enable the independent Non-Executive Directors to assess and monitor the Society's progress.

Independent professional advice

All Directors have access to the advice and services of the Society's Secretary. Members of the Board may take independent professional advice at the Society's expense in the furtherance of their duties. The Society's Secretary is responsible for ensuring that Board procedures are followed.

Board induction and training programme

The Chair is responsible for ensuring that each Non-Executive Director receives induction training, upon joining the Board, and subsequent ongoing training which is tailored to their individual needs and requirements.

The Society's induction programme for new Non-Executive Directors covers all aspects of the Society's operations and the regulatory environment in which the Society operates. This enables new members of the Board to function effectively as a Board member, as quickly as possible. The induction programme is reviewed annually by the Governance and Nominations Committee to ensure that it remains appropriate, and includes a series of meetings with Executives, Non-Executive Directors and the Society's Secretary. As well as briefings from members of senior management, new Non-Executive Directors also have the opportunity to attend key management meetings and to visit areas of the business.

Keeping up to date with key business developments is essential in order to ensure that Directors properly discharge their responsibilities. This is achieved through:

- Presentations made to the Board from industry specialists, executives and senior managers drawn from within the business on key developments and significant matters
- Providing the Board with updated financial plans, budgets and forecasts which are regularly reviewed and discussed
- Providing Board members with access to external training sources; and
- Providing the Board with regular updates on the economic and regulatory environments within which the Society operates

The Society's Secretary maintains an ongoing Board training and development programme and during 2022 the following areas were addressed:

- Briefing on the response to the crisis in Ukraine
- The impact and considerations of growth
- Enabling strategy through change
- Hybrid working and Transforming the Workplace
- Operational resilience and Cloud Strategy
- Lending to Registered Social Landlords
- Mortgage Sales and Origination (MSO) software
- Residential Mortgage Backed Security (RMBS)

Individual performance evaluation

The Society has a framework in place to ensure that all Directors and individuals appointed to relevant senior manager positions have the appropriate fitness and propriety to properly discharge their responsibilities, both at the time of their appointment and duration of their appointment.

The Chair is responsible for assessing annually the fitness and propriety of the Society's independent Non-Executive Directors and the Chief Executive Officer. The Senior Independent Director is responsible for leading the evaluation of the Chair's performance, in conjunction with the other Non-Executive Directors, and for conducting their annual fit and proper assessment. The Chief Executive Officer is responsible for carrying out the annual performance appraisal and fit and proper assessment for each of the Executive Directors. Each of the relevant fit and proper assessments were carried out during the course of 2022 and the Chair continues to be satisfied that each Non-Executive Director is fit and proper and has the requisite knowledge and skills to be able to discharge their responsibilities effectively.

Board effectiveness review

The collective effectiveness of the Board is subject to an external evaluation every three years with the last external review performed in November 2021 by Nasdaq who specialise in performing board evaluations. The latest internal review was conducted in November 2022. The principal conclusion from the review was that the Board continues to fulfil its governance role strongly. The themes arising from the review which will result in action being taken to further strengthen Board governance include:

- Prior to COVID-19, the Board engaged in a range of wider Society activities such as Branch visits, member events and network events. The Board are committed to increasing the time spent on this
- The Board would like to create opportunities for colleagues to gain exposure to the Board in order to develop talent and capability. This will ensure the Board observe the strength and capability of those identified as talent and/or potential successors
- Further enhancement of the Board Skills Matrix by defining a Board composition and succession plan aligned to current and future strategic needs, culture and D&I and including this in the Board's annual appraisal and development planning process
- Continued focus on Board reporting and meeting management. The Secretariat will continue to ensure papers are succinct and the forward schedule is well managed

Progress with work to implement the actions arising from the Board Effectiveness Evaluation has been regularly monitored by the Board and the Governance and Nominations Committee.

Stakeholder engagement

Directors are required to act in the way they consider, in good faith, would be most likely to promote the success of the Society for the benefit of Members as a whole and in doing so have regard to a number of key areas:

- The likely consequences of any decision in the long-term
- How the interests of employees are considered
- How constructive relationships with wider stakeholder groups are fostered (e.g. suppliers)
- How a reputation for high standards of business conduct is maintained
- Consideration of how any community and the environment is impacted by our operations
- The need to act fairly and balance the interests of Members

As a building society, we put our Members at the centre of all the decisions made by the Board, but also understand how important it is to take into account the views and needs of all our key stakeholders. Listening to, and acting upon, the views of our stakeholders helps us to fulfil our purpose and to develop our strategy in a way that continues to benefit our key stakeholder groups over the long-term. In 2022 the Board reviewed its engagement with key stakeholders to ensure that their voices continue to be part of our Board discussions. A summary is shown below of the key stakeholder relationships:

Key stakeholders	Who they are	How we listen and engage	What they expect from us
Members and Customers	Retail Borrowers	Member Panel	Offer good value and flexible savings accounts and mortgages
	Retail Savers	Member Panel Annual General Meeting	Deliver helpful, effective, approachable, friendly and efficient service
	Commercial Borrowers	Focus groups and panels	Invest in the products and services they need to gain better financial resilience or buy a home
	Housing Associations	Society website Direct engagement through specialist teams (face-to-face, online web chat, telephone calls, letters, emails, social media)	Run a strong, secure and sustainable business in their long-term interests

Colleagues	Full and part time colleagues	A range of colleague forums and networks including Pride, Carers and REACH	Encourage and support development and training
	Agency colleagues	Colleague surveys Employee Value Proposition	Reward colleagues fairly
	Contractors	Intranet (live Q&As, news, blogs) Direct engagement through leadership teams, including a Non-Executive Director appointed to lead on colleague representation	Care about the physical, mental and financial wellbeing of colleagues. To be treated with empathy, respect and fairness on an equal level with Members and customers
Government, Regulators and Trade Bodies	Central and Local Governments (inc Welsh Government)	Direct engagement through specialist teams (face-to-face, telephone calls, letters and emails)	Act within the law and regulation and in the interests of our Members and customers
	PRA	Engaging with consultations	Swiftly and proactively resolve customer issues
	FCA	Monitoring, engaging and complying with regulatory change and reporting	Be financially strong and secure by maintaining adequate resources including capital and liquidity
Media	Local, national	Direct engagement through specialist teams	Be open, helpful and approachable
Communities	Local communities in which the Society operates	Details of our community engagement programme can be found on pages 23 to 24	Be a sustainable business and act as a socially responsible organisation
Third Parties	Brokers, banks and investors	Direct engagement through specialist teams	Be professional, open and collaborative
Partners	Agency partners, suppliers, auditors	Direct engagement through specialist teams	Act with honesty, integrity and to role model our values and behaviours

The Society is part of both a local and global community, and our operations impact a range of stakeholders. The Society adheres to all regulatory requirements and reports our emissions under the Streamlined Energy and Carbon (SECR) framework. The Chief Risk Officer is the senior manager responsible for managing the financial risks of climate change and he is supported by a sustainability manager, to demonstrate the importance of this topic.

Nigel Annett (to September 2022) and Debra Evans-Williams (from October 2022) attend meetings of our Colleague Forum, which is made up of representatives from across the Society and reports back to the Board on discussions taking place in that forum. During the year, that forum has focused its attention on transforming our workplace with hybrid working and the cost of living challenge.

The Society is committed to fostering and maintaining good communications with Members. In 2021, the Members' Forum was retired and replaced with a Member panel, called the Member Pulse, an on-line community made up of approximately 2,000 Members. The intention is to increase this to around 4,000 Members over the next few years. This will enhance our ability to canvass Member views on topics quickly and at scale, ensuring we continue to make decisions that are underpinned by the view points and needs of our Members.

Annual General Meeting (AGM)

As a mutually owned organisation, the Board is answerable and accountable to the Society's Members. The Board is committed to and proud of the Society's mutual status and, as detailed above, proactively works to balance Member interests with those of other stakeholder groups.

The Society seeks to encourage all eligible Members to participate in the AGM, either by attending in person, or via a live-stream and by voting. The AGM provides Members with the opportunity to hold the Board to account through raising questions and voting either for or against any of the resolutions on the agenda at that meeting. A resolution on the Report on Directors' Remuneration is included on the agenda. The voting process is overseen by independent scrutineers, who also attend the meeting in person to count votes cast by Members. The results of the vote are published on the Society's website. In accordance with the Society's rules, all eligible Members are sent the Notice of the AGM at least 21 days prior to the Meeting. All Directors attend the Meeting unless their absence cannot be avoided. All Directors who stood for election or re-election in 2022 were duly elected or re-elected. All Directors will again stand for election or re-election at the 2023 AGM, with the exception of Derek Howell who retires from the Society's Board in March 2023.

Following the success of the 2022 AGM, the 2023 AGM is planned to be a hybrid event where Members can either access a live-stream of the AGM via the internet, or physically attend in person at Principality House in Cardiff. An exciting change for our 2023 AGM, is that we will also show the live-streamed event at a selection of our branches (secondary locations) where Members can join local teams to take part in the AGM. This supports the hyper-local approach in our strategy Framing Our Future and we hope to see increased Member involvement and voting. More details on the branches involved can be found on our Notice of AGM.

Sally Jones-Evans
Chair
17 February 2023

Governance and Nominations Committee Report

for the year ended 31 December 2022

Committee responsibilities

The Governance and Nominations Committee is responsible for oversight of the Board and Executive Management Succession Plan and making recommendations for new appointments to the Board.

The Society's Board is strongly committed to promoting diversity and making appointments on merit, against objective criteria.

Committee membership

The Governance and Nominations Committee is a Board Committee and in 2022 comprised all of the Non-Executive Directors. The Committee met on five occasions during the year.

The Committee regularly invites the Chief Executive Officer, the Chief Governance Officer and the Chief People Officer to attend the meetings, along with other colleagues from across the business, where appropriate.

Activity during the year

During the year, the Committee appointed Green Park Limited (who have no other relationships with the Society) to support the process, which led to the appointment of two Non-Executive Board Associates, and Ian Greenstreet as a new Non-Executive Director and member of the Society's Board. All appointments are subject to extensive external checks and, where required, regulatory approval. All new Non-Executive Directors undergo a tailored and comprehensive induction programme on appointment.

The Committee also considered the resignation of Tom Denman, former Chief Financial Officer and Lorna Kerr, former Chief People Officer, and work was undertaken to fill these roles. Michael Jones, Chief Risk Officer, has tendered his resignation and the Committee will oversee the appointment of his successor.

During the year the Committee has:

- Reviewed the size and composition of the Board and its committees
- Reviewed the mix of the skills and experience of the Board
- Agreed that as a minimum, at least two Directors should have a diverse background
- Reviewed the Board and Senior Management Succession Plans
- Reviewed the time commitment of Non-Executive Directors
- Reviewed and agreed a Board development plan and activity designed to support this
- Reviewed the induction programme for new Non-Executive Directors
- Received a report on the arrangements in place, which enable the Society to comply with the provisions contained in the Corporate Governance Code as far as the Code can reasonably be applied to a building society
- Received regular reports on corporate governance related developments
- Received regular reports on the progress being made with work to implement the actions arising from the 2021 externally facilitated review of the Board's effectiveness and that of its committees

The Committee is responsible for monitoring progress with work to meet the gender diversity targets set out in the Board Diversity Policy and the wider target for gender diversity put in place by the Board on agreeing to support the Women in Financial Services Charter. In September 2016, the Board agreed to establish a five year diversity target of 33.3%. The table below shows the ratio of women to men in senior management positions within the Society over the period 1 January 2019 to 31 December 2022:

Ratio as at 31 December 2020	Ratio as at 31 December 2021	Ratio as at 31 December 2022
31%	30%	39%

At 31 December 2022, 44% (2021: 27%) of Board members were female.

The Board is committed to diversity and agreed that as a minimum, at least two Directors should have a diverse background. In 2022, Ian Greenstreet joined the Board as a Non-Executive Director. Ian is a qualified accountant (FCA), Investment banker and risk professional with over 35 years of financial services experience (banks, insurance companies and fintech organisations). The Board is committed to continued diversity, including diversity of thought. The Society is continuing to work on the development of its diversity policies. In 2022, the Board worked with an organisation called Chemistry, which profiled their intellect, personality, motivations, behaviours and experience to understand how best the Board could work together better. The Executive Directors and the senior leaders of the Society went through the same assessment process in 2021. The combined results help to identify areas of diversity of thought, behaviours and motivations, which will lead to a more diverse Board and ultimately better decisions.

Other matters

Following each Governance and Nominations Committee meeting, the Chair of the Committee provides an oral update to the Board on matters considered by the Committee. In addition, minutes of Committee meetings are available to the Board, if further detail is required.

Sally Jones-Evans
Chair of the Governance and Nominations Committee
17 February 2023

Board Risk Committee Report

for the year ended 31 December 2022

The Committee seeks to ensure the continued safety and security of the Society by ensuring all principal and significant emerging risks are identified, managed, monitored and mitigated as effectively as possible. The Committee recommends to the Board risk appetite measures in respect of these risks. Exposure against risk appetite is monitored at each meeting and is integral to the Society's business planning and forecasting.

The Committee is also responsible for ensuring the continued adequacy of the Society's financial resources and recovery plans. To this end, the Committee reviews the output of stress testing and scenario analysis, using such assessments to inform its view of potential, albeit unlikely, adverse outcomes.

Committee membership

The Committee was chaired by David Rigney until his resignation in April 2022, he was then replaced as Chair by Jonathan Baum. For the remainder of 2022, the Committee comprised three independent Non-Executive Directors, Jonathan Baum, Derek Howell and Claire Hafner. The Committee regularly invites the Chief Executive Officer, Chief Financial Officer and Chief Risk Officer to attend the meetings, together with other colleagues from across the business, where appropriate. The Committee met on five occasions during the year.

Management of risk

The Society has developed and implemented an Enterprise Risk Management Framework (ERMF), which sets out the Board's approach to managing risk and the provision of oversight by defining and documenting the Society's purpose and objectives, risk appetite and tolerance and governance and control systems.

a) Risk culture

The Society operates a simple business model and senior management places significant emphasis on ensuring a high level of engagement is maintained between individual business functions and colleagues at all levels, with regard to the awareness and effective management of risk. A key element of the Society's risk culture is a genuine emphasis on putting Members' interests and needs first. This is reflected, for instance, in the absence of sales-related incentives for any colleagues.

b) Three lines of defence model

The ERMF employs a 'three lines of defence' model to ensure clear independence of responsibilities for risk control, oversight and governance. This is key to ensuring that risk management is embedded across the Society, encouraging colleagues to take ownership for identification and management of risk within their respective areas of operation.

Three lines of defence model:

First line of defence

Day-to-day risk management
Every employee is responsible for managing the risks which fall within their day-to-day activities. The first line of defence ensures all key risks within their operations are identified, monitored and mitigated by appropriate controls.

Second line of defence

Risk oversight and compliance
Dedicated teams within the Society's Risk and Compliance functions are responsible for providing independent oversight and challenge of activities conducted in the first line.

Third line of defence

Audit
The Society's Internal Audit function provides independent assurance of the activities in both the first and second lines of defence.

c) Risk management

Primary responsibility for the identification, assessment, control, mitigation and monitoring of risk rests with the business; the first line of defence.

Oversight and governance are provided through specialist support functions, including Risk, Finance and Compliance and Conduct. The role of these functions is to maintain and review policies, establish quantitative limits and qualitative standards, which are consistent with the Society's risk appetite. These functions additionally monitor and report on compliance with those limits and standards and provide a holistic oversight role to the management of risk.

The Society's Internal Audit function provides independent assurance regarding the activities of the business and of the specialist functions across the Society and reports on the effectiveness of the control environment to the Audit Committee on a quarterly basis.

The Committee monitors the arrangements for assessing risk inherent in the Society's activities on behalf of the Board.

d) Risk appetite and tolerance

The Board approves risk appetite statements identifying and defining the types and levels of risk it is willing to accept in the pursuit of its strategic goals. This provides the business with a framework within which decision making and planning can be undertaken.

Board risk appetite statements are linked to the Society's strategy and are supported by a broad suite of Board level risk metrics, appetites and tolerances, designed to monitor the Society's exposure to key prudential and conduct related risks. These are set in a hierarchy that links the Board's tolerance for risk to its strategic goals, medium-term plans and 'business as usual' activities.

e) Planning and stress testing

The Society undertakes stress testing, scenario analysis and contingency planning to understand the impact of unlikely, but severe risk events, to better enable it to react should events of this severity occur. A range of multi-risk category stress tests, reverse stress tests and operational risk scenario analyses are undertaken, with the results forming a central component of the Society's capital and liquidity adequacy assessments.

Reverse stress testing is a key component of the Society's existing stress testing framework and considers extreme events that could result in failure of the Society. As such, it complements the existing ICAAP and ILAAP processes, helping to improve risk identification and measurement. A qualitative approach is used to explore potential scenarios, which, if crystallised, could result in failure of the Society. This is supplemented by quantitative assessments, which determine the potential impact to the Society's capital or liquidity arising as a consequence of the scenarios. A key outcome from the process is to consider whether any of the scenarios considered are sufficiently plausible to necessitate a change to the

Society's strategy, require mitigating actions to be taken, or require supplementary management information to monitor the likelihood of crystallisation.

The Society is aware of the potential long-term risks which climate change represents to its business model and to the wider economy. The Society's stress testing framework includes the assessment of the financial risks emanating from climate change, which takes into account current relevant risks in addition to those which may plausibly arise in the future. The Society will take a strategic approach to managing the financial risks arising from climate change, based on the outcome of assessments undertaken. The Committee will review the output of these assessments and re-appraise the approach to the management and mitigation of the associated risks where necessary.

f) Recovery and resolution planning

The UK and European regulatory authorities require all banks and building societies to formulate plans to minimise both the risk of failure and the impact of failure. The recovery plan outlines the steps the Society can take to prevent failure, whilst the resolution plan includes information required by the Bank of England to establish an orderly resolution of the Society's affairs, in the event that recovery cannot be achieved. The process of preparation for such extreme events enables the Board to plan actions it would take to recover from adverse conditions, which would otherwise lead to failure. The recovery plan represents a 'menu of options' for the Society to manage firm-specific or market-wide stress and which can be incorporated into a credible and executable plan.

g) Governance and control

There is a formal structure for managing risks across the Society, which is documented in detailed risk management policies. These policies, and associated limits, are owned and reviewed at least annually by the following committees, which report to the Board Risk Committee and the Board. Each committee includes appropriate representation drawn from the Executive Committee (ExCo), divisional management and risk specialists:

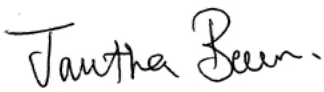
- **Executive Risk Committee (ERC)** is chaired by the Chief Risk Officer and is responsible for oversight and monitoring of all prudential and conduct risks across the Society and reviewing risk exposures
- **Model Governance Committee (MGC)** is chaired by the Chief Financial Officer and is responsible for the approval and oversight of models used by the Society to assess and quantify exposure to credit risk, and to assist in the quantification of impairment provisions required under IFRS 9
- **Credit Risk Committee (CRC)** is chaired by the Head of Prudential Risk and is responsible for monitoring and reviewing exposure to credit risks in the Society's retail and commercial loan portfolios
- **Operational Risk Committee (ORC)** is chaired by the Head of Enterprise Risk and is responsible for monitoring and reviewing exposure to operational and financial crime risks arising from the Society's day-to-day activities
- **Compliance & Conduct Risk Committee (CCRC)** is chaired by the Head of Compliance and Conduct Risk, and is responsible for monitoring and reviewing exposure to conduct risks arising from the Society's day-to-day activities
- **Finance Committee (FC)** is chaired by the Chief Financial Officer and, in addition to its financial management responsibilities, has responsibility for the assessment and management of financial risks and relevant risk appetites

Activity during the year

The following outlines the Committee's activities and areas of focus during the year:

Topic	Activity
Strategy & risk appetite	• Review of Strategic Risk Appetite and Tolerance Statements • Development of Operational Resilience Framework • Review of approach for Assessment of Climate Change Risks
Policy	• Annual review and approval of Treasury Policy Statement and Retail and Commercial Lending Policies • Annual approval of Compliance and Conduct Risk Management Policy and Conduct Monitoring Plan • Approval of Cyber Risk Penetration Testing Programme • Approval of Financial Crime Policy
Stress testing	• Annual review and recommendation of the ICAAP to the Board • Annual review and recommendation of the ILAAP to the Board • Annual review and recommendation of the Recovery & Resolution Plan to the Board
Risk management	• Review of Credit Risk profile of mortgage portfolios • Review of annual Money Laundering Reporting Officer's Report • Review of the impact of COVID-19 on the inherent risk profile of business and assessment of the management and mitigation of those risks • Review of Cyber Risk Management and results of Penetration Testing Programme
Risk monitoring	• Review of risk exposure relative to appetite and tolerance measures • Review of CRO's report and Key Risk heat map • Horizon scanning • Oversight of Executive Risk Committee and subsidiary Risk Management Committees • Review of Compliance and Conduct Risk monitoring activity and relevant Internal Audit Reports • In tandem with the Remuneration Committee, review the management of key risks in determining the variable pay awards due to the Executive Directors and senior management

Following each meeting, the Chair of the Committee provides an oral update to the Board on matters considered by the Committee. In addition, minutes of Committee meetings are available to the Board, if further detail is required.



Jonathan Baum
Chair of the Board Risk Committee
17 February 2023

Audit Committee Report

for the year ended 31 December 2022

Committee responsibilities

The Audit Committee assists the Board in fulfilling its oversight responsibilities in respect of matters relating to financial reporting, internal control, and internal and external audit. The Committee acts as Audit Committee for both the Society and its subsidiary business, Nemo Personal Finance Limited.

The Committee is responsible for ensuring that the key accounting policies and judgements supporting the Society's financial statements are appropriate. This work is supported by the external auditor, Deloitte LLP ("Deloitte").

Committee membership

The Audit Committee is a Board Committee and in 2022 comprised three independent non-executive Directors, Derek Howell (Chair), David Rigney (to 31 March 2022), Claire Hafner and Jonathan Baum. The Committee met on eight occasions during the year.

Each Committee member has recent and relevant financial experience in accordance with the UK Corporate Governance Code ("UK Code"). The Board continues to be satisfied that the Committee has the requisite levels of knowledge and understanding relevant to the markets in which the Society operates.

The Committee regularly invites the Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, Chief Internal Auditor, Chief Governance Officer and representatives from the Society's external auditor, Deloitte, to attend the meetings, along with other colleagues from across the business, where appropriate.

The overlap of membership between the Committee, the Board Risk Committee and the Remuneration Committee is one of the mechanisms for ensuring that the linkage between the Audit Committee and other Board Committees avoids gaps or unnecessary duplication.

Activity during the year

Financial Reporting Judgements and Estimates

The Committee has conducted detailed reviews of the interim and year-end financial statements and Pillar 3 Disclosures (which are published on the Society's website). The reviews included consideration of the narrative reports, together with the description of the business model, strategy and the risks inherent in the business model. Following its review, the Committee recommended these documents to the Board for approval. As a result of discussions with both management and the external auditor, the Committee determined that the key risks of misstatement of the group's financial statements related to the following areas where judgements are required:

- **Impairment provisions on loans**
  During the year the Committee has closely monitored the output from the IFRS 9 impairment provision models and the performance of the Society's loan books. The level of impairment suggested by the models and the assumptions which inform the models are key areas of judgement. The Committee has given careful consideration to the appropriateness of the methodologies used by management to assess the likelihood of losses (Probability of Default) and the severity of losses (Loss Given Default) against each loan book, in conjunction with the overall adequacy of the provisions held against those loan books. As part of the assessment, the Committee has reviewed the outputs from the revised retail IFRS 9 model. The Committee concluded that the assumptions that are used to inform management's assessment as to the adequacy of impairment provisions remain appropriate. The Committee has continued to monitor the volatility in the economic environment, including actions taken to manage the impact of the current cost of living challenges, on the performance of the Society's loan books and consequent impact on the IFRS 9 impairment provision.

- **Retirement benefit obligations**
  The Committee has considered the key assumptions used by the Scheme Actuary to determine the liability under IAS 19 in connection with the Society's Defined Benefit Retirement Scheme obligation. The Committee agreed that the assumptions used for this purpose were reasonable.

- **Going concern and viability assessment**
  During the year, the Committee has received regular reports from the Chief Financial Officer outlining the basis on which it is reasonable for the group to continue to prepare its financial statements on a going concern basis and has continued to be satisfied that it is appropriate to consider the viability assessment over a three year planning horizon. It assessed, together with the Board Risk Committee, the levels of capital and availability of funding and liquidity, together with outputs of stress tests and reverse stress tests. The Committee also considered risks from business activities and current and forecast economic factors such as the impacts from high levels of interest rates, inflation and on-going volatility in the economic environment.

- **Provisions for regulatory and customer redress**
  The Committee has considered the assumptions made by management in connection with the scale of the provision recognised for this purpose. The level of provision reflects management's best estimates of complaint volumes, customer behaviour, the rate at which these claims are upheld and the level of redress paid on each complaint. The Committee continues to be satisfied that the scale of the provision recognised for this purpose is appropriate.

After reviewing reports by management and after consulting with the Society's external auditor, the Audit Committee was satisfied that the financial statements appropriately addressed the critical judgements and key estimates. The Committee is also satisfied that the significant assumptions used for determining the value of the group's assets and liabilities have been appropriately scrutinised, challenged and are sufficiently robust.

Deloitte, as the Society's external auditor, has reported on both the interim and year-end financial statements and the Committee considered those reports prior to recommending approval of the financial statements to the Board. Deloitte has reported to the Committee on the work carried out in relation to the most significant areas of audit risk and where accounting assumptions and estimates have been applied by management. Management confirmed to the Committee that they were not aware of any material misstatements or immaterial misstatements made intentionally to achieve a particular presentation. Deloitte calculated its materiality level and the clearly trivial threshold which were presented to the Committee at the planning stage, and these were accepted by the Committee. The Auditor provided the Committee with a summary of misstatements which exceeded that threshold which had been identified during the course of the testing and no material amounts remain unadjusted. The Committee is also responsible for considering the annual Deloitte management letter and has received reports from management on progress with work to address findings set out in the management letter during the year.

Hedge accounting

The Committee recognises that hedge accounting remains a particularly complex area of activity. Significant volatility in economic conditions has directly contributed to major changes in the valuation of hedging instruments in the year. The Committee concluded that the valuation, completeness and appropriateness of hedge accounting remained appropriate.

Assessment of internal controls / oversight of the internal control framework

Management is responsible for establishing and maintaining a robust control environment that is designed to evolve as the risks faced by the Society change over time. The Committee is responsible for monitoring and ensuring the operating effectiveness of those controls. This is primarily driven through the work performed by the Internal Audit function. Members of the Committee are actively involved in planning the work undertaken by the Chief Internal Auditor's team which is designed to reflect a risk based approach, having regard to the risks embedded in the Society's operations.

The Committee receives regular reports on the operating effectiveness of the systems and controls framework including financial controls, internal controls, the regulatory reporting framework and risk management systems.

The Committee is responsible for approving the annual Internal Audit plan and receives regular reports from the Chief Internal Auditor on the adequacy of resources available to that department; results of any unsatisfactory audits and associated action plans; and progress of management's implementation of audit recommendations and adherence to the control framework. In order to preserve the independence of the Chief Internal Auditor, the individual performing that role continues to have a dual reporting line to the Chief Executive Officer and Chair of the Audit Committee. The Chief Internal Auditor also has direct access to the Society's Chair. In addition, the Committee also monitors the effectiveness of the Internal Audit function. This work includes monitoring the progress of the Internal Audit team against the Audit Plan and reviewing progress with work to implement audit recommendations. During the year, the Committee received a report on the effectiveness of the Internal Audit function from the Chief Internal Auditor and has reviewed the Internal Audit Charter.

Following the resignation of the Chief People Officer, the Chief Internal Auditor was appointed as Chief People Officer leaving the role of Chief Internal Auditor vacant at year-end.

During the year, an Audit quality assessment of the Internal Audit function was performed by KPMG with results presented to the Committee, the overall assessment was that the function was performing adequately. The Committee also considered carefully the risks associated with management circumventing the control framework. Work undertaken by the Internal Audit team during the year and by Deloitte, as part of the annual audit cycle, has enabled the Committee to be satisfied that the control framework remains robust. The Committee was satisfied that no significant control failings or weaknesses were identified during 2022.

The Committee has held two private meetings with Deloitte during the year.

Whether the Annual Report taken as a whole is fair, balanced and understandable and provides the necessary information for the Society's Members to assess the Society's performance, business model and strategy

The Audit Committee is responsible for considering on behalf of the Board whether the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for Members to assess the group's performance, business model and strategy. In justifying this statement, the Audit Committee has considered the robust process which operates in creating the Annual Report and Accounts, which includes the following:

- Changes to regulatory requirements, including the UK Corporate Governance Code, are considered on an ongoing basis
- Key accounting judgements are presented to the Audit Committee for approval
- Whether the description of the group's business model is accurate; whether the narrative reports explain the financial statements; whether the principal risks and uncertainties faced by the group are clearly described, together with mitigating actions and whether the group's projected solvency and liquidity positions over the next three years are adequate to support the going concern assessment
- Whether there are any significant control weaknesses, or failings which should be brought to the attention of the Society's Members
- A thorough process of review and evaluation of the inputs into the accounts to verify accuracy and consistency, including review by senior management
- A meeting of the Audit Committee to review and consider the draft Annual Report and Accounts in advance of the final sign-off. The Chair of the Audit Committee reports the Committee's conclusions to the Board and final sign-off is provided by the Board of Directors

As part of the Committee's assessment of the Annual Report and Accounts, prior to reporting to the Board on this topic, the Committee draws on reports prepared by and discussions with the Chief Financial Officer and members of his senior management team. The Committee is satisfied that senior members of the Finance team are fully familiar with the fair, balanced and understandable requirement. The Committee receives assurance from members of the Executive team that they consider the content for which they are responsible is fair, balanced and understandable. The Chair of the Committee also receives an early draft of the Annual Report to conduct a timely review and challenge the content of the report.

Auditor independence and effectiveness

The Audit Committee is responsible for assessing the effectiveness of the annual audit process, monitoring the independence and objectivity of the external auditor and making recommendations to the Board in relation to the appointment, reappointment, remuneration and removal of the external auditor.

As part of its annual assessment of the effectiveness of the external audit process, the Committee conducts a formal review whereby members of the Committee and senior members of the Finance team consider the performance, qualifications, expertise, resources, independence and objectivity of the external auditor. The results of the review are discussed by the Committee without the external auditor being present and any actions or suggestions about the external process are subsequently discussed with the external auditor. During the year, the Committee has also reviewed and approved the external auditor's overall work plan which further ensures that the process is effective.

There is periodic rotation of the audit partner responsible for the audit engagement, and each year the external audit firm confirms to the Audit Committee that it considers itself to be independent as defined by the current rules of the Financial Reporting Council. The Society's previous audit partner completed his five year term at the conclusion of the 2021 external audit. For the 2022 external audit, the new audit partner is David Heaton who is expected to serve for the next five years.

In order to safeguard auditor objectivity and independence, the Committee maintains a formal policy which governs the engagement of the external auditor for non-audit services. The policy is designed to ensure that the provision of such services does not have an impact on the external auditor's independence and objectivity. This policy identifies services which can only be undertaken with appropriate authority from the Committee Chair or the Committee where non-audit fees will exceed pre-set thresholds. The external auditor may only provide such services if such advice does not conflict with their statutory responsibilities and ethical guidance. Non-audit services prohibited by ethical standards are not permitted to be undertaken under any circumstances.

The Committee receives a schedule of fees for non-audit work paid to the audit firm at each meeting, an annual report on the non-audit services being provided and the cumulative total of non-audit fees. The audit fee for the year in respect of the group was £717k. Non-audit fees, mainly in relation to further assurance services, were £79k.

Other matters

Following each Audit Committee meeting, the Chair of the Committee provides an oral update to the Board on matters considered by the Committee. In addition, minutes of Committee meetings are available to the Board, if further detail is required.

Derek Howell
Chair of the Audit Committee
17 February 2023

Remuneration Committee Report

for the year ended 31 December 2022

Annual Statement from the Chair of the Remuneration Committee

On behalf of the Remuneration Committee, I am pleased to share the Director's Remuneration Report for the year ended 31 December 2022 detailing pay, incentives and benefits for our Directors.

During the year this report has been reformatted in order to be further aligned with the UK Corporate Governance Code (The Code) and the reporting requirements that apply to UK FTSE listed companies. Whilst it is not a legal requirement for the Society, we are committed to considering the application of The Code to our policy and disclosures, to the extent that it is relevant and practicable to do so.

The Remuneration Report is split into the following key sections:

- The Remuneration Committee, which details membership and the role and responsibilities of the Committee
- The Director's Remuneration Policy which outlines the policy by which remuneration is paid; including performance measures, maximum possible payments and specific scenarios such as loss of office
- The Annual Report on Remuneration which details all elements of remuneration for our Executive and Non-Executive Directors in 2022

Committee activity in 2022

In addition to standard items in line with the Terms of Reference, the Remuneration Committee made some additional decisions during the 2022 financial year which are outlined below.

Executive team changes

Iain Mansfield was appointed as Chief Financial Officer following Tom Denman's resignation in 2022. The position of Chief Operating Officer is not currently considered an Executive Director role.

Pay decisions

In the context of rising inflation and the current economic environment, colleague pay has been the main focus of our conversations in 2022.

Cost of living payment

In response to the cost of living crisis, the Society agreed to a one off payment of £1,000 to be made to all colleagues (excluding Senior Leaders and Executives).

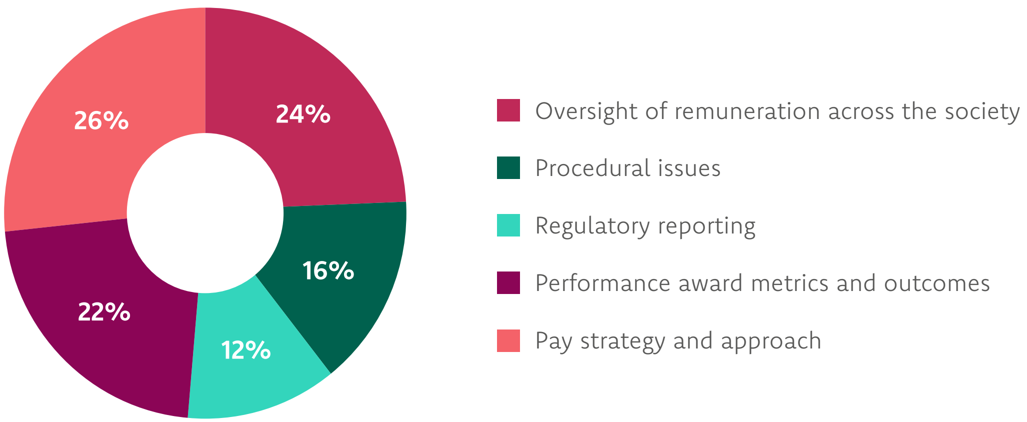
Pay reviews

We reaffirmed our commitment to paying the Real Living Wage to colleagues by becoming an accredited employer by the Living Wage Foundation. After listening to feedback from our colleagues across the organisation about the difficulties they are facing as a result of the cost of living crisis, we announced we will focus pay increases for lower paid roles. The annual pay review was brought forward three months to November (except for Executives) and this was strongly supported by our trade union, Unite, with a minimum increase of 8% for all colleagues and 5% for Senior Leaders. This has also enabled us to be more competitive when recruiting future talent into the Society.

Variable pay performance

Following strong Society performance, the Rewarding Excellence Award (REA) for all colleagues will pay out at 10.26% this year, 4.26% above target. The Leading Excellence Award (LEA) will pay out at 19.63% for Executives (1.63% above target) and at 9.30% for Senior Managers (0.30% above target).

Proportion of time spent by the Remuneration Committee



Conclusion

For 2022 I confirm we operated in line with the Remuneration Policy, detailed within this report. The Committee has not exercised any discretion in 2022. Nigel Annett left the Society in October 2022 and I would like to take this opportunity to thank Nigel for his significant contribution during his tenure on the Remuneration Committee.

This report is approved by the Remuneration Committee and signed on its behalf by:

Claire Hafner
Chair of the Remuneration Committee
17 February 2023

Committee membership

The Committee comprises three members, all of which are independent Non-Executive Directors. The Chair of the Board (Sally Jones-Evans) also serves on the Committee. For 2022, membership comprised of the following:

- **Claire Hafner**
  Chair of the Remuneration Committee and Non-Executive Director

- **Debra Evans-Williams**
  Non-Executive Director

- **Nigel Annett**
  Non-Executive Director (until leave date October 2022)

- **Jonathan Baum**
  Non-Executive Director (as of December 2022)

Only members of the Committee have the right to attend Committee meetings. However, the Chief Executive Officer, Chief People Officer and Head of Reward are invited to attend on a regular basis. Other colleagues may be invited to attend all or part of any meeting, as and when appropriate and necessary. PricewaterhouseCoopers LLP ('PwC'), our independent external advisers, also attend the Committee meetings.

External advisers

The Committee retained PwC as independent external remuneration consultants whom the Committee re-appointed following a tender process in 2021. During the year, the Committee sought independent advice from PwC in relation to Executive remuneration and regulatory developments. PwC is a signatory to the voluntary Code of Conduct in relation to remuneration in the UK. The Committee reviews all other services provided by PwC to ensure they continue to be independent and objective and is satisfied that PwC is providing independent, robust and professional advice.

A fixed fee structure has operated since appointment to cover standard services, with any additional items charged on a time/cost basis. The total fees paid for advice to the Committee during 2022 totalled £36,000 (inclusive of VAT). PwC are also appointed separately to provide the Society with advice on taxation matters.

Key roles and responsibilities

The Committee is responsible for the oversight of the development and implementation of the Society's remuneration policies and practices ensuring that remuneration policies and practices are appropriate to enable the Society to attract, retain and reward individuals with the right skills, experience, knowledge and behaviours to support the achievement of the Society's purpose.

Further details of the functions carried out by the Committee can be found in the Remuneration Committee Terms of Reference which are available on our website.

Directors' Remuneration Policy

Overview

Our Members tell us that the Society's people are special; we strive to be an employer of choice so that we can continue to attract and retain talented and passionate people. Therefore, the Remuneration Policy is deliberately designed to:

- Ensure that the business is run safely and successfully for our Members

- Recognise the principles of the Remuneration Code and Corporate Governance Code

- Support the delivery of our overall 'Framing our Future' business strategy, by ensuring we are a trusted business for the mutual benefit of customers, colleagues and communities. Our Remuneration Policy forms part of our broader people strategy

The Remuneration Policy aims to:

- Attract, motivate, reward and retain high quality Directors who can deliver the purpose of our organisation, ensuring that Principality continues to deliver value to Members and to be profitable in a competitive and often uncertain marketplace. This is done by positioning all aspects of pay and benefits for Directors, 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
- Promote the right behaviours that align with the Society's short-term strategy, position on risk, as well as its culture as a Member owned mutual building society
- Encourage sound conduct and risk management practices by setting capital and liquidity hurdles to be met before any variable pay award can be made and, for the Executive team and Senior Leadership team, deferring an element of variable pay
- Align remuneration with the Society's strategy including a focus on our purpose, Members, colleagues and the communities in which we work, while ensuring our approach is fair and inclusive

The Remuneration Committee is satisfied that the Remuneration Policy operated as intended throughout 2022.

Measures taken by the Committee to avoid or manage conflicts of interest:

- Declarations of interests must be confirmed by Committee members at the start of meetings
- No Executive member sits on the Remuneration Committee
- No individual is present when decisions about their own remuneration are being made
- Non-Executive Director remuneration is determined by a separate Remuneration Committee, which is led by the Chief Executive Officer and Chief People Officer

Alignment with the Corporate Governance Code provisions

In developing our Remuneration Policy, we have considered the requirements of the UK Corporate Governance Code as set out in the table below. Whilst not a legal requirement for the Society, we are committed to considering the application of The Code to our policy and disclosures, to the extent that it is relevant and practicable to do so. While the Corporate Governance Code's focus is primarily on Executive remuneration, as the structure of reward at the Society is primarily designed for the workforce as a whole, we can be confident that the characteristics apply Society-wide and not just to the Executive team.

Code requirement	How the Committee has considered the requirement when determining policy and practices
Clarity – remuneration arrangements should be transparent and promote effective engagement with the workforce	Information regarding our pay and benefit structures including eligibility (where applicable) is available to all colleagues on our intranet. Attendance of the monthly Colleague Forum meetings by one of the Non-Executive Directors to ensure colleagues have a voice at the Remuneration Committee meetings. The full Remuneration Policy is clearly laid out in the Director's Remuneration Report. All colleagues within the Society are eligible for the Rewarding Excellence Award (REA), promoting engagement across the workforce.
Simplicity – remuneration structures should avoid complexity and their rationale and operation should be easy to understand	Clear disclosure within this report of the rationale and operation of each element of Directors' remuneration. The Society's variable pay schemes are simple with only two schemes across the Society. Each scheme has clear targets as detailed within this report. Participants are sent copies of relevant documents and scheme rules. Additionally, all Material Risk Takers (MRTs) sign for their acceptance and understanding of the variable pay scheme rules. Executive Directors are incentivised via schemes for which the performance metrics and maximum payment details are disclosed within this report.
Risk – remuneration arrangements should ensure reputational and other risks from excessive rewards, and behavioural risks that can arise from target-based incentive plans, are identified and mitigated	The design of our remuneration arrangements are approved by the Remuneration Committee with input from our external advisors to ensure best practice is applied. Specifically, the Leading Excellence Award (LEA) has an element of deferral (further detail included within this report), which is held back to enable us to reward and retain our most senior leaders, and consider if risk adjustments are required. The Society operates a framework for adjustments to variable pay policy, which considers events which may result in an adjustment to scheme payments being paid. Furthermore, our variable pay schemes have gateways which focus on capital and liquidity controls, financial targets and individual minimum performance levels. Additionally, the Remuneration Committee can apply malus and clawback to an award made to an Executive, Senior Leader and/or MRT if it is discovered that the award should not be paid. Malus and clawback triggers are outlined in our variable pay scheme rules and within this Policy document. The results relating to variable pay schemes are subject to audit and governance checks as appropriate.

Predictability – The range of possible values of rewards to individual Directors and any other limits or discretions should be identified and explained at the time of approving the policy	We have fixed, on target, and maximum variable pay opportunities. Therefore, we do not have any uncapped variable pay. Scenario charts within this report illustrate potential payments under each element of variable remuneration. Key areas of Committee discretion are clearly outlined within this report and are also detailed within our variable pay scheme rules.
Proportionality – The link between individual awards, the delivery of strategy and the long-term performance of the company should be clear. Outcomes should not reward poor performance	Variable pay schemes are reviewed each year to maintain alignment to strategy. The targets, weightings and stretch are defined within the scheme each year which are approved by the Remuneration Committee. The LEA has an individual gateway, such that it is not payable if the individual's performance does not meet requirements. Receipt of the REA is subject to minimum performance being met, such that any colleague who receives a rating of 'Unsatisfactory' or is on a Final Written Warning will not be entitled to receive an award.
Alignment to culture – Incentive schemes should drive behaviours consistent with company purpose, values and strategy	The remuneration policies have been created in order to support the strategy of the Society. Executive Director remuneration outcomes are considered alongside the context of the remuneration of the wider workforce. Variable pay is based on strategic KPIs agreed by the Remuneration Committee, which measure the delivery of the business strategy.

Policy on remuneration of Executive Directors

The following table sets out the key elements of remuneration for Executive Directors.

Element	Base Salary
Link to strategy	To attract and retain Executives who have appropriate capabilities, skills, and experience to deliver the purpose and strategy of the organisation.
Operation	The Committee undertakes a review of the Executive Directors' base salaries each financial year, taking into account factors such as individual and business performance, market conditions, and the level of salary increase applied to other colleagues across the Society. The base salary of newly appointed Executives is positioned based on market conditions, skills and experience, and salary relative to other Executives.
Maximum potential value	There is no formal cap set on salaries. Increases are typically in line with the rest of the workforce. Other increases may be implemented in cases such as new responsibilities, development and progress in role.
Performance conditions and assessment	N/A although individual performance is considered when planning base pay increases.

Element	Variable pay – Rewarding Excellence Award (REA)
Link to strategy	To support attraction, motivation, engagement, and retention of our colleagues. Performance conditions are chosen to demonstrate a strong commitment to our customers, whilst recognising the importance of meeting our profit targets to keep our business safe. Targets are reviewed and set each year by the Remuneration Committee, taking into account a number of factors, which may include the Society's strategy, short term priorities, and the market environment.
Operation	All colleagues at the Society are eligible, except the Chief Risk Officer and Chief Internal Auditor. There are initial gateway requirements for the award, which consist of capital and liquidity conditions, financial targets, individual performance and the absence of any material regulatory breaches. Each year, a number of key business measures are identified and threshold, target and stretch performance is approved by the Remuneration Committee. The Remuneration Committee can apply malus and clawback to an award made to an Executive, Senior Leader and Material Risk Taker (MRT) if it is discovered that the award should not be paid. Malus and clawback are outlined in our variable pay scheme rules. Subject to approval, payment will be made in March following the financial year end. There will be no partial deferral of payment. Colleagues who join the scheme part way through the scheme year will be entitled to receive a pro-rated award based on full months worked.
Maximum potential value	Potential payments for Executive Directors: Nil for threshold performance. 6% of salary for achieving target. 12% of salary for attaining highly stretching targets.
Performance conditions and assessment	Each year at mid-year and end of year the variable pay scheme measures are assessed by the Remuneration Committee to evaluate the scheme gateways and performance of the measures in relation to variable pay and calculate payment.

Element	Variable pay – Leading Excellence Award (LEA)
Link to strategy	Focus on strategic and enterprise wide measures which look at longer term performance and leadership of the Society. Drives the shared ownership of objectives. Performance conditions are chosen to focus on strategic and enterprise wide measures which look at longer term performance and leadership of the Society. Targets are reviewed and set each year by the Remuneration Committee, taking into account a number of factors, which may include the Society's strategy, short term priorities, and the market environment.
Operation	The LEA is an annual incentive scheme for Executives and Senior Leaders (except the Chief Risk Officer and Chief Internal Auditor), with an element of deferred payment. There are initial gateway requirements for the award, which consist of capital and liquidity conditions, financial targets, individual performance and the absence of any material regulatory breaches. Each year a number of key business measures are identified and threshold, target and stretch performance is approved by the Remuneration Committee. The Remuneration Committee can apply malus and clawback to an award made to an Executive if it is discovered that the award should not be paid. Malus and clawback are outlined in our variable pay scheme rules. Subject to approval, a proportion of the award is paid in the March following the scheme year and annually thereafter as detailed in the deferral table in the Remuneration Report. Colleagues who join the scheme part way through the scheme year will be entitled to receive a pro-rated award based on full months worked.
Maximum potential value	Potential payments for Executive Directors: • Nil for threshold performance • 19% of salary for achieving target • 38% of salary for attaining highly stretching targets Potential payments for Senior Leaders: • Nil for threshold performance • 9% of salary for achieving target • 18% of salary for attaining highly stretching targets
Performance conditions and assessment	Each year at mid-year and end of year the variable pay scheme measures are assessed by the Remuneration Committee to evaluate the scheme gateways and performance of the measures in relation to variable pay and calculate payment.

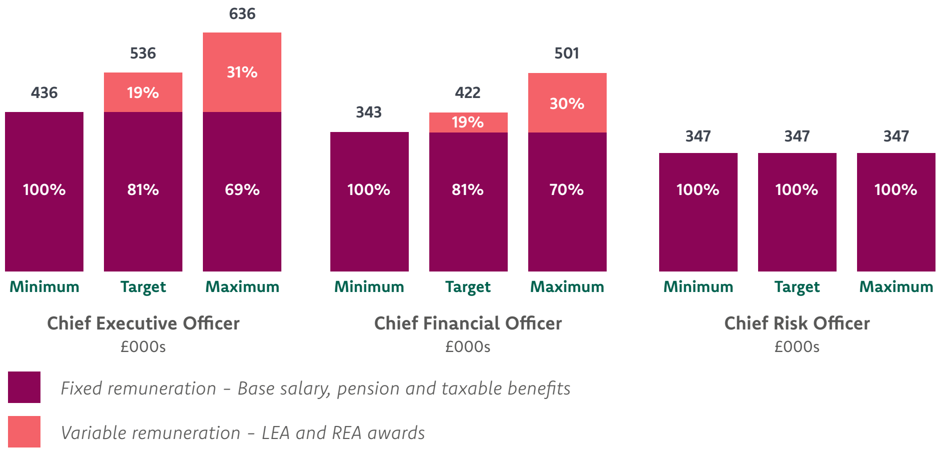
Element	Pension
Link to strategy	To attract and retain Executives who have appropriate capabilities, skills, and experience to deliver the purpose and strategy of the organisation.
Operation	The Society operates a single defined contribution pension scheme and all colleagues have the opportunity to participate. Newly appointed Executives or Executive Directors are entitled to receive a pension contribution that is in line with that of the workforce, currently 8% of base salary. There is one Executive with a legacy arrangement, who is entitled to receive a pension contribution of 15% of base salary.
Maximum potential value	Pension contribution of 8% of base salary or equivalent cash allowance.
Performance conditions and assessment	N/A

Element	Benefits
Link to strategy	To attract and retain Executives who have appropriate capabilities, skills, and experience to deliver the purpose and strategy of the organisation.
Operation	• Includes family private medical insurance, critical illness cover, life assurance and annual health checks • New appointments are entitled to the above benefits • Some Executive Directors are entitled to legacy car allowance (this has been phased out for new appointments since 2020)
Maximum potential value	There is no maximum level, however, the overall value is determined by the nature of the benefit offering, which is subject to change each year.
Performance conditions and assessment	Executive Directors are entitled to fully funded family medical insurance. All other colleagues are entitled to personal private medical insurance after one year of service. Health checks are only available to Executives.

Performance scenario illustrations

The below graph shows the remuneration that each of the Executive Directors could earn for 2023 in line with our Remuneration Policy as a minimum, at target and as a maximum. These are calculated using Executive Director salaries as at February 2023.

Fixed remuneration figures include salary, pension and taxable benefits. The variable remuneration percentages are shown as a proportion of total fixed remuneration. Actual variable pay is calculated using base salary.



Remuneration Committee Report

Malus and clawback

Awards made to MRTs are subject to malus and clawback provisions.

The Remuneration Committee reserves the right to apply malus at the time of payment or at any time before. In doing so, they can reduce or remove any award (or deferred portion of an award) including in the following circumstances:

- A significant downturn in the financial performance of the Society resulting in a breach of the initial gateway requirements
- A significant change in the risk profile of the Society arising from a deterioration in the external macro-economic environment
- Material failure in risk management, regulatory compliance and/or business conduct
- Reasonable evidence of serious misconduct on the part of the individual
- Reasonable evidence of a failure or misconduct for, which the individual could be deemed indirectly responsible by virtue of their role or seniority

In determining any such reduction, the Remuneration Committee shall act fairly and reasonably but its decisions shall be final and binding.

Clawback is defined as when an individual agrees to, or is required by the Society, to return an amount of remuneration under certain circumstances. The Remuneration Committee reserves the right to reclaim any cash bonuses paid for a one-year period in the event of the following:

- Material misstatement of the Society's Financial Report and Accounts
- Error in the calculation of performance measures(s)
- Reasonable evidence of serious misconduct on the part of the individual
- Some other substantive or serious reason
- Where the employee:

    1. Participated in, or was responsible for, conduct which resulted in significant losses to the Society; or
    2. Failed to meet appropriate standards of fitness and propriety

Policy on remuneration of Non-Executive Directors

The table below sets out the sole element of Non-Executive Directors' remuneration and how it operates.

Element	Fees
Link to strategy	There are set fees for all Non-Executive Directors with additional fees for chairing any Committees to reflect the additional level of responsibility.
Operation and deferral	• Each Non-Executive Director receives a basic fee which is standard for all Non-Executive Directors, apart from the Chair, who receives a higher fee to reflect the additional level of responsibility • An additional Directors' fee is then paid to the Non-Executive Directors who act as Chairs of the various Committees
Maximum potential value	There is no 'maximum' fee opportunity.

The elements detailed above are the only elements of remuneration paid to Non-Executive Directors. Non-Executive Directors are not eligible to participate in any form of variable remuneration scheme and do not receive pensions or other benefits. Travel and subsistence expenses are reimbursed.

The policy when setting fees for the appointment of new Non-Executive Directors is to apply the same policy which applies to current Non-Executive Directors.

Approach to recruitment remuneration

The remuneration arrangements for appointees will be in line with the policy tables above.

Where there is an internal promotion the policy allows the flexibility to preserve existing remuneration arrangements granted before the individual joined the Board.

Where a new recruit forfeits remuneration awards or opportunities in order to join Principality, we may consider replacing these. This will be done, as far as possible, on a 'like for like' basis, with the size of the buy-out award being no higher than what has been forfeited. Any such awards will be in line with the requirements of the PRA/FCA remuneration rules.

Directors' service contracts

The Chief Executive Officer has a service contract that can be terminated by either party on one year's notice or by the payment by the Society of an amount equivalent to one year's remuneration. The other Executives have service contracts that can be terminated by the Society on one year's notice or by the payment by the Society of an amount equivalent to one year's remuneration, and by the Executive giving six months' notice.

Executive Director	Date of appointment as a Director of the Society
Chief Executive Officer – Julie-Ann Haines	14/09/2020 (Appointed as Chief Executive Officer) 18/05/2016 (Appointed as Executive Director)
Chief Financial Officer – Iain Mansfield	15/07/2022 (Appointed as Chief Financial Officer) 31/12/2019 (Appointed as Executive Director)
Chief Risk Officer – Michael Jones	14/09/2020 (Re-appointed as Chief Risk Officer) 01/12/2019 (Appointed as Interim Chief Executive Officer) 01/02/2013 (Appointed as Executive Director and Chief Risk Officer)

Non-Executive Directors are initially appointed for a term of three years, unless terminated earlier by either party giving no less than three months' notice.

Loss of office

The policy for loss of office for each element of remuneration is set out in the table below.

Element	Policy
Fixed remuneration	Salary, pension, and contractual benefits continue during the notice period. Payments in lieu of notice of salary only. Payments in lieu of notice are not pensionable.
Variable remuneration	Colleagues who are not employed by the Society on the date that a proportion of the award is to be paid, or are under notice of dismissal, or have tendered resignation, will not be entitled to receive that proportion of the award or any proportion due thereafter. This is with the exception of any colleague who has left or is leaving the Society either as a result of redundancy, or due to the completion of a fixed term contract, where all contractual terms have been fulfilled, and the contract has come to an end as per the agreed fixed term.

Consideration of remuneration for individuals elsewhere in the Society

The Committee does not currently consult employees on Remuneration Policy for Directors, but it does take into consideration remuneration arrangements for the wider population in the Society when determining Executive remuneration. This includes consideration of where our wider colleague population is positioned against market data and broader people metrics.

As part of voluntarily adopting the Corporate Governance Code (The Code) for listed companies, the Society has a designated Non-Executive Director who attends the monthly Colleague Forum meetings. This enables the Society to ensure employees' views are reflected in Board discussions and decisions.

Consideration of Member views

The Remuneration Committee takes into consideration Member feedback given at the AGM when determining policy and outcomes.

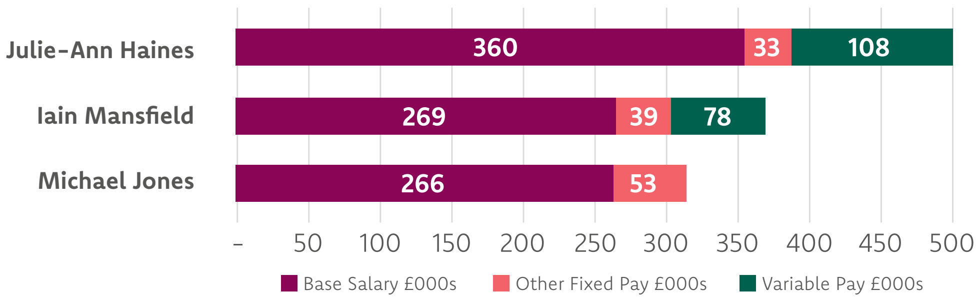
Annual Report on remuneration

This section of the report sets out remuneration awarded to Executive and Non-Executive Directors for 2022. All remuneration decisions have been made in accordance with the Remuneration Policy, detailed within the Remuneration Policy section of this report.

Executive Directors' remuneration

The below graph provides a summary of the single total figure of remuneration for Executive Directors for the 2022 financial year. See the single total figure of remuneration table and notes below for further information.

Iain Mansfield was appointed Chief Financial Officer in July 2022. His 2022 salary was split between his earnings as Chief Operating Officer and Chief Financial Officer. When appointed into the Chief Financial Officer role, Iain's legacy benefit arrangements (pension and car allowance) were removed and incorporated into his new salary to align his package with our Remuneration Policy for new appointments. Iain's variable remuneration is calculated pro-rata for the time spent in each role.



Single total figure of remuneration of Executive Directors

The following table provides the audited information showing a single total figure of remuneration for the 2022 financial year for each of the Executive Directors and a comparison to the prior year.

Iain Mansfield was appointed Chief Financial Officer in July 2022 and therefore his 2022 salary was split between his earnings as Chief Operating Officer, where his salary was £232,000 and Chief Financial Officer, where his salary increased to £300,000. Iain's new salary reflects the consolidation of his legacy benefits, an increase to pay to reflect his new role and current market conditions. Additionally, an amount of back pay was paid to Iain in early 2022 to reflect a change to his salary in 2021.

Michael Jones' salary was reviewed in 2022 in light of Iain's appointment to Chief Financial Officer and an increase in pay to £290,000 was applied to reflect his role and current market conditions. This increase will appear as a back dated payment in the 2023 accounts and is therefore not reflected in this report. No change was made to Michael's benefits in the context of his future retirement in 2023.

Tom Denman left the role of Chief Financial Officer in July 2022 and did not receive any variable payments for 2022. Eligibility for any deferred elements of remuneration also ceased in line with the loss of office policy detailed earlier in this report.

Benefits comprise of life assurance, critical illness insurance and private medical insurance. Michael Jones, Iain Mansfield and Tom Denman's taxable benefits also include legacy car allowance and pension contributions. Following his appointment to Chief Financial Officer, Iain's legacy benefits were removed as part of his change of role.

Audited information Individual	Year	Base Salary £000 3% inc. for 2022	Taxable Benefits £000	Annual Variable Pay (REA & LEA) £000	Pension £000	Total Remuneration £000	Total Fixed Remuneration £000
Chief Executive Officer Julie-Ann Haines	2022	360	4	108	29	501	393
	2021	350	4	126	28	508	382
Chief Risk Officer Michael Jones	2022	266	13	N/A	40	319	319
	2021	259	13	N/A	39	311	311
Chief Financial Officer/ Chief Operating Officer Iain Mansfield	2022	269	8	78	31	386	308
	2021	212	12	76	32	332	256
Chief Financial Officer Tom Denman	2022	116	7	-	17	140	140
	2021	225	12	81	34	352	271

Variable remuneration outcomes

Variable remuneration for Executive Directors consists of both the Rewarding Excellence Award (REA) and the Leading Excellence Award (LEA). The outcomes of both schemes for 2022 are detailed in the sections below.

Rewarding Excellence Award

All eligible colleagues, including Executive Directors, will receive an REA award for 2022 of 10.26%.

Performance measure	Weighting	Performance target	Award achievable at target	Performance result	Performance relative to target
Financial Performance Profit Before Tax	40%	£36m	2.4%	£49.3m	Exceeded stretch Maximum outturn achieved at 4.8%
Customer Service Maze Net Promoter Score	40%	81.0	2.4%	81.55	Exceeded target Outturn achieved 3.06%
Key Strategic Measure Net Retail Mortgage Growth[1]	20%	£72m	1.2%	£209m	Exceeded stretch Maximum outturn achieved at 2.4%

[1] *Net retail mortgage growth is a new measure for 2022. The definition of the measure is the annual growth in retail mortgage lending, including effective interest rate, interest in transit and loan provisions.*

Leading Excellence Award

The LEA is only awarded to Executives and Senior Leaders. As outlined in the Chair's Statement, the total LEA award for 2022 is 19.63% for Executives and 9.30% for Senior Leaders.

The below table shows the award for Executives and Senior Leaders.

Performance measure	Weighting	Performance target	Award achievable at target	Performance result	Performance relative to target
Financial Performance Return on Assets	25%	0.26%	4.75%	0.33%	Exceeded stretch Maximum outturn achieved Exec: 9.50% SL: 4.50%
Customer Service Ipsos Mori Net Promoter Score	25%	Top 20%ile	4.75%	71%ile	Threshold not met No outturn
Colleague Engagement Great Place to Work Engagement Index	25%	85%	4.75%	86%	Exceeded target Outturn achieved Exec: 6.33% SL: 3.00%
Shared Strategic Business Objective[1]	25%	Achievement is assessed against delivery of a combination of 'What' and 'How' measures	4.75%	Following assessment of 'What' and 'How' measures it was established these were achieved at 80% of target	Threshold exceeded Outturn achieved Exec: 3.80% SL: 1.80%

[1] *For 2022, the Shared Strategic Business Objectives are centred on driving our strategy forward. The objectives are a combination of 'What' and 'How' measures, which include supporting the Framing our Future journey, strategic KPIs and development of, as well as performance against, leadership behaviours.*

The impact of deferral

60% of the award for 2022 performance is payable in March 2022, with the remaining 40% deferred. The table below shows the percentage of the LEA, which will be paid to Executives in each year and any payments yet to be made.

Variable pay receivable	2022 (Payments made in 2022)	2023	2024	2025
2022 performance period	–	60%	20%	20%
2021 performance period	60%	20%	20%	–
2020 performance period	20%	20%	–	–

To receive each proportion of their award an individual must be employed on the corresponding payment date or be considered for payment. All other individuals will not be entitled to receive that proportion of the award or any proportion due thereafter.

Payments to past Directors

There were no payments to past Directors in 2022 that had not already been disclosed in previous reports.

Payments for loss of office

There were no payments for loss of office in 2022. Tom Denman did not receive any payments for loss of office, when he left the Society as outlined above.

Remuneration of the Chief Executive Officer over time

The table below shows the total remuneration of the Chief Executive Officer for the current and prior year.

Total remuneration includes base salary, pension, taxable benefits and variable pay awards under both the REA and LEA.

Year ended	Chief Executive Officer	Total Remuneration £000	Actual variable pay received as a percentage of maximum opportunity
2022	Julie-Ann Haines	501	60%
2021	Julie-Ann Haines	508	72%

Chief Executive Officer pay ratio

The Chief Executive Officer pay ratio provides a snapshot of the overall pay differential that exists between the Chief Executive Officer (the highest paid person within the organisation), against the total remuneration of the median employee and those who sit at the 25th and 75th percentiles. This means that when all colleagues' pay is listed from highest to lowest, the median is the middle value in that list, and the percentiles represent the lower and upper quartile position.

The table below shows that the Chief Executive Officer's pay is 14 times that of the median colleague pay and has remained consistent with 2021.

Year	25th percentile pay ratio	Median pay ratio	75th percentile pay ratio
2022	19:1	14:1	10:1
2021	20:1	14:1	10:1

The total remuneration and salary values for the 25th, median and 75th percentile employees for 2022 are:

	25th percentile	Median	75th percentile
Total remuneration	£28,650	£39,066	£56,011
Salary remuneration	£24,519	£33,599	£48,600

Notes to the Chief Executive Officer pay ratio:

- Employee data includes full time equivalent total remuneration for all UK employees as at 31 December 2022, following the November 2022 pay review
- To take into account the timing of the November 2022 pay review for colleagues, the CEO salary used for the purposes of the CEO pay ratio calculations is the February 2023 salary to ensure that the timing of these two pay reviews does not have a misleading impact on our CEO pay ratio in this report
- For each employee, remuneration was calculated based on all components of pay, including base salary, variable pay, benefits, and pension payments
- Our approach has not changed since the prior year. We recognise that this approach is not entirely in line with defined methodology, but we believe this approach gives a meaningful comparison that meets the spirit of the CEO pay ratio reporting regulations, and so we have continued to use the same methodology on the grounds of consistency and simplicity

Our approach to reward ensures that remuneration (including base pay, variable pay and benefits) at Principality is transparent, fair, free from discrimination and aligned to the external market.

Non-Executive Directors' Remuneration

The following table provides the audited information showing a single total figure of remuneration for the 2022 financial year for each of the Non-Executive Directors and compares this figure to the prior year. Fees contain a base fee element and an additional element for chairing a Committee to reflect the additional level of responsibility. In 2021, a fee review took place, which resulted in a within year change to the fee structure. In 2022, there was no increase to Non-Executive Director fees. Any changes between 2021 and 2022 are due to the transition from the previous fee structure and any changes to committee membership during the year. Additionally, whilst they are not Non-Executive Directors, our Non-Executive Board Associates receive annual fees of £30,000 for their contribution.

Audited information Non-Executive Directors	Fees	
	2022 £000	2021 £000
Sally Jones-Evans – Chair of the Board of Directors	121	103
Nigel Annett CBE – Chair of Technology Committee (until October 2022)	49	63
Derek Howell – Chair of Audit Committee and Senior Independent Director	73	73
David Rigney – Chair of Board Risk Committee (until March 2022)	17	68
Claire Hafner – Chair of Remuneration Committee	65	63
Debra Evans-Williams	53	51
Jonathan Baum – Chair of Board Risk Committee (from April 2022)	61	27
Laurence Adams – former Chair of the Board of Directors (until April 2021)	–	38
Total	439	486

Annual percentage change in remuneration of Directors and employees

The following table shows the percentage change in remuneration of each of the Directors from 2021 to 2022, compared with the average for all other employees. Data for all employees has been calculated on a full-time equivalent basis and reflects all employees (excluding Directors) as at 31 December 2022. Non-Executive Director fees did not increase from 2021 to 2022, though individual Non-Executive Directors may have received a change to their fees due to role changes during the year.

The change in average salary for colleagues occurred in 2022 due to two pay reviews (February and November), investment in our new minimum salary levels to support cost of living and market competitiveness for our lowest paid colleagues, the introduction of salary progression schemes in our large operational teams such as Retail and Customer Services and recruitment activity. This has then flowed through to benefits and pension provision, and variable pay calculations. Additionally, the performance of the REA scheme was stronger in 2022 than in 2021.

	% Change in remuneration between 2021 and 2022		
	Salary/Fees	Benefits	Variable Pay
Executive Directors			REA and LEA
Julie-Ann Haines	3%	3%	-14%
Michael Jones	7%	4%	N/A
Iain Mansfield	23%	-24%	3%
Non-Executive Directors			
All Non-Executive Directors	0%	N/A	N/A
All employees			REA only
Change in average salary	16%	17%	36%

Relative importance of spend on pay

The following table sets out the changes in underlying profit before tax for 2022 and 2021 and compares these with overall spend on remuneration. The Society only seeks to retain sufficient profit to maintain capital ratios and allow for investment in the business, returning any surplus above this to Members. Therefore, total assets have also been included in the table below, as the level of growth in mortgage and savings balances are a more appropriate comparator. Employee remuneration costs consist of wages and salaries, social security costs, and other pension costs as disclosed within the administrative expenses note to the Financial Statements within the Annual Report and Accounts. Underlying Profit Before Tax excludes fair value movements and reflects the true trading performance of the business. This is further explained in the Financial Review section of the Annual Report and Accounts.

The increase in employee remuneration costs reflects the increase in headcount, as well as the increase to salaries both from 2021 to 2022 and following the 2022 pay review, which was brought forward for all colleagues except Executives.

	2022 £m	2021 £m	percentage change %
Total assets	11,262	10,908	3
Employee remuneration costs	52.2	47.6	10
Underlying profit before tax	43.5	54.4	-20
Headcount (number of full-time equivalent employees)	1,198	1,110	8

Material Risk Takers (MRTs)

MRTs are defined as those 'whose professional activities have a material impact on an institution's risk profile'. The Remuneration Committee is responsible for approving remuneration policies, maintaining oversight of the remuneration of MRTs and for ensuring the remuneration paid to MRTs is in line with regulatory requirements.

Details of the MRT remuneration arrangements for 2022 are included in the Pillar 3 document, which is available on our website.

Looking ahead to 2023

The Committee undertakes a review of the Executive Director base salaries effective from 1 February of each financial year, taking into account factors such as individual and business performance, market conditions, and the level of salary increase applied to other colleagues across the Society.

For February 2023, it was agreed that Executive Directors would be treated the same way as the wider workforce in terms of consideration of market competitiveness, and have the same approach to increases applied to them. Taking into account market pay levels, the Committee decided to apply a market rate increase to the Chief Executive Officer's salary. In line with the approach to colleagues, a further 5% increase was made. For our Chief Financial Officer an increase of 5% was applied to salary.

The new salaries for these two roles are as follows:

Chief Executive Officer	£400,000
Chief Financial Officer	£315,000

No changes will be made to the benefits provided to Executive Directors for 2023. The variable pay schemes for 2023 will continue to be the LEA and REA schemes, with no change to target or maximum potential values.

Michael Jones, the Society's Chief Risk Officer, will be retiring in June 2023. The Society will be appointing a new Chief Risk Officer; this change and new appointment will be noted in the 2023 Director's Remuneration Report.

Non-Executive Director and Non-Executive Board Associate fees have been treated the same way as the wider workforce in terms of consideration of market competitiveness and the same level of increase applied to them.

This has resulted in a 5% increase to fees plus a further increase to our Chair's fee of £135,000.

Statement of Member voting

The Society is committed to open and honest dialogue with our Members and take an active interest in voting outcomes. The voting results for the 2021 Director's Remuneration Report are set out below.

Votes for 13,997	**Votes against 1,656**
% in favour 89.42	**% against 10.58**

* 474 votes were withheld

Approval

This report is approved by the Remuneration Committee and signed on its behalf by:

Claire Hafner
Chair of the Remuneration Committee
17 February 2023

Directors' Report

for the year ended 31 December 2022

The Directors are pleased to present the Annual Report and Accounts and Annual Business Statement of the Society and its subsidiary undertakings for the financial year ended 31 December 2022. The Directors confirm that, to the best of their knowledge, the Annual Report, taken as a whole, is fair, balanced, provides an understandable assessment of the Society's position and prospects and provides the information necessary to Members to assess the Society's performance, business model and strategy. Further information is provided in the Report on the Audit Committee at pages 62 to 66.

Directors

The names of the Directors at the date of this report, together with brief biographical details, are listed on pages 39 to 43. Details of changes affecting the composition of the Board are set out in the Corporate Governance Report on pages 38 to 55. In accordance with the UK Corporate Governance Code, and as permitted by Society Rule 26(1), all of the Directors retire and stand for re-election at the Annual General Meeting. With the exception of Derek Howell, who will retire from the Board in March 2023, all Directors are eligible and willing to continue serving on the Board and there have been no other nominations.

During the year, no Director of the Society was, or has since, been beneficially interested in the share capital of, or any debentures of, any connected undertaking of the Society.

The Society has made qualifying third party indemnity provisions for the benefit of its Directors and officers which remain in force at the date of this report.

Auditor

At the Annual General Meeting on 25 April 2022, the Members passed a resolution that Deloitte LLP be reappointed as auditor for the ensuing year.

Responsibilities of the Directors

The following statement, which should be read in conjunction with the statement of the auditor's responsibilities on page 100, is made by the Directors to explain their responsibilities in relation to the preparation of the Annual Accounts, the Report of the Remuneration Committee, the Annual Business Statement and the Directors' Report.

The Directors are required by the Building Societies Act 1986 to prepare, for each financial year, Annual Accounts which give a true and fair view of the income and expenditure of the Society and the group for the financial year and of the state of affairs of the Society and the group as at the end of the financial year and which provide details of Directors' emoluments in accordance with Part VIII of the Act and regulations made under it. In preparing the Annual Accounts, the Directors are required to:

- Select appropriate accounting policies and apply them consistently
- Make judgements and estimates that are reasonable and prudent
- State whether applicable accounting standards have been followed; and
- Prepare the Annual Accounts on the going concern basis, unless it is inappropriate to presume that the Society will continue in business for the next 12 months

The Act states that references to International Accounting Standards accounts giving a true and fair view, are references to their achieving a fair presentation. In addition to the Annual Accounts, the Act requires the Directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Society and its connected undertakings.

Directors' responsibilities for accounting records and internal controls

The Directors are responsible for ensuring that the Society and its subsidiary undertakings:

- Keep accounting records in accordance with the Building Societies Act 1986
- Take reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business, in accordance with the rules made under the Financial Services and Markets Act 2000

The Directors have general responsibility for safeguarding the assets of the Society and for taking reasonable steps for the prevention and detection of fraud and other irregularities. So far as each Director is aware, there is no relevant audit information of which the Society's auditors are unaware. Each of the Directors, whose names and functions are listed on pages 40 to 43, have taken all steps that he or she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Society's auditors are aware of that information. The Directors are also responsible for the integrity of statutory and audited information on the Society's website principality.co.uk.

The auditor accepts no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website. Information published on the internet is accessible in many countries with different legal requirements relating to the preparation and dissemination of financial statements. Information in these financial statements is provided under the legislation of the United Kingdom.

Directors' statement pursuant to the Disclosure and Transparency Rules

As required by the Disclosure and Transparency Rules of the Financial Conduct Authority, the Directors have included a management report containing a fair review of the business and a description of the principal risks and uncertainties facing the Society. This information is contained principally in the Strategic Report. The Directors confirm that, to the best of each of their knowledge and belief:

- The financial statements, prepared in accordance with IFRS' as adopted by the EU, present fairly the assets, liabilities, financial position and profit of the group and Society
- The management report contained in the Strategic Report includes a fair review of the development and performance of the business and the position of the group and Society as well as a description of the principal risks and uncertainties that they face

Long-term viability statement and going concern

The Directors have assessed the viability of the Society over a three-year period, taking into account the business strategy, current economic conditions and the principal risks as set out in the Strategic Report, which includes:

- **Geopolitical and macroeconomic environment** – The economic outlook remains volatile and uncertain for the future profile of interest rates, inflation and other macroeconomic variables, having been severely impacted by the cost of living crisis driven in part by the conflict in Ukraine and UK macroenvironment
- **Outlook for the mortgage and savings markets in the UK** – The level of future interest rates, mortgage affordability, the ability of customers to continue to save in the near term are key considerations. This could be driven by customer affordability in the face of higher inflation and the potential for higher unemployment, future house prices, shifting customer behaviours and regulatory changes
- **Climate change** – Risks continue to evolve as government policies mature, including transition towards greater requirements on Energy Performance Certificates (EPC), which is likely to play out across a number of other risks

The strategy and associated principal risks underpin the Society's three-year plan and scenario testing, which the Directors review at least annually. The three-year plan makes certain assumptions about the macroeconomic environment, the performance of the Society's lending portfolios and the availability of retail deposits and wholesale funding. The plan is stress tested through the Society's Internal Capital Adequacy Assessment Process ('ICAAP') and Internal Liquidity Adequacy Assessment Process ('ILAAP'). These processes use both scenarios determined by the Bank of England and internal scenarios, which reflect the specific nature of the Society'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.

The Directors have determined that a three-year period of assessment is an appropriate period over which to provide its viability statement. The three-year period is considered to be most appropriate as it is the longest period over which the Board considers that it can form a reasonable view of the likely macroeconomic environment and associated key drivers of business performance.

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

Strategic Report

The Society's strategic report information required by Schedule 7 to the Accounting Regulations and the capital structure of the Society are set out in the Strategic Report on pages 4 to 36.

Anti-Corruption and Anti-Bribery matters

The Society is committed to maintaining the highest standards of ethics and integrity in the way in which it operates and abiding by the law. The Society complies with the UK Bribery Act and any act of fraud, bribery or corruption is treated seriously by the Society. The Society expects its business partners to adopt the same approach.

All colleagues, including the Chief Executive Officer, and members of the senior leadership team have been trained in recognising and understanding bribery and corruption risks. The Society's exposure to potential bribery and corruption risks is reviewed annually and the outcome of that review is reported to the

Society's Risk Committee. Everyone in the business must comply with the Society's Bribery and Conflicts of Interest Policy.

The Chief Executive Officer is responsible for reminding all colleagues of the Society's values and zero tolerance approach to all forms of bribery and corruption. The Society uses an e-learning solution to support anti-bribery training and assessments. Details of the Risk Committee's remit, which includes adherence to the Bribery and Conflicts of Interest Policy, can be found on the Society's website.

Colleagues

More information on how the Society engages and supports it colleagues can be found in the Members, Colleagues and Communities section on pages 23 to 24.

Country by country reporting

The following information is disclosed in accordance with the Regulations of Article 89 of the Capital Requirements Directive IV (CRD IV) country by country reporting (CBCR):

a) Name, nature of activities and geographical location

Principality Building Society is the parent company and a list of the subsidiaries can be found in note 21 of these accounts. The principal activities of the Society can be found in the Strategic Report. All group companies operate in the United Kingdom only

b) Average number of employees

The average number of employees is disclosed in note 10

c) Annual turnover

Net operating income is set out in the Consolidated Income Statement

d) Pre-tax profit or loss

Profit before taxation is set out in the Consolidated Income Statement

e) Corporation tax paid

Corporation tax paid is set out in the Consolidated Statement of Cash flows

f) Public subsidies received

No public subsidies were received in 2022

Charitable and political donations

In 2022, the Society made donations to charities of £0.7m (2021: £0.2m). No political donations were made by the Society in the current or prior year.

Creditor payment policy

The Society's policy is to agree terms and conditions with suppliers that outline the way in which business is to be transacted, including the terms of payment, and to pay in accordance with contractual and other legal obligations.

The Society's creditor days stood at two days at 31 December 2022 (2021: two days).

Whistleblowing policy

The Society's Whistleblowing policy sets out the arrangements in place which enable colleagues (and others) to raise concerns relating to wrongdoing. The Society's Board reviewed and approved the Whistleblowing policy at its December 2022 meeting alongside receiving the annual Board Whistleblowing Champions Report.

On behalf of the Board of Directors:

Sally Jones-Evans
Chair
17 February 2023

Financial Statements

Independent Auditor's Report to the Members of Principality Building Society

Report on the audit of the financial statements

Opinion

In our opinion the financial statements of Principality Building Society (the 'Society') and its subsidiaries (the 'group'):

- Give a true and fair view of the state of the group's and of the Society's affairs as at 31 December 2022 and of the group's and Society's income and expenditure for the year then ended
- Have been properly prepared in accordance with United Kingdom adopted international accounting standards
- Have been prepared in accordance with the requirements of the Building Societies Act 1986.

We have audited the financial statements which comprise:

- The group and Society income statements
- The group and Society statements of comprehensive income
- The group and Society statements of financial position
- The group and Society statement of changes in Members' interests
- The group and Society cash flow statements
- The related notes 1 to 34

The financial reporting framework that has been applied in their preparation is applicable by law and United Kingdom international accounting standards.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK), (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the group and the Society in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. The non-audit services provided to the group and Society for the year are disclosed in note 9 to the financial statements. We confirm that we have not provided any non-audit services prohibited by the FRC's Ethical Standard to the group or the Society.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Summary of our audit approach

Key audit matters	The key audit matter that we identified in the current year was: • IFRS 9 Financial Instruments – Expected Credit Loss ('ECL') provisioning Within this report, key audit matters are identified as follows: Similar level of risk
Materiality	The materiality that we used for the group financial statements was £3.4m (2021: £3.1m), which was determined on the basis of 0.5% of Net Assets.
Scoping	Audit work to respond to the risks of material misstatement was performed by the group audit engagement team. Our audit scoping provides coverage of 98% of the group's revenue, 89% profit before tax and 100% of Net Assets.
Significant changes in our approach	The component scoping has been revised in the period. The Society's subsidiary, Nemo Personal Finance Limited, had reduced operations in the current year and as at 31 December 2022 no longer represents a significant component of the group. This impacted the scoping coverage of the group. There were no other significant changes in our approach.

Conclusions relating to going concern, principal risks and viability statement

In auditing the financial statements, we have concluded that the Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Our evaluation of the Directors' assessment of the group's and Society's ability to continue to adopt the going concern basis of accounting included:

- We have reviewed and challenged management's considerations regarding whether they consider it appropriate to adopt the going concern basis of accounting
- We have assessed the information supporting the liquidity and capital forecasts, including stress testing and reverse stress testing performed by management
- With the involvement of prudential regulation specialists, we have reviewed and assessed the group and Society's compliance with regulation including capital and liquidity requirements
- We have tested the historical accuracy of forecasts prepared by management, by comparing historic forecasting to actual results
- We have assessed the appropriateness of the going concern disclosures in the financial statements

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the group's and Society's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In relation to the reporting on how the group has applied the UK Corporate Governance Code, we have nothing material to add or draw attention to in relation to the Directors' statement in the financial statements about whether the Directors considered it appropriate to adopt the going concern basis of accounting.

Our responsibilities, and the responsibilities of the Directors with respect to going concern, are described in the relevant sections of this report.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

<table>
<tr><th colspan="2">IFRS 9 Financial Instruments – Expected Credit Loss Provisioning (ECL)</th></tr>
<tr><td>Key audit matter description</td><td>IFRS 9 is a complex accounting standard which has required considerable judgement, interpretation and modelling complexity to estimate ECL provisions. The models developed estimate the expected loss provisions against loans to customers within the following loan books:

• Residential mortgages
• Commercial
• Secured personal lending

The group held £31.9m of impairment provisions (2021: £17.8m) against total loans and advances to customers of £9,653.4m (2021: £9,210.4m)

ECL provisioning is considered a key audit matter as it involves significant judgements, particularly in light of the UK's cost of living crisis and its impact on the expected credit performance of the group's customers.

We have considered the most significant areas of judgement within the group's provisioning methodologies to be:

• Residential mortgages only: updated Probability of Default ('PD') and Significant Increase in Credit Risk ('SICR') methodology: the PD and SICR methodology for the residential mortgage portfolio has been revised in the year. Changes made to the model, are considered to be a complex area of statistical modelling and involve a significant level of judgement</td></tr>
</table>

Key audit matter description (continued)	• All loan books: macroeconomic scenarios and associated weighting applied: ECLs are required to be calculated on a forward-looking basis under IFRS 9. In determining both the economic scenarios, as well as the probability-weighting of each scenario to be incorporated into the ECL model, significant judgement is applied • All loan books: The Society's assessment of the cost of living crisis impact on ECL: In response to the rapidly growing severity of the cost of living crisis in the UK on consumers and businesses, the Society has included a number of Post Model Adjustments ('PMAs') to capture the risk of the cost of living crisis impacting the ability of certain customers to repay their mortgages. The identification and assessment of these PMAs is subject to significant levels of judgement Given the material effect of the significant judgements taken to derive the impact of the cost of living crisis on ECL, and to determine appropriate macroeconomic scenarios and associated weightings in the measurement of the provision, we also considered that there is a potential for fraud risk through possible manipulation of this balance. The group's loan loss provision balances are detailed within note 19. Director's associated accounting policies are detailed on pages 111-120 with detail about judgements in applying accounting policies and critical accounting estimates on pages 120-122. Directors' considerations of the effect of the future economic environment is disclosed on pages 143-144. The Audit Committee's consideration of the matter is described on page 63.
How the scope of our audit responded to the key audit matter	Our audit procedures included obtaining an understanding of the relevant controls around the impairment review process and the determination of the judgements within the model. This included evaluating the Model Governance Committee and their assessment of model monitoring and calibrations, review process and approval of macroeconomic scenarios and incorporated assumptions in the PMA. Our audit procedures to address the risks identified within the loan impairment process included the following procedures: **Assessment of model assumptions** • With involvement of our internal credit modelling specialists, we assessed whether the updated PD and SICR residential methodology meets the requirements of IFRS 9. We have also performed procedures to evaluate that the methodology changes have been reflected in the models through review of the underlying code. We have tested the completeness and accuracy of the data that supports conclusions regarding the appropriateness of the methodology changes • With involvement of our internal economic modelling specialists, we assessed the macroeconomic scenario forecasts that were incorporated into the ECL model, inclusive of the PMA applied to the model. The Society's forecasts and probability-weightings were benchmarked against external sources to assess their reasonableness, considering the forecasts in light of the cost of living crisis and any contradictory information

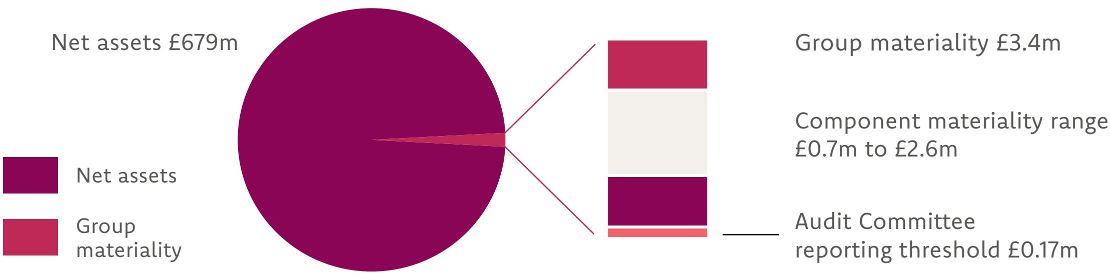
How the scope of our audit responded to the key audit matter	• We assessed the appropriateness of Director's assessment of the impact of the cost of living crisis, with support from our internal credit modelling specialists, by assessing whether the Post Model Adjustments ('PMAs') applied adequately, address the risk and independently recalculated those, which were included • As part of wider procedures over the expected credit losses, we assessed the appropriateness of other model inputs including exposure at default, probability of default and loss given default with reference to the most recently observable data and the impact of the cost of living crisis **Assessment of the ECL model** • With involvement of our internal credit modelling specialists, we evaluated the models and SAS scripts used to derive the ECL provision and assessed their consistency with the Society's model documentation and their compliance with the requirements of IFRS 9 • As part of wider procedures over the expected credit losses, we assessed whether changes had been made to the Society's processes in relation to the ECL models before placing reliance on prior year model documentation reviews by our credit risk modelling specialists **Assessment of data used in the ECL model** As part of our wider procedures over the expected credit losses: • We tested the data that supported each material judgement for completeness and accuracy • We assessed the appropriateness of data used in the model in light of the developments in the current economic environment
Key observations	Based on our audit procedures above, we concluded that the Society's provision is reasonably stated, and is supported by a methodology that is appropriately applied.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Society financial statements
Group materiality	£3.4m (2021: £3.1m)	£2.6m (2021: £2.4m)
Basis for determining materiality	0.5% of net assets (2021: 0.5% net assets)	0.5% of net assets (2021: 0.5% net assets)
Rationale for the benchmark applied	We have determined it appropriate to use net assets as the benchmark for materiality. This is based on professional judgement and taking consideration of the financial measures most relevant to users of the financial statements. The group and the Society are a balance sheet driven businesses and net assets are understood to be regulatory capital, which is of significant interest for users of the financial statements, including regulators.	



Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole.

	Group financial statements	Society financial statements
Performance materiality	70% (2021: 70%) of group materiality	70% (2021: 70%) of Society materiality
Basis and rationale for determining performance materiality	In determining performance materiality, we considered the following factors: a) The quality of the control environment, and that we were able to rely on controls for a number of key business cycles b) The moderate and isolated level of prior-year uncorrected and corrected misstatements and the likelihood or errors occurring based on our previous experience	

Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.17m (2021: £0.16m), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Identification and scoping of components

Our group audit was scoped by obtaining an understanding of the group and its environment, including group-wide controls, and assessing the risks of material misstatement at the group level. Audit work to respond to the risks of material misstatement was performed by the Group audit engagement team. Our audit scoping provides full scope and coverage of 100% (2021: 100%) of the group's net assets and a 98% (2021: 100%) coverage on revenue and 89% (2021: 100%) coverage on profit before tax. 4 (2021: 5) components were concluded as significant in the current period. Our audit of these components was executed at levels of materiality applicable to each individual component, which were lower than group materiality and ranged from £0.7m to £2.6m (2021: £1.0m to £2.4m).

Our consideration of the control environment

A controls reliance strategy over the residential first charge and commercial lending and savings cycles was planned and taken. We obtained an understanding of and tested the controls within these cycles, as well as controls of audit interest within the financial reporting, treasury and ECL cycles with the involvement of our IT specialist, we obtained an understanding of and tested the IT systems surrounding the above cycles.

Our consideration of climate-related risks

In planning our audit, we made enquiries of management to understand the extent of the potential impact of climate change risk on the group's financial statements.

Management concluded that there was no material impact on the financial statements. Our evaluation of this conclusion included performing enhanced risk assessment procedures over the key judgements and estimates in areas where we considered that there was greatest potential for climate change impact. This was principally in relation to the ECL.

We also considered the consistency of the climate change disclosures included in the Strategic Report, with the financial statements and our knowledge from our audit.

Other information

The other information comprises the information included in the annual report, other than the financial statements and our Auditor's Report thereon. The Directors are responsible for the other information contained within the annual report.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon. Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements, or our knowledge obtained in the course of the audit, or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Responsibilities of Directors

As explained more fully in the Directors' responsibilities statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the group's and the Society's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the group or the Society or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an Auditor's Report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: frc.org.uk/auditorsresponsibilities. This description forms part of our Auditor's Report.

Extent to which the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- The nature of the industry and sector, control environment and business performance including the design of the group's remuneration policies, key drivers for Directors' remuneration, bonus levels and performance targets

- Results of our enquiries of management, internal audit, and the Audit Committee about their own identification and assessment of the risks of irregularities
- Any matters we identified having obtained and reviewed the group's documentation of their policies and procedures relating to:
    - Identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance
    - Detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud
    - The internal controls established to mitigate risks of fraud or non-compliance with laws and regulations
- The matters discussed among the audit engagement team and relevant internal specialists including tax, financial instrument specialists, internal economic modelling, valuations, prudential regulation, pensions, IT, analytics and credit risk modelling specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in the following areas: IFRS 9 Financial Instruments - Expected Credit Loss ('ECL') Provisioning. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory frameworks that the group operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the Building Societies Act 1986 for the Society and the UK Companies Act for the subsidiaries.

In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements, but compliance with which may be fundamental to the group's ability to operate or to avoid a material penalty. The key laws and regulations we considered in this context included those set by the Financial Conduct Authority in respect of the misselling of payment protection insurance and other conduct related matters. In addition, we considered the regulation set by the Prudential Regulation Authority relating to regulatory capital and liquidity requirements, which are fundamental to the group's ability to continue as a going concern.

Audit response to risks identified

As a result of performing the above, we identified IFRS 9 Financial Instruments - Expected Credit Loss ('ECL') Provisioning as a key audit matter related to the potential risk of fraud. The key audit matters section of our report explains the matter in more detail and also describes the specific procedures we performed in response to that key audit matter.

In addition to the above, our procedures to respond to risks identified included the following:

- Reviewing the financial statement disclosures and testing to supporting documentation to assess compliance, with provisions of relevant laws and regulations described as having a direct effect on the financial statements
- Enquiring of management, the Audit Committee and in-house legal counsel concerning actual and potential litigation and claims
- Performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud

- Reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with the Prudential Regulation Authority, the Financial Conduct Authority and HMRC; and
- In addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Building Societies Act 1986

In our opinion, based on the work undertaken in the course of the audit:

- The annual business statement and the Directors' report have been prepared in accordance with the requirements of the Building Societies Act 1986
- The information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements
- The information given in the annual business statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given

In the light of the knowledge and understanding of the group and the Society and their environment obtained in the course of the audit, we have not identified any material misstatements in the Directors' report.

Opinion on other matter prescribed by the Capital Requirements (Country-by-Country Reporting) Regulations 2013

In our opinion the information given on page 91 to the financial statements for the financial year ended 31 December 2022 has been properly prepared, in all material respects, in accordance with the Capital Requirements (Country-by Country Reporting) Regulations 2013.

Corporate Governance Statement

Based on the work undertaken as part of our audit, we have concluded that each of the following elements of the Corporate Governance Statement is materially consistent with the financial statements and our knowledge obtained during the audit:

- the Directors' statement with regards the appropriateness of adopting the going concern basis of accounting and any material uncertainties identified set out on pages 90;
- the Directors' explanation as to its assessment of the group's prospects, the period this assessment covers and why the period is appropriate set out on pages 88-89;
- the Directors' statement on fair, balanced and understandable set out on page 88;
- the board's confirmation that it has carried out a robust assessment of the emerging and principal risks set out on page 90;
- the section of the annual report that describes the review of effectiveness of risk management and internal control systems set out on page 60-61; and
- the section describing the work of the audit committee set out on page 61.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Building Societies Act 1986 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the Society; or
- the Society's financial statements are not in agreement with the accounting records and returns; or
- we have not received all the information and explanations and access to documents we require for our audit.

We have nothing to report in respect of these matters.

Other matters

Audit tenure

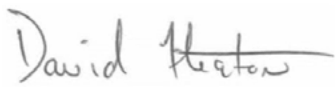
Following the recommendation of the audit committee, we were appointed at the annual general meeting by the members of the Society on 27 April 2007 to audit the financial statements for the year ending 31 December 2007 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 16 years, covering the years ending 31 December 2007 to 31 December 2022.

Consistency of the audit report with the additional report to the Audit Committee

Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

Use of our report

This report is made solely to the Society's members, as a body, in accordance with section 78 of the Building Societies Act 1986. Our audit 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, or for the opinions we have formed.



David Heaton **(Senior Statutory Auditor)**
For and on behalf of Deloitte LLP
Statutory Auditor
Manchester, United Kingdom
17 February 2023

Consolidated income statement *for the year ended 31 December 2022*

	Notes	2022 £m	2021 £m
Interest receivable and similar income	4	284.6	198.7
Interest payable and similar charges	5	(130.7)	(69.5)
Net interest income		153.9	129.2
Fees and commission receivable	6	3.9	3.9
Fees and commission payable		(2.2)	(1.8)
Net fee and commission income		1.7	2.1
Other operating income		3.1	0.8
Other fair value gains	8	5.8	9.6
Net operating income		**164.5**	**141.7**
Administrative expenses	9	(88.4)	(79.8)
Depreciation and amortisation	22 & 23	(10.5)	(10.8)
Other impairment losses	22 & 23	(1.3)	(2.5)
Operating expenses		(100.2)	(93.1)
Impairment provision (charge)/release on loans and advances	19	(14.8)	15.4
Provision for liabilities	20	(0.2)	–
Operating profit and profit before taxation		**49.3**	**64.0**
Taxation expense	13	(11.6)	(15.2)
Profit for the year		**37.7**	**48.8**

Consolidated statement of other comprehensive income

	Notes	2022 £m	2021 £m
Profit for the year		37.7	48.8
Items that will not be reclassified subsequently to profit and loss:			
Actuarial (loss)/gain on retirement benefit obligations	12	(4.2)	4.3
Tax charge/(credit) on retirement benefit obligations	13	1.0	(1.0)
Items that may be reclassified subsequently to profit and loss:			
Loss on fair value through other comprehensive income		(2.8)	(0.4)
Tax charge on fair value through other comprehensive income	13	0.7	–
Total comprehensive income for the year		**32.4**	**51.7**

All items dealt with in arriving at the profit before tax and the profit for the financial year, and the preceding financial year, relate to continuing operations.

The accounting policies and notes on pages 111 to 170 form part of these accounts.

Income statement of the Society *for the year ended 31 December 2022*

	Notes	2022 £m	2021 £m
Interest receivable and similar income	4	277.4	190.5
Interest payable and similar charges	5	(130.7)	(69.5)
Net interest income		146.7	121.0
Fees and commission receivable	6	3.9	3.9
Fees and commission payable		(2.2)	(1.7)
Net fee and commission income		1.7	2.2
Other operating income		3.1	0.8
Income from investments	7	47.0	–
Other fair value gains (losses)/gains	8	(23.9)	(0.8)
Net operating income		**174.6**	**123.2**
Administrative expenses	9	(87.6)	(79.1)
Depreciation and amortisation	22 & 23	(10.5)	(10.8)
Other impairment losses	22 & 23	(1.3)	(2.5)
Operating expenses		(99.4)	(92.4)
Impairment provision (charge)/release on loans and advances	19	(13.8)	13.0
Provision for liabilities	20	0.1	0.6
Operating profit and profit before taxation		**61.5**	**44.4**
Taxation expense	13	(10.7)	(13.6)
Profit for the year		**50.8**	**30.8**

Statement of other comprehensive income of the Society

	Notes	2022 £m	2021 £m
Profit for the year		50.8	30.8
Items that will not be reclassified subsequently to profit and loss:			
Actuarial (loss)/gain on retirement benefit obligations	12	(4.2)	4.3
Tax charge/(credit) on retirement benefit obligations	13	1.0	(1.0)
Items that may be reclassified subsequently to profit and loss:			
Loss on fair value through other comprehensive income		(2.8)	(0.4)
Tax charge on fair value through other comprehensive income	13	0.7	–
Total comprehensive income for the year		**45.5**	**33.7**

All items dealt with in arriving at the profit before tax and the profit for the financial year, and the preceding financial year, relate to continuing operations.

The accounting policies and notes on pages 111 to 170 form part of these accounts.

Consolidated statement of financial position *as at 31 December 2022*

	Notes	2022 £m	2021 £m
Assets			
Liquid assets:			
Cash in hand and balances with the Bank of England		1,566.9	1,645.8
Loans and advances to credit institutions	14	277.1	165.8
Debt securities	15	160.2	76.3
		2,004.2	1,887.9
Derivative financial instruments	16	369.0	52.8
Loans and advances to customers:			
Loans fully secured on residential property		8,495.7	8,598.2
Other loans		299.3	285.1
	17	8,795.0	9,883.3
Intangible fixed assets	22	23.5	26.0
Property, plant and equipment	23	36.3	36.6
Investment properties	23	5.8	6.2
Current tax assets		6.3	–
Deferred tax assets	28	2.9	2.3
Retirement benefit	12	–	3.2
Other assets		0.5	–
Prepayments and accrued income		13.8	9.6
Total assets		**11,257.3**	**10,907.9**
Liabilities			
Shares	24	8,113.6	7,43.8
Deposits and debt securities:			
Amounts owed to credit institutions	25	1,639.0	1,296.2
Amounts owed to other customers		255.0	270.1
Debt securities in issue	26	467.2	696.0
		2,361.2	2,262.3
Derivative financial instruments	16	63.6	24.7
Current tax liabilities		–	0.8
Other liabilities	27	13.7	11.3
Provision for liabilities	20	2.8	2.7
Accruals and deferred income		10.9	10.6
Deferred tax liabilities	28	11.8	5.4
Retirement benefit obligations	12	0.9	–
Total liabilities		10,578.5	10,261.6
General reserve		680.1	645.5
Other reserves		(1.3)	0.8
Total equity and liabilities		**11,257.3**	**10,907.9**

The accounting policies and notes on pages 111 to 170 form part of these accounts. These accounts were approved by the Board and authorised for issue on 17 February 2023.
Signed on behalf of the Board:

Sally Jones Evans
Chair

Julie-Ann Haines
Chief Executive Officer

Iain Mansfield
Chief Financial Officer

Statement of financial position of the Society *as at 31 December 2022*

	Notes	2022 £m	2021 £m
Assets			
Liquid assets:			
Cash in hand and balances with the Bank of England		1,566.9	1,645.8
Loans and advances to credit institutions	14	180.4	93.7
Debt securities	15	160.2	76.3
		1,907.5	1,815.8
Derivative financial instruments	16	333.4	50.1
Loans and advances to customers:			
Loans fully secured on residential property		8,415.7	8,489.8
Other loans		299.2	285.1
	17	8,714.9	8,774.9
Subsidiary asset	21	0.1	0.1
Intangible fixed assets	22	23.5	26.0
Property, plant and equipment	23	35.8	36.0
Investment properties	23	5.8	6.2
Current tax assets		6.2	–
Deferred tax assets	28	2.8	2.2
Retirement benefit	12	–	3.2
Other assets		0.5	–
Prepayments and accrued income		13.7	9.6
Total assets		**11,044.2**	**10,724.1**
Liabilities			
Shares	24	8,113.6	7,943.8
Deposits and debt securities:			
Amounts owed to credit institutions	25	1,716.3	1,622.1
Amounts owed to other customers		255.0	270.1
Debt securities in issue	26	289.8	298.4
		2,261.1	2,190.6
Subsidiary liability	21	1.7	16.0
Derivative financial instruments	16	63.6	23.8
Current tax liabilities		–	0.8
Other liabilities	27	13.7	11.3
Provision for liabilities	20	0.6	0.7
Accruals and deferred income		10.0	10.1
Deferred tax liabilities	28	11.7	5.3
Retirement benefit obligations	12	0.9	–
Total liabilities		10,476.9	10,202.4
General reserve		568.6	520.9
Other reserves		(1.3)	0.8
Total equity and liabilities		**11,044.2**	**10,724.1**

The accounting policies and notes on pages 111 to 170 form part of these accounts. These accounts were approved by the Board and authorised for issue on 17 February 2023.
Signed on behalf of the Board:

Sally Jones Evans
Chair

Julie-Ann Haines
Chief Executive Officer

Iain Mansfield
Chief Financial Officer

Statement of changes in Members' interests *for the year ended 31 December 2022*

	2022			2021		
	General Reserve £m	Fair Value through OCI Reserve £m	Total equity attributable to Members £m	General Reserve £m	Fair Value through OCI Reserve £m	Total equity attributable to Members £m
Group						
At 1 January	645.5	0.8	646.3	593.4	1.2	594.6
Comprehensive income for the year	34.6	(2.1)	32.5	52.1	(0.4)	51.7
At 31 December	**680.1**	**(1.3)**	**678.8**	**645.5**	**0.8**	**646.3**
Society						
At 1 January	520.9	0.8	521.7	486.8	1.2	488.0
Comprehensive income for the year	47.7	(2.1)	45.6	34.1	(0.4)	33.7
At 31 December	**568.6**	**(1.3)**	**567.3**	**520.9**	**0.8**	**521.7**

The group's capital at 31 December 2022 comprises the general reserve adjusted in line with regulatory rules. The group complied with all regulatory capital requirements throughout the current and prior year.

Consolidated statement of cash flows *for the year ended 31 December 2022*

	2022 £m	2021 £m
Net cash flows from operating activities (see below)	(129.4)	372.8
Cash flows from investing activities		
Purchase of intangible assets	(1.5)	(5.7)
Purchase of property, plant and equipment	(6.3)	(7.7)
Purchase of investment securities	(107.6)	(8.7)
Proceeds from sale and maturity of investment securities	20.9	10.7
Net cash flows from investing activities	**(94.5)**	**(11.4)**
Cash flows from financing activities		
Interest paid on debt securities in issue	(12.0)	(11.1)
Proceeds from issuance of debt securities in issue	489.6	1.1
Redemption of debt securities in issue	(220.3)	(268.0)
Repayment of lease liabilities	(1.0)	(1.0)
Net cash flows from financing activities	**256.3**	**(279.0)**
Increase in cash and cash equivalents	32.4	82.4
Cash and cash equivalents at the beginning of year	1,811.6	1,729.2
Cash and cash equivalents at the end of year	**1,844.0**	**1,811.6**
Represented by:		
Cash and balances with the Bank of England	1,566.9	1,645.8
Loans and advances to credit institutions repayable on demand	277.1	165.8
	1,844.0	**1,811.6**
Cash flows from operating activities		
Profit before taxation	49.3	64.0
Adjusted for:		
Depreciation and amortisation	10.5	10.8
Charge on defined benefit scheme	(0.1)	–
Impairment on loans and advances to customers	14.8	(15.4)
Impairment on fixed assets	0.4	1.5
Impairment on intangible assets	–	1.0
Change in fair values	239.5	99.8
Release of other provisions	0.1	–
Interest on debt securities in issue	16.1	10.8
Non-cash items included in profit before tax	(0.1)	(0.4)
Changes in net operating assets		
Loans and advances to customers	(180.2)	223.1
Other operating assets	(4.7)	0.9
Derivative financial instruments	(277.4)	(110.6)
Shares	175.2	(238.4)
Deposits	(165.2)	338.8
Other operating liabilities	3.6	(2.1)
Contributions paid into defined benefit scheme	–	(1.7)
Taxation paid	(11.2)	(9.3)
Net cash flows from operating activities	**(129.4)**	**372.8**

Statement of cash flows of the Society *for the year ended 31 December 2022*

	2022 £m	2021 £m
Net cash flows from operating activities (see below)	63.3	121.8
Cash flows from investing activities		
Purchase of intangible assets	(1.5)	(5.7)
Purchase of property, plant and equipment	(6.3)	(7.7)
Purchase of investment securities	(107.5)	(8.7)
Proceeds from sale and maturity of investment securities	20.9	10.7
Dividend from subsidiary	47.0	–
Net cash flows from investing activities	**(47.4)**	**(11.4)**
Cash flows from financing activities		
Interest paid on debt securities in issue	(7.1)	(7.7)
Repayment of lease liabilities	(1.0)	(1.0)
Net cash flows from financing activities	**(8.1)**	**(8.7)**
Increase in cash and cash equivalents	7.8	101.7
Cash and cash equivalents at the beginning of year	1,739.5	1,637.8
Cash and cash equivalents at the end of year	**1,747.3**	**1,739.5**
Represented by:		
Cash and balances with the Bank of England	1,566.9	1,645.8
Loans and advances to credit institutions repayable on demand	180.4	93.7
	1,747.3	**1,739.5**
Cash flows from operating activities		
Profit before taxation	61.5	44.4
Adjusted for:		
Depreciation and amortisation	10.5	10.8
Charge on defined benefit scheme	(0.1)	–
Impairment on loans and advances to customers	13.8	(13.0)
Impairment on fixed assets	0.4	1.5
Impairment on intangible assets	–	1.0
Change in fair values	239.5	99.8
Release of other provisions	(0.1)	(0.6)
Interest on debt securities in issue	7.1	7.7
Non-cash items included in profit before tax	(46.6)	0.5
Changes in net operating assets		
Loans and advances to customers	(207.5)	187.9
Decrease in loans to subsidiary companies	–	23.9
Increase in loans from subsidiary companies	(14.3)	16.0
Other operating assets	(5.7)	2.0
Derivative financial instruments	(243.5)	(99.9)
Shares	175.2	(238.4)
Deposits	79.1	89.7
Other operating liabilities	3.2	(2.0)
Contributions paid into defined benefit scheme	–	(1.7)
Taxation paid	(9.2)	(7.8)
Net cash flows generated from operating activities	**63.3**	**121.8**

Notes to the accounts

for the year ended 31 December 2022

1. Accounting policies

Basis of preparation

The group and Society financial statements are prepared in accordance with international accounting standards in conformity with the requirements of the Building Societies Act 1986 and with those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 (as amended) that are applicable. International accounting standards which have been adopted for use within the UK have also been applied in these financial statements.

The financial statements have been prepared under the historical cost convention, except for certain financial assets and liabilities held at fair value and all derivative contracts, and on a going concern basis, as discussed in the Directors' Report, under the heading 'Long-Term Viability Statement and Going Concern'.

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements unless noted otherwise.

New and amended standards adopted by the group

Amendments to IFRS 3, IAS 16 and IAS 37 have been adopted in the year with a mandatory effective date of 1 January 2022.

Adoption of other amendments to existing standards and annual improvements applicable in 2022 did not have any impact on the group's accounting policies and did not require retrospective adjustments.

Impact of standards issued but not yet applied

At the date of authorisation of these financial statements, a number of new standards and interpretations, which have not been applied in these financial statements, were in issue but not yet effective.

Basis of consolidation

The group financial statements consist of the financial statements of the ultimate parent (Principality Building Society) and all entities controlled by the Society (its subsidiaries and special purpose entities).

A subsidiary is an entity the operating and financing policies of which are controlled directly or indirectly by the Society. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commenced. Intra-group balances and transactions are eliminated in preparing the consolidated financial statements.

Investments in subsidiaries

Investments in subsidiaries are recorded in the Society's statement of financial position at cost, less impairment for cost of shares, and amortised cost for loans to subsidiaries.

Securitisation transactions

The group has securitised certain mortgage loans by the transfer of the loans to Special Purpose Entities (SPEs) controlled by the group. The securitisation enables a subsequent issuance of debt by the SPEs to investors who gain the security of the underlying assets as collateral.

1. Accounting policies (continued)

The SPEs are fully consolidated into the group's accounts under IFRS 10 – Consolidated Financial Statements.

The transfer of the mortgage loans to the SPEs is not treated as a sale by the Society. The Society continues to recognise the mortgage loans on its own statement of financial position after the transfer because it retains their risks and rewards through the receipt of substantially all of the profits or losses of the SPEs. In the accounts of the Society, the proceeds received from the transfer are accounted for as a deemed loan repayable to the SPEs. To manage interest rate risk, both the Society and the SPEs enter into derivative transactions in the form of interest rate swaps. Interest rate swaps with external counterparties in relation to securitisation transactions are recognised in accordance with IAS 39.

Interest receivable and payable

Interest receivable and payable for loans and advances to customers and customer accounts are recognised in the income statement using the effective interest method.

The effective interest method calculates the amortised cost of a financial asset or a financial liability, and allocates the interest income or interest expense over the expected product life. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the product or, when appropriate, a shorter period, to the net book value of the financial asset or financial liability. Where calculating the effective interest rate, the group estimates cash flows considering all contractual terms of the product (for example prepayment options) but does not consider future credit losses. The calculation includes all amounts received or paid by the group that are an integral part of the overall return and the direct incremental transaction costs related to the acquisition or issue of a product.

Interest income on debt securities, derivatives and other financial assets accounted for at either fair value through the statement of other comprehensive income or fair value through profit or loss is included in interest receivable and similar income.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Fees and commission and other income

Loan origination fees are reflected in the calculation of the effective interest rate on a loan. Fees received for loan servicing and other business processes is reflected in the income statement in the period in which the activity is carried out.

The group receives trail commission based on the performance of previous sales of insurance products. Income is recognised when it is highly probable that it will be received. Other fees and commissions and other income are recognised on an accruals basis when the service has been provided.

Classification and measurement of financial assets and liabilities

Financial assets

At initial recognition, the group measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss (FVTPL), transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVTPL are expensed in profit or loss. Thereafter, financial assets are classified and measured in one of the three following measurement categories:

- those to be measured at amortised cost;
- those to be measured subsequently at fair value through other comprehensive income (FVOCI); or
- those to be measured subsequently at fair value through profit or loss

The classification and subsequent measurement of financial assets depends on the business model for managing the financial assets and the contractual terms of the cash flows.

Debt instruments

Debt instruments comprise the group's cash in hand and balances with the Bank of England, loans and advances to credit institutions, debt securities and loans and advances to customers.

Subsequent measurement of debt instruments depends on the group's business model for managing the asset and the cash flow characteristics of the asset. There are three measurement categories into which the group classifies its debt instruments:

- Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost using the effective interest method, net of provision for impairment Interest earned from these financial assets is included in interest receivable and similar income. Impairment losses are presented as a separate line item in the income statement
- FVOCI: Assets that are held for collection of contractual cash flows and for selling the financial assets, where the assets' cash flows represent solely payments of principal and interest, are measured at FVOCI. Movements in fair value are taken through OCI and, on derecognition, the cumulative gain or loss previously recognised in OCI is reclassified to the income statement. Interest is recognised using the effective interest method and included in interest receivable and similar income
- FVTPL: Assets that do not meet the criteria for amortised cost or FVOCI are measured at FVTPL

Financial liabilities

Financial liabilities comprise shares, amounts owed to credit institutions and other customers and debt securities in issue.

Financial liabilities are initially recognised at fair value, being the issue proceeds net of premiums, discounts and transaction costs incurred. Thereafter, the majority of financial liabilities are subsequently measured at amortised cost using the effective interest method. Amortised cost is adjusted for the amortisation of any transaction costs, premiums and discounts. The amortisation is recognised in interest expense and similar charges using the effective interest method.

In certain instances financial liabilities will be classified and measured at FVTPL. This classification is adopted where such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise. Changes in fair value are recognised in other fair value gains/losses.

Impairment losses on loans and advances to customers and credit institutions

In accordance with IFRS 9, the group uses a three stage model for impairment based on changes in credit quality since initial recognition. Each stage represents a change in the credit risk of a financial instrument since origination. Credit risk is measured using Probability of Default (PD), Exposure At Default (EAD) and Loss Given Default (LGD). If a significant increase in credit risk (SICR) since initial recognition is identified but the asset is not yet deemed to be credit impaired, the financial instrument is moved from stage 1 to stage 2. Financial instruments that are deemed to be credit impaired are moved to stage 3. This assessment is performed on a monthly basis.

Financial instruments in stage 1 have their expected credit loss (ECL) measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Financial instruments in stages 2 or 3 have their ECL measured based on expected credit losses on a lifetime basis.

1. Accounting policies (continued)

Significant increase in credit risk

Retail financial services and secured personal lending

There are three main components to the staging criteria for the retail financial services and secured personal lending portfolios. In order to move from stage 1 to stage 2, a loan is required to meet at least one of the following criteria:

1. Forbearance activity;
2. PD grade deterioration over a predetermined threshold relative to the starting point; and
3. 30 days past due.

Loans are moved from stage 2 to stage 3 when they are credit impaired. Loans are considered to be credit impaired if they are 90 days past due or the borrower has been declared bankrupt.

Subject to the characteristics of the borrower, a loan will move back from stage 2 or 3 following a reversal of the criteria described above after completing a 6 (retail financial services) or 12 (secured personal lending) month probation period.

Commercial lending

There are two main components to the Commercial lending staging criteria. In order to move from stage 1 to stage 2 a loan is required to meet at least one of the following criteria:

1. Risk grade deterioration - all loans are assigned a risk grade between 1-10 based on a range of qualitative and quantitative factors. A risk grade deterioration of between 1 and 2 risk grades relative to the starting point will trigger a stage movement; and
2. 30 days past due.

Loans subject to forbearance are included in the Commercial lending model although forbearance does not automatically trigger a stage movement.

Loans are moved from stage 2 to stage 3 when they are credit impaired. Loans are considered to be credit impaired if they are 90 days past due or the borrowers risk grade has increased beyond a predetermined threshold, this is 1 risk grade for forbearance accounts and 2 risk grades otherwise.

Subject to the characteristics of the borrower, a loan will move back from stage 2 or 3 following a reversal of the criteria described above.

Expected Credit Loss Models

Expected credit losses are the discounted product of the Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD), defined as follows:

- PD is the likelihood of a borrower defaulting on its financial obligation either in the next 12 months or over the remaining lifetime of the obligation
- EAD is based on the amounts the group expects to be owed at the time of default
- LGD represents the group's expectation of the extent of loss on defaulted exposures

The calculation of PD is specific to each loan portfolio as set out opposite:

Portfolio	Approach to PD calculation
Retail financial services and secured personal lending	Calculated via a behavioural scorecard approach, using internal account level specific data including arrears history and external credit profile data provided by credit reference agencies.
Commercial Lending	Based on defined internal risk grading methodologies, using a combination of qualitative and quantitative measures including forward looking factors.

Treasury assets
Significant judgements included within the treasury assets expected credit loss model include the Credit Default Swaps (CDS) price and the haircut applied within the LGD model. Significant judgements are reviewed on an ongoing basis as part of the IFRS 9 model governance process or earlier where new treasury assets are acquired.

Asset class	Significant increase in credit risk	Expected credit loss model
Cash in hand and balances with the Bank of England	A significant increase in credit risk is deemed to have occurred if the credit rating of UK Treasury drops below investment grade. All balances with the Bank of England are in stage 1.	PDs for balances with the Bank of England are based on the CDS price of UK Treasury.
Loans and advances to credit institutions	A significant increase in credit risk is deemed to have occurred if the credit rating of the credit institution drops below investment grade. All loans and advances to credit institutions are in stage 1.	PDs for loans and advances to credit institutions are based on the CDS price of the credit institution.
Debt securities	A significant increase in credit risk is deemed to have occurred if the credit rating of the debt issuer drops below investment grade. All debt securities are in stage 1.	PDs for debt securities are based on historical default rate of comparable rate securities.

Forward-looking information in the ECL models
The assessment of SICR and the calculation of ECL both incorporate forward looking information. The group has performed historical analysis and identified the economic variables impacting credit risk and expected credit losses for each portfolio. Forecasts of these economic variables together with probability weightings are supplied by an external provider. Economic scenarios are selected which take account of a range of possible economic outcomes.

Loans and advances to credit institutions
Where swaps are not centrally cleared, the International Swaps and Derivatives Association (ISDA) Master Agreement is Principality's preferred agreement for documenting derivative activity. For certain counterparties a Credit Support Annex (CSA) has been executed in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between counterparties to mitigate the market contingent counterparty risk inherent in the outstanding positions.

1. Accounting policies (continued)

Derivative financial instruments and hedge accounting

The group undertakes transactions in derivative financial instruments, which include currency swaps, interest rate swaps, forward rate agreements, and similar instruments. The group's derivative activities are entered into for the purpose of matching or eliminating risk from potential movements in interest rates, foreign exchange rates and market indices inherent in the group's assets, liabilities and positions. All derivative transactions are for economic hedging purposes. Financial instruments are initially recognised at fair value.

i) Derivative financial instruments

Derivatives are initially measured at fair value and are subsequently re-measured to fair value at each reporting date with movements recorded in the income statement. Fair values are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations from counterparties. Fair values are calculated using mid-prices. All derivatives are classified as assets where their fair value is positive and liabilities where their fair value is negative. Where there is the legal ability and intention to settle net, the derivative is classified as a net asset or liability, as appropriate.

Where cash collateral is received, to mitigate the risk inherent in amounts due to the group, it is included as a liability within 'amounts owed to credit institutions'. Where collateral is given, to mitigate the risk inherent in amounts due from the group, it is included as an asset in 'loans and advances to credit institutions'.

ii) Embedded derivatives

Certain derivatives are embedded within other non-derivative host instruments to create a hybrid instrument. Where the economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and risk of the host instrument, the group separates the embedded derivative from the host instrument and measures it at fair value with the changes in fair value recognised in the income statement.

iii) Hedge accounting

When transactions meet the criteria specified in IAS 39, the group applies fair value hedge accounting so that changes in the fair value of the underlying asset or liability that are attributable to the hedged risk are recorded in the income statement to offset the fair value movement of the related derivative.

To qualify for hedge accounting at inception the hedge relationship must be clearly documented. At inception the derivative must be expected to be highly effective in offsetting the hedged risk, and effectiveness must be tested throughout the life of the hedge relationship. A hedge is considered to be highly effective if the changes in fair value or cash flows attributable to the hedged risk are expected to be offset by the hedging instrument in a range of 80% to 125%.

To calculate the changes in fair value of the hedged item attributable to the hedged risk, the group uses the hypothetical derivative method. The hypothetical derivative method involves establishing a notional derivative that would be the ideal hedging instrument for the hedged exposure (normally an interest rate swap or forward contract with no unusual terms and a zero fair value at inception of the hedge relationship). The fair value of the hypothetical derivative is then used as a proxy for the net present value of the hedged future cash flows against which changes in value of the actual hedging instrument are compared to assess effectiveness and measure ineffectiveness.

Within its risk management and hedging strategies, the group differentiates between macro and micro fair value hedging strategies, as set out below. In accordance with its hedging strategy, the group matches the principal of the hedging instruments to the principal of the hedged items, including prepayment expectations. The group uses pay fixed/receive floating interest rate swaps to hedge its fixed rate debt instruments and pay floating/receive fixed interest rate swaps to hedge its fixed rate liabilities.

Portfolio (macro) fair value hedges

The group applies macro fair value hedging to its fixed rate savings and mortgages. The group determines hedged items by identifying portfolios with homogenous characteristics based on their contractual interest rates, maturity and other risk characteristics. Loans or deposits within the identified portfolios are allocated to repricing time buckets based on expected, rather than contractual, repricing dates. The interest rate swaps are designated appropriately to those repricing time buckets. Hedge effectiveness is measured on a monthly basis, by comparing fair value movements of the designated proportion of the bucketed loans due to the hedged risk, against the fair value movements of the derivatives, to ensure that they are within an 80% to 125% range.

The aggregated fair value changes in the hedged loans are recognised as part of the fair value adjustment for hedged risk as detailed in note 15. At the end of every month, in order to minimise the ineffectiveness from early repayments and accommodate new exposures and regardless of the results of the retrospective hedge effectiveness testing, the group voluntarily de-designates the hedge relationships and re-designates them as new hedges. From the date of de-designation, the fair value hedge accounting adjustments are amortised on a straight-line basis over the original hedged life.

Micro fair value hedges

The group applies micro fair value hedging when the hedged item (or group of items) is a distinctively identifiable asset or liability hedged by one or a few hedging instruments. The financial instruments hedged for interest rate risk in a micro fair value hedge relationship are interest only fixed rate commercial lending mortgages. These hedge relationships are assessed for prospective and retrospective hedge effectiveness on a monthly basis. If the hedging instrument expires or is sold, terminated or exercised, or when the hedge no longer meets the criteria for hedge accounting, or the group decides to voluntarily discontinue the hedging relationship, the hedge relationship is discontinued prospectively. If the relationship does not meet the hedge effectiveness criteria, the group discontinues hedge accounting from the last date on which compliance with hedge effectiveness was demonstrated. If the hedge accounting relationship is terminated for an item recorded at amortised cost, the accumulated fair value hedge adjustment to the carrying amount of the hedged item is amortised over the remaining term of the original hedge. If the hedged item is derecognised, the unamortised fair value adjustment is recognised immediately in the income statement.

In a portfolio hedge, the adjustment is included in fair value adjustments for hedged risk. In the case of a micro hedge, the carrying value of the hedged item is adjusted for the change in value of the hedged risk.

The group discontinues hedge accounting when:

i) it is evident from testing that a derivative is not, or has ceased to be, highly effective as a hedge;

ii) the derivative expires, or is sold, terminated or exercised; or

iii) the underlying item matures or is sold or repaid.

1. Accounting policies (continued)

The group may also decide to cease hedge accounting even though the hedge relationship continues to be highly effective by ceasing to designate the financial instrument as a hedge. If the derivative no longer meets the criteria for hedge accounting, the cumulative fair value hedging adjustment is amortised over the period to maturity of the previously designated hedge relationship. If the underlying item is sold or repaid, the unamortised fair value adjustment is immediately reflected in the income statement.

Taxation

The tax expense represents the sum of the current tax charge and deferred tax movement.

The current tax charge is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

Deferred tax liabilities are defined as the amounts of income taxes payable in future periods in respect of taxable temporary differences. Deferred tax assets are defined as the amounts of income taxes recoverable in future periods. Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences. In contrast, deferred tax assets are only recognised to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised.

Both current and deferred tax balances are calculated using tax rates that have been enacted or substantively enacted by the date of the statement of financial position and are expected to apply to the period when the liability is settled or the asset is realised.

Leases

All leases entered into are recognised as a right of use asset and a corresponding lease liability on the date the leased asset is ready for use. Assets and liabilities arising from a lease are initially measured at the present value of the lease payments over the term of the lease. The lease payments are discounted using the interest rate implicit in the lease or, if that rate cannot be determined, the group's incremental borrowing rate is used.

The finance cost is charged to the income statement so as to produce a constant periodic rate of interest on the remaining balance of the lease liability for each period. The right of use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

Intangible assets

Computer software

IAS 38 'Intangible Assets' requires the capitalisation of certain expenditure relating to software development costs. Software development costs are capitalised if it is probable that the asset created will generate future economic benefits. Costs incurred to establish technological feasibility or to maintain existing levels of performance are recognised as an expense.

Web costs are capitalised where the expenditure is incurred on developing an income-generating website.

Where software costs are capitalised, they are amortised using the straight-line method over their estimated useful lives which is three to seven years. The amortisation periods used are reviewed annually.

Costs associated with maintaining software are expensed as they are incurred.

Investment properties, property, plant and equipment

Investment properties comprise parts of freehold properties that are not used in the business. These primarily include flats above branches and floors one to four of Principality Buildings in Queen Street, Cardiff which are used to generate rental income. Investment properties are stated at cost less accumulated depreciation and any provision for impairment.

Freehold and long leasehold properties comprise mainly branches and office buildings. Property, plant and equipment is stated at cost less accumulated depreciation and provision for impairment, as appropriate. Additions and subsequent expenditure are included in the asset's carrying value or are recognised as a separate asset only when they improve the expected future economic benefits to be derived from the asset. Valuations are completed annually by independent surveyors.

Properties in the course of construction for production, supply or administrative purposes, or for purposes not yet determined, are carried at cost, less any recognised impairment loss. Cost includes professional fees and, for qualifying assets, borrowing costs capitalised in accordance with the group's accounting policy. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

Land is not depreciated. Depreciation on other assets is provided using the straight-line method to allocate costs less residual values over estimated useful lives, as follows:

Freehold property (including investment properties)	2% - 4%
Leasehold property	2% or unexpired period of the lease
Major alterations to buildings	5% - 10%
Plant, equipment, fixtures and fittings	10% - 15%
Computer equipment	20% - 33%
Motor vehicles	25%

Residual values and useful lives of assets are reviewed, and adjusted if appropriate, at the date of each statement of financial position. Where the cost of freehold land can be identified separately from buildings, the land value is not depreciated. Fixed assets are subject to impairment testing and any impairment is recognised immediately in the income statement.

Gains and losses on disposal are determined by comparing the net disposal proceeds with the carrying amount of the asset and are included in the income statement.

Pension costs

The Society operates two pension schemes, a defined contribution scheme and a defined benefit scheme.

A defined contribution scheme is one into which the group and the employee pay fixed contributions, without any obligation to pay further contributions. Payments into the defined contribution scheme are charged to the income statement as they become payable in accordance with the rules of the scheme. The majority of the group's employees are members of this scheme.

A defined benefit scheme is one that defines the benefit an employee will receive on retirement, depending on such factors as age and length of service. Defined benefit pension scheme assets are measured using closing market values. Scheme liabilities are measured using the projected unit method and discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability. This scheme closed to future accruals on 31 July 2010.

1. Accounting policies (continued)

The expected return on the scheme's assets and the increase during the period in the present value of the scheme's liabilities, arising from the passage of time, are included in other operating income.

Actuarial gains and losses are recognised in full in the statement of other comprehensive income.

Qualifying insurance policies are reflected in plan assets at their fair value, which is defined as the present value of the related defined benefit obligations. The difference between the fair value of plan assets and the cost of the policy is treated as an actuarial loss which is recognised in full in the statement of other comprehensive income.

Segmental reporting

A business segment is defined as a group of assets and operations providing products and services that are subject to different risks and returns from the other business segments. The group considers that business segments are its primary reporting format for segmental analysis. Business segments are reported in a manner consistent with the internal reporting provided to the Board which has been identified as the chief operating decision maker.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including: cash and non-restricted balances with central banks, treasury bills and other eligible bills, loans and advances to banks, other amounts due from banks and short-term Government securities.

Provisions and contingent liabilities

A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will be settled and it can be reliably estimated. Where it is not probable that the obligation will be settled and/or it cannot be reliably estimated, a contingent liability is disclosed in the notes to the accounts.

Advertising and promotional costs

Advertising and promotional costs are expensed as incurred. Where payment has been made in advance of the rendering of the service or the delivery of goods, a prepayment is recognised. The costs are then recognised in the income statement on a straight line basis over the term of the contract.

Sale and repurchase agreements

Investment and other securities may be lent or sold subject to a commitment to repurchase them (a 'repo'). Such securities are retained on the statement of financial position when substantially all the risks and rewards of ownership remain within the group, and the counterparty liability is included separately on the statement of financial position as appropriate.

Similarly, where the group borrows or purchases securities subject to a commitment to resell them (a 'reverse repo') but does not acquire the risks and rewards of ownership, the transactions are treated as collateralised loans, and the securities are not included in the statement of financial position.

2. Judgements in applying accounting policies and critical accounting estimates

The preparation of these financial statements involves making judgements in the application of accounting policies which affect the amounts recognised. In addition, critical accounting estimates and assumptions are made that could have a significant impact on the reported amounts of assets and liabilities within the next financial year and beyond.

The critical judgements and the most significant areas where accounting estimates are made are as follows:

a) Critical judgements and sources of key estimation uncertainty

Significant increase in credit risk

As described in note 1 on page 114 one of the primary tests for determining whether a loan has experienced a significant increase in credit risk is Probability of Default (PD) grade deterioration over a predetermined threshold relative to the starting point, expressed as a percentage increase.

Management judgement is applied in determining the thresholds to use in the assessment. The aim of the approach is to allow for the movement of loans through the stages in sequential order, such that loans entering stage 3 and default should ordinarily be expected to originate from the stage 2 population.

Sensitivity analysis has been performed on the staging criteria. A 10% variance has been selected as this is deemed to be the maximum variation likely to occur over a 12 month period in the current economic environment. The impact of 10% of the loans currently in stage 1 moving to stage 2 and assigned an average non-arrears stage 2 PD and the impact of 10% of loans currently in stage 2 moving to stage 1 are as follows:

Stage	Retail financial services £m	Secured personal lending £m	Commercial lending £m
Stage 1 to stage 2	3.2	0.1	1.8
Stage 2 to stage 1	(0.7)	(0.1)	(0.1)

Retail IFRS 9 model changes
During 2022, changes have been made to the Retail IFRS 9 model. The fundamental change is a redevelopment of the Economic Response Model (ERM), which has resulted in changes to the Long Run Probability of Defaults (LRPD) used within the expected credit loss (ECL) calculations.

The introduction of the revised ERM model required the recalibration of significant increase in credit risk thresholds. The model includes an absolute LRPD threshold which prevents any customer with an LRPD of less than 3% from migrating to stage 2, unless the customer is in arrears. This captures 6,434 accounts, representing 8.2% of the total book, removal of the threshold would result in these customers moving from stage 1 to stage 2. Increasing the proportion of customers in stage 2 would not be reflective of the low risk nature of the Retail book.

These changes have resulted in an increase in modelled provisions of £2.3m.

Post model adjustment - refinance risk
The increase in the Bank of England base rate and impact on mortgage pricing is going to place additional affordability pressures on customers due to refinance within the next 12 months. With price inflation significantly higher than wage inflation certain customers may struggle to afford their mortgage repayments when their rate resets. In order to address this risk a group of 887 customers, based on credible evidence that they will be unable to afford their mortgage payments when they refinance and their payments increase, deemed most at risk has been identified. A Post Model Adjustment (PMA) of £2.9m has been applied and the customers have been moved into stage 2. Extending the refinance period to 18 months would increase the PMA by £1.7m.

Post model adjustment – cost of living
Record levels of inflation over the past 12 months has resulted in significant cost of living pressures and whilst total inflation is starting to fall food inflation remains high. These pressures are expected to continue into 2023 and there is a risk that this will result in increased levels of arrears and defaults that are not captured by the model. In response to this challenge data has been obtained from an external third party to estimate the potential impact on the Retail portfolio. This data has indicated that a group of 3,801 customers may be adversely impacted by key affordability metrics including food and fuel inflation. In order to capture the risk in relation to this group a PMA of £1.5m has been applied. The PMA is based on customers meeting three or more affordability indicators, reducing to two indicators will increase the PMA by £2.7m, increasing to four indicators will reduce the PMA by £0.7m.

2. Judgements in applying accounting policies and critical accounting estimates (continued)

Industry weightings alignment

The governance and review of economic data used within the IFRS 9 models includes a peer benchmarking exercise, whilst the economic forecasts benchmark consistently with peers the peer benchmarking exercise identified an element of optimism within the weightings used (as shown on page 143), particularly given the likelihood that the UK is heading into a recession. In order to ensure a closer allignment to peers a PMA of £2.5m has been applied across all three portfolios based on the impact of recalculating modelled provisions using industry average weightings. The increase is driven by an increase in the level of weightings applied to downturn scenarios from 30% to 41%.

b) Significant accounting estimates

Impairment provision on loans and advances

The significant accounting estimates applied in determining expected credit loss provisions are forward looking UK macro-economic variables and the number and probability weightings of macro-economic scenarios used. Further information is included in note 19.

Retirement benefit obligations

The group has to make significant estimations in relation to the assumptions on the mortality and inflation when valuing its pension liability and the cost of benefits provided. Changes in these assumptions would change the reported liability, service cost and expected return on pension plan assets. Further information is included in note 12.

3. Business segments

The group operates three main business segments: retail financial services, commercial lending and secured personal lending. These segments are used for internal reporting to the Board which is responsible for all significant decisions. Transactions between the business segments are on normal commercial terms and conditions. All items relate to continuing operations.

	2022			
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Total £m
Net interest income	128.8	17.8	7.3	153.9
Other income & charges	3.3	1.5	-	4.8
Fair value gain	5.8	-	-	5.8
Net operating income	**137.9**	**19.3**	**7.3**	**164.5**
Operating expenses	(96.6)	(2.8)	(0.8)	(100.2)
Impairment provision for losses on loans & advances	(7.7)	(6.3)	(0.8)	(14.8)
Provision for liabilities	0.1	-	(0.3)	(0.2)
Operating profit and profit before taxation	**33.7**	**10.2**	**5.4**	**49.3**
Taxation expense				(11.6)
Profit after taxation				**37.7**

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	2021			
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Total £m
Net interest income	106.6	14.4	8.2	129.2
Other income & charges	1.5	1.4	-	2.9
Fair value gain	9.6	-	-	9.6
Net operating income	**117.7**	**15.8**	**8.2**	**141.7**
Operating expenses	(89.8)	(2.6)	(0.7)	(93.1)
Impairment provision for losses on loans & advances	3.8	9.2	2.4	15.4
Provision for liabilities	0.6	-	(0.6)	-
Operating profit and profit before taxation	**32.3**	**22.4**	**9.3**	**64.0**
Taxation expense				(15.2)
Profit after taxation				**48.8**

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

	Group	
	2022 £m	2021 £m
Total assets by business segments		
Retail financial services	10,436.5	10,008.5
Commercial lending	738.8	774.9
Secured personal lending	82.0	124.5
Total assets	**11,257.3**	**10,907.9**
Total liabilities & equity by business segment		
Retail financial services & Commercial lending	11,175.3	10,783.4
Secured personal lending	82.0	124.5
Total liabilities & equity	**11,257.3**	**10,907.9**

Retail financial services and commercial lending are part of the same legal entity and liabilities are not shown for each business segment for internal reporting purposes.

4. Interest receivable and similar income

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
On loans fully secured on residential property	219.8	213.1	212.5	203.5
On other loans	10.6	9.9	10.6	9.9
On loans to subsidiaries	-	-	-	1.4
On debt securities	2.1	0.8	2.1	0.8
On other liquid assets	21.6	1.5	21.6	1.5
On derivative financial instruments	30.5	(26.6)	30.6	(26.6)
	284.6	**198.7**	**277.4**	**190.5**

5. Interest payable and similar charges

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
On shares held by individuals	89.6	58.7	89.6	58.7
On deposits and debt securities	36.7	14.6	31.6	18.8
On lease liabilities	0.3	0.3	0.2	0.2
On derivative financial instruments	4.1	(4.1)	9.3	(8.2)
	130.7	**69.5**	**130.7**	**69.5**

6. Fees and commission receivable

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Insurance & related financial service products	0.7	0.9	0.7	0.9
Mortgage related administration fees	3.2	3.0	3.2	3.0
	3.9	**3.9**	**3.9**	**3.9**

7. Dividends

Income from investments of £47.0m (2021: £nil) relates to a dividend paid, at £470 per share, during the year from Nemo Personal Finance Limited to Principality Building Society. As Nemo is a wholly owned subsidiary of Principality Building Society the income is reduced to nil within the group accounts upon consolidation.

8. Other fair value gains and losses

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Gains on derivatives in hedging relationships	245.1	107.0	245.1	107.0
Gains/(losses) on derivatives not in hedging relationships	0.2	2.3	(29.5)	(8.1)
Gains on derivatives	**245.3**	**109.3**	**215.6**	**98.9**
(Losses)/gains on economic hedged items	(6.0)	5.9	(6.0)	5.9
Losses on hedged items attributable to the hedged risk	(233.5)	(105.6)	(233.5)	(105.6)
Losses on hedged items	**(239.5)**	**(99.7)**	**(239.5)**	**(99.7)**
	5.8	**9.6**	**(23.9)**	**(0.8)**

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.

9. Administrative expenses

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Wages and salaries	45.5	41.4	45.5	41.4
Social security costs	4.1	3.7	4.1	3.7
Other pension costs	2.6	2.5	2.6	2.5
	52.2	**47.6**	**52.2**	**47.6**
Other administrative expenses	36.2	32.2	35.4	31.5
	88.4	**79.8**	**87.6**	**79.1**

	Group		Society	
	2022 £000	2021 £000	2022 £000	2021 £000
Other administrative expenses include:				
Auditor's remuneration				
For audit of the Society's Annual Accounts	610.2	524.0	610.2	524.0
For audit of the Society's subsidiaries	106.4	101.0	-	-
Total	716.6	625.0	610.2	524.0
For other services				
Further assurance services (interim review and treasury related assurance services)	78.5	65.0	78.5	65.0
Total other services	78.5	65.0	78.5	65.0

Auditor's remuneration is stated exclusive of value-added tax.

10. Employees

The average number employed including Executive Directors was:

	Full-time		Part-time	
	2022 Number	2021 Number	2022 Number	2021 Number
Society's head office	714	675	124	125
Society branches	183	185	136	119
Employed by the group	**897**	**860**	**260**	**244**

11. Emoluments of the Society's Directors

Directors' emoluments are shown as part of the Report of the Remuneration Committee in accordance with Schedule 5, paragraphs 4 and 5 to the Building Societies (Accounts and Related Provisions) Regulations 1998. Total Directors' emoluments for the year were £1.6m (2021: £1.9m).

12. Retirement benefit obligations

The group operates two pension schemes, a defined contribution scheme and a defined benefit scheme.

Defined contribution scheme

The group operates a defined contribution scheme, the Group Flexible Retirement Plan (GFRP). A defined contribution scheme is one into which the group and the employee pay contributions, without any obligation to pay further contributions. Staff employed after 1 January 2001 and those staff who were formerly members of the defined benefit scheme are eligible to join this scheme. The cost to the group and Society of employer's contributions (before salary sacrifice arrangements) to the scheme in 2022 was £2.8m (2021: £2.5m). There were no contributions outstanding or prepaid at the end of the year.

Defined benefit scheme

A defined benefit scheme is one that defines the benefit an employee will receive on retirement, depending on such factors as age, length of service and salary. Staff, including Executive Directors, who entered service before 1 January 2001 were eligible to join the Society's Defined Benefit Scheme which is designed to provide pension entitlements based on career average salary (final salary until 31 December 2005) with assets held outside the Society in a separate fund administered by the Trustees of the pension fund. Membership of the scheme is, however, available at the discretion of the Society, and a small number of new members have been admitted to the scheme on this basis subsequent to 1 January 2001.

The defined benefit scheme was subject to a triennial valuation by the scheme's independent actuary on 30 September 2019. This valuation was completed in October 2020. The next triennial valuation at the 30 September 2022 is underway with the valuation expected to be completed later in 2023.

The defined benefit scheme closed to future accruals on 31 July 2010 and was replaced with an enhanced defined contribution scheme, the GFRP, described in the above section.

During 2012, the Trustees of the defined benefit scheme agreed a buy in of the pensioner element of the scheme with Legal & General Assurance Society Limited. The buy in involved the purchase of a bulk annuity policy by the scheme under which Legal & General assumed full responsibility for the benefits payable to the scheme's current pensioners. The buy in took effect from September 2012. The pensioner liability and the matching annuity policy remain within the scheme.

No contributions were paid to the pension scheme by the Society in 2022 (2021: £1.7m). There aren't any committed contributions to be paid by the Society in 2023. The Society may, however, pay additional amounts at any time.

Scheme management consists of a Board of Trustees, comprising four individuals, three of which are Society Nominated Trustees and one Member Nominated Trustee. The power of appointment and removal of the Trustees is vested in the Society in accordance with the Trust Deed.

The Trustees have continued to act in accordance with the Statement of Investment Principles adopted on 6 December 2013 as required by Section 35 of the Pensions Act 1995. The scheme's investment assets, excluding the insured assets which are held by Legal and General Assurance, are held under a Fiduciary Management arrangement with Legal and General Investment Management (LGIM). Under the Fiduciary Management agreement, the Trustees make the key strategic decisions relating to the scheme's investments (after taking appropriate advice), and have appointed LGIM as the Fiduciary Manager, giving LGIM discretion over the implementation and day-to-day management of the scheme's investments. Barnett Waddingham are engaged to provide oversight on the Fiduciary Manager.

The Society also funds the cost of life assurance cover for staff members, and provides unfunded pensions directly to certain Directors and employees who retired prior to 1997.

The cumulative amount of actuarial losses recognised in other comprehensive income since the date of transition to IFRS is £37.0m (2021: £32.8m).

The major assumptions used for the purpose of the actuarial valuation were as follows:

	At 31 December				
	2022 %	2021 %	2020 %	2019 %	2018 %
Rate of increase of pensions in payment:					
CPI 3%	2.00	2.40	2.10	1.95	2.25
CPI 5%	2.60	2.80	2.40	2.15	-
CPI 3% fixed	-	-	3.00	-	-
Discount rate	4.70	1.80	1.30	2.00	2.80
Inflation assumption (RPI)	3.20	3.35	2.95	3.00	3.20
Inflation assumption (CPI)	2.65	2.80	2.40	2.15	2.20

The assumptions used for the valuation at 31 December 2022 take into account the estimated impact of the RPI reforms from 2030 and will be reviewed at least annually as more information becomes available.

12. Retirement benefit obligations (continued)

The assumptions on mortality are determined by the following tables:

	2022	2021
Retired and non-retired members	S3NA CMI 2021 LTR 1.25%	S3NA CMI 2020 LTR 1.25%
The assumptions are illustrated by the following years of life expectancy at age 60:		
Retired Members		
Males currently aged 60	26.5	26.7
Females currently aged 60	29.3	29.5
Non-retired Members		
Males currently aged 40	27.9	28.1
Females currently aged 40	30.8	30.9

The retirement benefit obligation relating to the scheme recognised in the statement of financial position is made up as follows:

	At 31 December				
	2022 £m	2021 £m	2020 £m	2019 £m	2018 £m
Target return funds	-	-	-	-	-
Multi asset	18.2	46.7	40.2	36.5	29.0
LDI	12.7	9.6	11.7	8.5	6.7
Annuities	17.6	24.7	26.0	25.5	23.9
Bonds and cash	1.1	3.7	4.8	3.8	3.4
Total fair value of plan assets	**49.6**	**84.7**	**82.7**	**74.3**	**63.0**
Present value of funded obligations	(50.0)	(81.0)	(84.9)	(73.8)	(66.4)
Present value of unfunded obligations	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)
Net (deficit)/surplus recognised in the statement of financial position	**(0.9)**	**3.2**	**(2.7)**	**-**	**(3.9)**

During the year, the pension scheme surplus switched to a deficit at the end of the year, primarily as a result of lower than expected returns on plan assets and an actuarial loss on financial assumptions.

The actual loss on plan assets was £32.2m during the year (2021: £3.6m gain).

The amounts recognised in the income statement are as follows:

	Group and Society	
	2022 £m	2021 £m
Analysis of the amounts recognised in the income statement		
Interest on pension scheme assets	(1.5)	(1.1)
Interest on pension scheme liabilities	1.4	1.1
Net interest expense	**(0.1)**	**-**
Past service cost	-	-
Total amount recognised in the income statement	**(0.1)**	**-**
Analysis of amount recognised in statement of other comprehensive income		
Gain on scheme assets in excess of interest	(33.8)	2.5
Experience losses on liabilities	(3.0)	(0.1)
Gains from changes to demographic assumptions	0.7	0.2
Gains from changes to financial assumptions	31.9	1.7
Total remeasurement	**(4.2)**	**4.3**
Analysis of the movement in the statement of financial position deficit		
Deficit in scheme at beginning of year	3.2	(2.7)
Movement in year:		
Net interest expense	0.1	-
Remeasurements	(4.2)	4.3
Contributions paid and accrued	-	1.6
Past service cost	-	-
(Deficit)/surplus in scheme at end of year	**(0.9)**	**3.2**
Analysis of the movement in the fair value of pension scheme assets		
Fair value of assets at the beginning of the year	84.8	82.7
Interest on assets	1.5	1.1
Society contributions	-	1.7
Benefits paid	(3.0)	(3.3)
Return on plan assets less interest	(26.6)	3.8
Change in fair value of the annuity policy	(7.1)	(1.3)
Fair value of assets at the end of the year	**49.6**	**84.7**
Analysis of the movement in the present value of the pension scheme liabilities		
Present value of liabilities at the beginning of the year	81.5	85.4
Interest expense	1.5	1.1
Remeasurement losses/(gains):		
Actuarial gains & losses arising from changes in demographic assumptions	(0.7)	(0.2)
Actuarial gains & losses arising from changes in financial assumptions	(31.9)	(1.7)
Actuarial gains & losses arising from experience adjustments	3.0	0.1
Benefits paid	(2.9)	(3.2)
Past service cost	-	-
Present value of liabilities at the end of the year	**50.5**	**81.5**

12. Retirement benefit obligations (continued)

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 taking into account the change in the value of both the scheme's liabilities and the bulk annuity contract. No allowance has been made for any changes to the non-insured asset values. The weighted average duration of the liabilities is 18 years and the duration of insured pensioners is estimated to be around 10 years.

	Group and Society	
	Increase 0.5% £m	Decrease 0.5% £m
Discount rate	(3.3)	3.3
Inflation	2.5	(2.5)
Life expectancy (+1 year/-1 year)	1.4	(1.4)

Sensitivities of 0.5% have been used to reflect a significant but reasonably likely market event that causes a one off shock to the actuarial assumptions. The sensitivity analysis above may not be representative of the actual change in the scheme liabilities as it is unlikely that the change in assumptions would occur in isolation of one another, some of the assumptions may be correlated.

13. Taxation

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Current tax				
UK corporation tax charge for the year	4.0	12.2	3.1	10.5
Adjustments in respect of prior years	(0.1)	0.5	(0.1)	0.6
	3.9	12.7	3.0	11.1
Deferred tax				
Deferred tax charge for year	8.1	2.4	8.1	2.4
Adjustments in respect of prior years	(0.4)	0.1	(0.4)	0.1
	7.7	2.5	7.7	2.5
Taxation expense	**11.6**	**15.2**	**10.7**	**13.6**

The statutory rate of corporation tax has remained at 19% during 2022 and is increasing to 25% in April 2023.

The actual tax charge for the year differs from that calculated using the statutory rate of corporation tax in the UK. The differences are explained below:

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Profit before taxation	49.3	64.0	61.5	44.4
Profit multiplied by the statutory rate of corporation tax at 19.0% (2021: 19.0%)	9.4	12.2	11.7	8.4
Effects of:				
Impact of banking surcharge at 8.0%	-	1.5	-	1.5
Impact of rate change	1.7	0.9	1.7	0.9
Expenses not deductible for tax purposes	0.9	-	(7.9)	0.1
Adjustments to prior years	(0.4)	0.6	(0.5)	0.7
Timing differences	-	-	5.7	2.0
Taxation on profit from ordinary activities	**11.6**	**15.2**	**10.7**	**13.6**

In addition to the amount charged to the income statement, the following amounts relating to tax have been recognised in other comprehensive income:

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Current tax				
Relating to retirement benefit obligations	-	(0.3)	-	(0.3)
	-	(0.3)	-	(0.3)
Deferred tax				
Relating to retirement benefit obligations	(1.0)	1.3	(1.0)	1.3
Gain on fair value through other comprehensive income	(0.7)	-	(0.7)	-
	(1.7)	1.3	(1.7)	1.3
Total charged to other comprehensive income	**(1.7)**	**1.0**	**(1.7)**	**1.0**

14. Loans and advances to credit institutions

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Loans and advances to credit institutions	277.1	165.8	180.4	93.7

Included in the above amount for the group is £177.5m of collateral given under Credit Support Annex (CSA) agreements (2021: £76.7m).

15. Debt securities

	Group and Society	
	2022 £m	2021 £m
Issued by other borrowers and unlisted	112.1	26.1
Issued by Supranational entities	48.1	50.2
	160.2	**76.3**

Debt securities are held at fair value through other comprehensive income.

The movement in debt securities is summarised as follows:

	Group and Society	
	2022 £m	2021 £m
At 1 January	76.3	78.7
Additions	101.5	8.7
Disposals and maturities	(14.8)	(10.7)
Losses from changes in fair value	(2.8)	(0.4)
At 31 December	**160.2**	**76.3**

16. Derivative financial instruments

The group undertakes transactions in derivative financial instruments, which include currency swaps, interest rate swaps, forward rate agreements and similar instruments. These are commitments to exchange one set of cash flows for another. No exchange of principal takes place.

The group only enters into derivative contracts for risk management purposes, as explained in note 1. Derivatives held for risk management purposes include hedges that either meet the hedge accounting requirements or hedges that are economic hedges, but do not meet the hedge accounting requirements. The table below shows the fair values of derivative financial instruments recorded as assets or liabilities together with their notional amounts. The notional amount is recorded gross and is the quantity of the derivative contracts' underlying instrument. The notional amounts indicate the volume of transactions outstanding at the year end and are not indicative of either the market or credit risk.

	Group			
	Contract/notional amount		Fair Value	
	2022 £m	2021 £m	2022 £m	2021 £m
Derivative assets:				
Interest rate swaps	6,122.4	3,282.6	369.0	52.8
Total recognised derivative assets	**6,122.4**	**3,282.6**	**369.0**	**52.8**
Derivative liabilities:				
Interest rate swaps	1,589.9	2,755.4	63.6	24.7
Total recognised derivative liabilities	**1,589.9**	**2,755.4**	**63.6**	**24.7**

	Society			
	Contract/notional amount		Fair Value	
	2022 £m	2021 £m	2022 £m	2021 £m
Derivative assets:				
Interest rate swaps	5,289.1	3,560.7	333.4	50.1
Total recognised derivative assets	**5,289.1**	**3,560.7**	**333.4**	**50.1**
Derivative liabilities:				
Interest rate swaps	2,423.3	3,157.9	63.6	23.8
Total recognised derivative liabilities	**2,423.3**	**3,157.9**	**63.6**	**23.8**

Derivative financial instruments held or issued for hedging purposes

The group uses derivatives for economic hedging purposes as part of its asset and liability management in order to reduce its exposure to market risks by hedging specific financial instruments. Where possible, the group applies hedge accounting. The accounting treatment explained in note 1 depends on the nature of the item hedged and compliance with the IAS 39 hedge accounting criteria.

Derivatives in economic hedge relationships

Included in this classification are any derivatives entered into by the group in order to economically hedge its exposures for risk management purposes that are not designated in hedge relationships as they do not meet the IAS 39 hedge accounting criteria.

This table shows the split of derivatives between those in a fair value hedge relationship and those in an economic hedge relationship, this has been further split by derivative assets and liabilities.

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Derivatives				
Total derivatives in economic hedge relationships				
Interest rate swaps	260.0	266.2	1,093.3	946.8
Total derivatives used as fair value hedges				
Interest rate swaps	6,619.1	5,771.8	6,619.1	5,771.8
Derivative assets in economic hedge relationships				
Interest rate swaps	143.0	200.7	143.0	200.7
Derivative assets used as fair value hedges				
Interest rate swaps	5,146.1	3,081.9	5,146.1	3,360.0
Derivative liabilities in economic hedge relationships				
Interest rate swaps	117.0	65.5	117.0	65.5
Derivative liabilities used as fair value hedges				
Interest rate swaps	1,472.9	2,689.9	2,306.3	3,092.4

16. Derivative financial instruments (continued)

The table below shows the breakdown of the fair value movement in the underlying hedged items between micro, macro and economic hedge relationships.

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Fair value hedges				
Micro hedges				
Commercial loans	112.0	104.1	112.0	104.1
Wholesale	300.0	300.0	300.0	300.0
FV adjustment on hedged item (asset)	24.0	8.1	24.0	8.1
FV adjustment on hedged item (liability)	(8.9)	(8.9)	(8.9)	(8.9)
Macro hedges				
Residential and commercial loans	5,167.3	4,670.0	5,167.3	4,670.0
Retail savings	952.3	680.9	952.3	680.9
FV adjustment on hedged item (asset)	221.6	111.8	221.6	111.8
FV adjustment on hedged item (liability)	(3.2)	(5.4)	(3.2)	(5.4)
Other underlying adjustments				
Amortisation/unwinds	6.0	(5.6)	6.0	(5.6)

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Hedging strategy outcome				
Micro hedge – asset				
Commercial loans – hedged items	24.0	8.1	24.0	8.1
Commercial loans – hedged instruments	(26.7)	(6.5)	(26.7)	(6.5)
Micro hedge – liability				
Wholesale – hedged items	(8.9)	(8.9)	(8.9)	(8.9)
Wholesale – hedged instruments	8.8	8.9	8.8	8.9
Macro hedge – asset				
Residential and commercial loans – hedged items	221.6	111.8	221.6	111.8
Residential and commercial loans – hedged instruments	(235.4)	(114.8)	(235.4)	(114.8)
Macro hedge – liability				
Retail savings – hedged items	(3.2)	(5.4)	(3.2)	(5.4)
Retail savings – hedged instruments	8.3	5.4	8.3	5.4
Economic hedge items				
Amortisation/unwinds	6.0	(5.9)	6.0	(5.9)
Economic hedge instruments				
Dedesignation	–	(0.3)	–	(0.3)
Economic hedges – awaiting designation	0.4	(1.9)	0.4	(1.9)
Economic hedges – securitisation	–	–	29.8	10.4

The Society's fair value gains and losses shown in the table above are split by hedge relationship type and whether the fair value movement was related to an asset or a liability.

The group and Society's derivatives are shown in the table below based on their remaining term to maturity and subsequently by their hedge relationship.

Group As at 31 December 2022	Less than 1 month £m	Between 1 month and 3 months £m	Between 3 months and 12 months £m	Between 1 year and 5 years £m	More than 5 years £m	Total £m
Fair value hedges – derivatives						
Micro hedge						
Commercial interest rate swaps	–	2.8	9.7	39.8	156.7	209.0
EMTN interest rate swaps	–	–	300.0	–	–	300.0
Macro hedge						
Retail mortgages interest rate swaps	70.0	160.0	1,306.0	3,431.0	123.0	5,090.0
Commercial interest rate swaps	–	–	6.0	15.8	43.3	65.1
Savings interest rate swaps	25.0	25.0	655.0	250.0	–	955.0
Economic hedges						
Retail mortgages interest rate swaps	–	–	–	105.0	33.0	138.0
Commercial interest rate swaps	–	–	–	–	7.0	7.0
Savings interest rate swaps	–	–	20.0	95.0	–	115.0
	95.0	**187.8**	**2,296.7**	**3,936.6**	**363.0**	**6,879.1**

Society As at 31 December 2022	Less than 1 month £m	Between 1 month and 3 months £m	Between 3 months and 12 months £m	Between 1 year and 5 years £m	More than 5 years £m	Total £m
Fair value hedges – derivatives						
Micro hedge						
Commercial interest rate swaps	–	2.8	9.7	39.8	156.7	209.0
EMTN interest rate swaps	–	–	300.0	–	–	300.0
Macro hedge						
Retail mortgages interest rate swaps	70.0	160.0	1,306.0	3,431.0	123.0	5,090.0
Commercial interest rate swaps	–	–	6.0	15.8	43.3	65.1
Savings interest rate swaps	25.0	25.0	655.0	250.0	–	955.0
Economic hedges						
Retail mortgages interest rate swaps	–	–	–	105.0	33.0	138.0
Commercial interest rate swaps	–	–	–	–	7.0	7.0
Savings interest rate swaps	–	–	20.0	95.0	–	115.0
Securitisation interest rate swaps	–	–	–	833.3	–	833.3
	95.0	**187.8**	**2,296.7**	**4,769.9**	**363.0**	**7,712.4**

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16. Derivative financial instruments (continued)

Group As at 31 December 2021	Less than 1 month £m	Between 1 month and 3 months £m	Between 3 months and 12 months £m	Between 1 year and 5 years £m	More than 5 years £m	Total £m
Fair value hedges – derivatives						
Micro hedge						
Commercial interest rate swaps	–	2.2	11.1	30.4	72.7	116.4
PIBS & EMTN interest rate swaps	–	–	–	300.0	–	300.0
Macro hedge						
Retail mortgages interest rate swaps	21.0	213.0	992.0	3,294.0	65.0	4,585.0
Commercial interest rate swaps	–	–	29.2	20.9	41.2	91.3
Savings interest rate swaps	25.0	7.0	500.0	150.0	–	682.0
Economic hedges						
Retail mortgages interest rate swaps	–	–	–	67.0	125.0	192.0
Commercial interest rate swaps	–	–	–	–	21.3	21.3
Savings interest rate swaps	–	–	–	50.0	–	50.0
	46.0	**222.2**	**1,532.3**	**3,912.3**	**325.2**	**6,038.0**

Society As at 31 December 2021	Less than 1 month £m	Between 1 months and 3 months £m	Between 3 months and 12 months £m	Between 1 year and 5 years £m	More than 5 years £m	Total £m
Fair value hedges – derivatives						
Micro hedge						
Commercial interest rate swaps	–	2.2	11.1	30.4	72.7	116.4
PIBS & EMTN interest rate swaps	–	–	–	300.0	–	300.0
Macro hedge						
Retail mortgages interest rate swaps	21.0	213.0	992.0	3,294.0	65.0	4,585.0
Commercial interest rate swaps	–	–	29.2	20.9	41.2	91.3
Savings interest rate swaps	25.0	7.0	500.0	150.0	–	682.0
Economic hedges						
Retail mortgages interest rate swaps	–	–	–	67.0	125.0	192.0
Commercial interest rate swaps	–	–	–	–	21.3	21.3
Savings interest rate swaps	–	–	–	50.0	–	50.0
Securitisation interest rate swaps	–	–	162.7	517.9	–	680.6
	46.0	**222.2**	**1,695.0**	**4,430.2**	**325.2**	**6,718.6**

17. Loans and advances to customers

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Fully secured on residential property	8,803.4	8,637.2	8,720.9	8,528.0
Fully secured on land	299.2	285.1	299.3	285.1
	9,102.6	**8,922.3**	**9,020.2**	**8,813.1**
Provision for impairment losses	(31.9)	(17.8)	(28.2)	(14.7)
Effective Interest Rate adjustments	12.7	13.5	11.4	11.2
Fair value adjustment for hedged risk	(288.4)	(34.7)	(288.5)	(34.7)
	8,795.0	**8,883.3**	**8,714.9**	**8,774.9**

Retail financial services & secured personal lending

The split of loans between stages 1, 2 and 3 is as follows:

Stage	31 December 2022 %	31 December 2021 %
1	81	86
2	18	13
3	1	1

The split of the loans within stage 2 by staging reason is as follows:

Staging reason	31 December 2022 %	31 December 2021 %
PD grade deterioration	97	96
30-60 days past due	3	4
Forbearance	-	-

Commercial

The split of loans between stages 1, 2 and 3 is as follows:

Stage	31 December 2022 %	31 December 2021 %
1	89	89
2	10	10
3	1	1

The split of the loans within stage 2 by staging reason is as follows:

Staging reason	31 December 2022 %	31 December 2021 %
Risk grade deterioration	100	99
30-60 days past due	-	1

18. Asset encumbrance

The wholesale funding initiatives of the group require that, from time to time, certain assets become encumbered as collateral against such funding. Assets that have been utilised in this way cannot be used for other purposes. The group's principal forms of encumbrance relate to secured funding transactions and third party sale and repurchase agreements, with encumbrance also arising from excess collateral balances and cash collateral posted. As at 31 December 2022, the encumbrance ratio was 22.0% (31 December 2021: 21.7%). All other assets are defined as unencumbered.

An analysis of the group's encumbered and unencumbered on-balance sheet assets as at 31 December 2022 and 2021 is set out below.

	2022		2021	
	Encumbered £m	Unencumbered £m	Encumbered £m	Unencumbered £m
Cash in hand & balances at the Bank of England	-	1,566.9	-	1,645.8
Loans and advances to credit institutions	273.9	3.2	76.6	89.2
Debt securities	-	160.2	-	76.3
Derivative financial instruments	-	369.0	-	52.8
Loans and advances to customers	2,109.2	6,685.8	2,291.1	6,592.2
Other assets	-	89.1	-	83.9
Total	**2,383.1**	**8,874.2**	**2,367.7**	**8,540.2**

19. Provision for impairment losses

Group 2022	Retail £m	Commercial lending £m	Secured personal lending £m	Total £m
New loans	2.7	2.7	-	5.4
Settled loans	(1.1)	(1.6)	(0.3)	(3.0)
Changes in model assumptions	2.1	-	-	2.1
Changes in credit quality	3.9	5.3	0.9	10.1
Balance sheet impact	**(7.6)**	**(6.4)**	**(0.6)**	**(14.6)**
(Utilisation)/recoveries	**(0.1)**	**-**	**(0.1)**	**(0.2)**
Income statement impact	**(7.7)**	**(6.4)**	**(0.7)**	**(14.8)**

Group 2021	**Retail £m**	**Commercial lending £m**	**Secured personal lending £m**	**Total £m**
New loans	0.8	1.4	-	2.2
Settled loans	(1.7)	(3.7)	(0.6)	(6.0)
Changes in model assumptions	(1.7)	-	-	(1.7)
Changes in credit quality	(1.7)	(7.0)	(2.2)	(10.9)
Balance sheet impact	**4.3**	**9.3**	**2.8**	**16.4**
(Utilisation)/recoveries	**(0.5)**	**(0.1)**	**(0.4)**	**(1.0)**
Income statement impact	**3.8**	**9.2**	**2.4**	**15.4**

Provision for impairment losses at 31 December 2022 include £31.9m for loan loss provisioning impairment (2021: £17.8m) and £1.6m on other debt instruments (2021: £1.1m). Total ECL coverage as at 31 December 2022 was 0.22% (2021: 0.14%) in respect of retail financial services and secured personal lending and 1.36% in respect of commercial lending (2021: 0.72%). Changes in model assumptions for 2022 include the model changes and PMAs discussed in note 2.

Also included within provision for impairment losses is £1.3m (2021: £0.4m) in respect of provisions against off-balance sheet exposures, namely retail mortgage offers and loan commitments contracted but not paid across the retail and commercial loan books.

The following tables analyse the movements in gross loan balances during the year by stage. The difference between gross loan balances shown in the tables below and loans and advances to customers as per the balance sheet relates to commitments and undrawn balances. New loans are those advanced in the year and their subsequent stage movements during the course of the year.

Group 2022	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2022	8,063.2	1,189.0	67.0	9,319.2
Transfers:				
Stage 1 transfers	(481.2)	-	-	(481.2)
Stage 2 transfers	-	470.3	-	470.3
Stage 3 transfers	-	-	10.9	10.9
New loans	2,018.0	190.3	0.4	2,208.7
Settled loans	(1,324.0)	(154.7)	(11.6)	(1,490.3)
Repayments	(264.0)	(36.6)	(1.6)	(302.2)
Gross loan balance at 31 December 2022	**8,012.0**	**1,658.3**	**65.1**	**9,735.4**

Society 2022	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2022	8,006.2	1,151.2	53.0	9,210.4
Transfers:				
Stage 1 transfers	(475.6)	-	-	(475.6)
Stage 2 transfers	-	463.5	-	463.5
Stage 3 transfers	-	-	12.1	12.1
New loans	2,018.0	190.3	0.4	2,208.7
Settled loans	(1,314.3)	(149.5)	(9.8)	(1,473.6)
Repayments	(257.8)	(33.5)	(0.8)	(292.1)
Gross loan balance at 31 December 2022	**7,976.5**	**1,622.0**	**54.9**	**9,653.4**

19. Provision for impairment losses (continued)

Group 2021	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2021	8,290.4	1,236.3	71.3	9,598.0
Transfers:				
Stage 1 transfers	46.9	-	-	46.9
Stage 2 transfers	-	(59.6)	-	(59.6)
Stage 3 transfers	-	-	12.7	12.7
New loans	1,110.2	192.6	0.5	1,303.3
Settled loans	(1,101.9)	(139.5)	(15.8)	(1,257.2)
Repayments	(282.4)	(40.8)	(1.7)	(324.9)
Gross loan balance at 31 December 2021	**8,063.2**	**1,189.0**	**67.0**	**9,319.2**

Society 2021	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2021	8,203.6	1,196.6	56.2	9,456.4
Transfers:				
Stage 1 transfers	54.6	-	-	54.6
Stage 2 transfers	-	(66.0)	-	(66.0)
Stage 3 transfers	-	-	11.4	11.4
New loans	1,110.2	192.6	0.5	1,303.3
Settled loans	(1,087.7)	(134.3)	(14.2)	(1,236.2)
Repayments	(274.5)	(37.7)	(0.9)	(313.1)
Gross loan balance at 31 December 2021	**8,006.2**	**1,151.2**	**53.0**	**9,210.4**

The following tables analyse the movements in loan loss provisions during the year by stage.

Group 2022	Stage 1 12 month ECL £m	Stage 2 Lifetime ECL £m	Stage 3 Lifetime ECL £m	Total £m
At 1 January 2022	3.1	8.9	5.8	17.8
Transfers:				
Stage 1 transfers	(3.6)	-	-	(3.6)
Stage 2 transfers	-	2.5	-	2.5
Stage 3 transfers	-	-	1.2	1.2
New loans	3.5	2.0	-	5.5
Settled loans	(0.5)	(1.7)	(0.9)	(3.1)
Changes in credit quality	9.4	0.1	-	9.5
Changes in model assumptions	2.6	(0.5)	-	2.1
Loss allowance at 31 December 2022	**14.5**	**11.3**	**6.1**	**31.9**

Society 2022	Stage 1 12 month ECL £m	Stage 2 Lifetime ECL £m	Stage 3 Lifetime ECL £m	Total £m
At 1 January 2022	3.1	8.3	3.3	14.7
Transfers:				
Stage 1 transfers	(3.3)	-	-	(3.3)
Stage 2 transfers	-	2.4	-	2.4
Stage 3 transfers	-	-	1.0	1.0
New loans	3.5	2.0	-	5.5
Settled loans	(0.5)	(1.6)	(0.6)	(2.7)
Changes in credit quality	9.1	(0.2)	(0.2)	8.7
Changes in model assumptions	2.5	(0.6)	-	1.9
Loss allowance at 31 December 2022	**14.4**	**10.3**	**3.5**	**28.2**

Group 2021	Stage 1 12 month ECL £m	Stage 2 Lifetime ECL £m	Stage 3 Lifetime ECL £m	Total £m
At 1 January 2021	5.1	18.7	10.5	34.3
Transfers:				
Stage 1 transfers	(2.7)	-	-	(2.7)
Stage 2 transfers	-	1.1	-	1.1
Stage 3 transfers	-	-	1.7	1.7
New loans	0.6	1.5	0.1	2.2
Settled loans	(0.8)	(2.2)	(3.1)	(6.1)
Changes in credit quality	2.4	(9.9)	(3.4)	(10.9)
Changes in model assumptions	(1.5)	(0.3)	-	(1.8)
Loss allowance at 31 December 2021	**3.1**	**8.9**	**5.8**	**17.8**

Society 2021	Stage 1 12 month ECL £m	Stage 2 Lifetime ECL £m	Stage 3 Lifetime ECL £m	Total £m
At 1 January 2021	5.1	16.9	6.4	28.4
Transfers:				
Stage 1 transfers	(2.7)	-	-	(2.7)
Stage 2 transfers	-	1.3	-	1.3
Stage 3 transfers	-	-	1.4	1.4
New loans	0.6	1.5	0.1	2.2
Settled loans	(0.8)	(1.9)	(2.7)	(5.4)
Changes in credit quality	2.4	(9.2)	(1.9)	(8.7)
Changes in model assumptions	(1.5)	(0.3)	-	(1.8)
Loss allowance at 31 December 2021	**3.1**	**8.3**	**3.3**	**14.7**

19. Provision for impairment losses (continued)

The following tables show an analysis of expected credit losses by PD band and the average provision coverage within each PD band as at 31 December 2022.

Retail and Secured personal lending	2022		2021	
	Sum of ECL £m	Coverage %	Sum of ECL £m	Coverage %
0.00% - 0.11%	1.7	0.07	0.9	0.02
0.11% - 0.17%	1.0	0.05	0.9	0.05
0.17% - 0.25%	1.3	0.08	0.7	0.06
0.25% - 0.41%	1.3	0.11	0.5	0.07
0.41% - 0.60%	1.2	0.18	0.3	0.08
0.60% - 0.88%	1.1	0.31	0.4	0.15
0.88% - 1.49%	1.7	0.56	0.4	0.27
1.49% - 2.96%	1.8	1.10	0.4	0.57
2.96% - 6.84%	1.0	1.89	0.3	1.15
6.84%+	7.0	5.57	6.7	6.15
Total	**19.1**		**11.4**	

Commercial lending	2022		2021	
	Sum of ECL £m	Coverage %	Sum of ECL £m	Coverage %
PD:				
0.28%	0.3	0.2	0.1	0.1
0.56%	1.6	0.6	0.3	0.1
1.13%	4.5	1.2	0.8	0.3
2.25%	3.9	2.8	1.3	0.8
4.50%	0.5	4.0	1.8	3.1
9.00%	0.2	4.0	1.1	8.9
18.00%	0.3	8.1	0.1	3.0
36.00%	-	-	0.1	16.6
100.00%	1.5	22.7	0.9	11.3
Total	**12.8**		**6.4**	

The IFRS 9 models calculate expected credit losses for each of the scenarios and then apply the relative weightings of the forward-looking economic scenarios to generate the weighted output for each model.

The scenarios consist of the following forecasts between December 2023 to December 2027, the figures are as at 31 December for each year:

GDP Growth %	Scenario	Weighting at 31 December 2022 %	2023	2024	2025	2026	2027
	Base	50	2.8	3.4	2.5	2.3	2.2
	Upside	20	5.3	3.1	2.1	2.3	2.4
	Downside	23	3.2	2.1	(1.2)	3.6	2.9
	Severe downside	7	(10.9)	(0.3)	4.1	2.8	1.7
	Weighted average		**2.4**	**2.8**	**1.6**	**2.6**	**2.4**

Unemployment (Absolute)	Scenario	Weighting at 31 December 2022 %	2023	2024	2025	2026	2027
	Base	50	4.3	4.5	4.5	4.6	4.6
	Upside	20	3.9	3.6	3.7	4.0	4.2
	Downside	23	5.6	7.0	7.0	6.9	6.6
	Severe downside	7	7.4	8.3	8.2	7.9	7.2
	Weighted average		**4.7**	**5.1**	**5.2**	**5.2**	**5.2**

HPI %	Scenario	Weighting at 31 December 2022 %	2023	2024	2025	2026	2027
	Base	50	(4.4)	2.3	4.8	2.9	0.8
	Upside	20	9.0	5.4	2.1	(1.2)	(2.1)
	Downside	23	(14.5)	(12.0)	1.9	5.5	2.6
	Severe downside	7	(20.7)	(10.9)	4.4	4.3	3.4
	Weighted average		**(5.2)**	**(0.7)**	**3.6**	**2.4**	**0.6**

The equivalent scenarios and weightings for the period ending 31 December 2021 were as follows:

GDP Growth %	Scenario	Weighting at 31 December 2021 %	2022	2023	2024	2025	2026
	Base	50	6.8	4.6	2.5	1.7	2.1
	Upside	20	11.3	3.7	2.9	2.3	2.3
	Downside	23	(1.5)	5.3	2.9	2.2	2.1
	Severe downside	7	(3.8)	4.1	2.1	2.1	1.9
	Weighted average		**5.1**	**4.5**	**2.7**	**2.0**	**2.1**

19. Provision for impairment losses (continued)

Unemployment (Absolute)	Scenario	Weighting at 31 December 2021 %	2022	2023	2024	2025	2026
	Base	50	4.7	4.4	4.4	4.5	4.5
	Upside	20	3.9	3.3	3.5	3.8	4.0
	Downside	23	6.2	6.6	6.5	6.3	5.9
	Severe downside	7	7.2	7.5	7.2	7.1	6.6
	Weighted average		**5.1**	**4.9**	**4.9**	**4.9**	**4.9**

HPI %	Scenario	Weighting at 31 December 2021 %	2022	2023	2024	2025	2026
	Base	50	3.4	6.0	5.2	3.7	2.0
	Upside	20	14.2	8.5	4.8	2.1	0.7
	Downside	23	(9.8)	(8.1)	(1.9)	4.4	8.3
	Severe downside	7	(13.4)	(10.3)	(2.5)	4.3	7.7
	Weighted average		**1.3**	**2.1**	**3.0**	**3.6**	**3.6**

Other variables are used within the models, including Consumer Price Index, Nominal Mortgage Refinancing and Real Disposable Income per Capita. These have not been included in the analysis above as full details have been provided for the more commonly used variables for comparability.

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. A PMA of £2.5m has been applied in respect of sensitivity to peer benchmarked weightings, see page 116.

Portfolio	Upside £m	Severe downside £m	ECL Range £m
Retail financial services	2.7	22.1	19.4
Secured personal lending	1.6	4.3	2.7
Commercial lending	5.2	11.4	6.2

20. Provision for liabilities

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
At 1st January	2.7	2.8	0.7	1.3
Charge for the year	(0.2)	-	-	0.1
Release during the year	0.3	(0.1)	(0.1)	(0.7)
At 31 December	**2.8**	**2.7**	**0.6**	**0.7**

At 31 December 2022, the group held a provision of £2.8m (2021: £2.7m) in respect of various claims. This 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

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 behaviour analysed in order ensure the provision remains appropriate.

21. Investments in subsidiary undertakings

	Society	
	2022 £m	2021 £m
Shares in subsidiary undertakings	0.1	0.1
Loans to subsidiary undertakings	-	-
	0.1	**0.1**

	Subsidiary undertakings	
	Shares £m	Loans £m
Movement in investments in subsidiary undertakings:		
At 1 January 2022	0.1	-
Loan repayment	-	-
At 31 December 2022	**0.1**	**-**

	Society	
	2022 £m	2021 £m
Surplus cash received from subsidiaries	1.7	16.0
	1.7	**16.0**

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21. Investments in subsidiary undertakings (continued)

The Society has the following subsidiary undertakings which operated in the United Kingdom during the year and are included in the group accounts:

	Place of registration	Principal activity	Class of shares held	Interest of Society	Direct or indirect
Nemo Personal Finance Limited	England and Wales	Secured personal lending	Ordinary	100%	Direct
Principality Mortgage and Insurance Services Limited	England and Wales	Provision of mortgage & financial advice	Ordinary	100%	Direct
Principality Covered Bond LLP	England and Wales	Covered bond LLP	Ordinary	100%	Direct

Principality Building Society consolidates funding vehicles Friary No.4 PLC, Friary No.5 PLC, Friary No.6 PLC and Friary No.7 PLC into the group accounts. These companies are not wholly owned by the Society but the Society retains substantially all of the risk and reward of the assets, and therefore the Society's interests in these entities are, in substance, no different than if they were 100% held subsidiary undertakings and consequently they are consolidated into the group accounts. Principality Mortgage and Insurance Services Limited and Principality Covered Bond LLP will be taking the subsidiary audit exemption for the year ending 31 December 2022.

The Society continues to participate in the Ely Bridge development, a scheme which aims to deliver an 800 house development on a brownfield site in Cardiff being a mix of affordable, social and private dwellings ultimately funded by the capital markets. Ely Bridge Development Company Limited was incorporated on 28 March 2012. The company is not-for-profit and limited by guarantee. The Society holds no beneficial interest in the company but has agreed to contribute £1 to the assets of the company in the event of it being wound up.

The Society also holds 100% of the ordinary share capital of the following subsidiary undertakings. None of the subsidiary businesses listed below carried out business during the year and so meet audit exemption criteria. All subsidiary businesses were incorporated in the United Kingdom, at the registered address of Principality House, The Friary, Cardiff, CF10 3FA.

- Energy Assess Wales Limited
- Home Information Pack Wales Limited
- Principality Limited
- Principality Asset Management Limited
- Principality Bank Limited
- Principality Direct Limited
- Principality Estate Agency Limited
- Principality Financial Management Limited
- Principality Group Limited
- Principality Homes Limited
- Principality (IFA Services) Limited
- Principalty Independant Financial Advisors Limited
- Principality Life Assurance Services Limited
- Principality (Life & Pensions) Limited
- Principality Mortgage Corporation Limited
- Principality Personal Loans Limited
- Principality Property Development Services Limited
- Principality Property Sales Limited
- Principality Property Services Limited
- Principality Property Solutions Limited
- Principality Surveyors Home Condition Report Limited
- Principality Surveyors Limited
- Principality Syndicated Loans Limited
- The Principality Home Information Pack Limited

22. Intangible assets

	Group and Society	
	2022 £m	2021 £m
Cost:		
At 1 January	40.1	35.4
Additions	1.5	5.7
Impairment	–	(1.0)
At 31 December	**41.6**	**40.1**
Amortisation:		
At 1 January	14.1	10.0
Charge for the year	4.0	4.1
At 31 December	**18.1**	**14.1**
Net book value:		
At 31 December	**23.5**	**26.0**

Computer software capitalised during the year relates to the group's transformation programme and associated technology investment. Assets in the course of construction which are not yet ready for use and therefore have no amortisation charged against them was nil at 31 December 2022 (2021: £8.3m).

23. Property, plant and equipment

2022	Right of use assets		Land and buildings		Equipment, fixtures, fittings & vehicles		Total	
	Group £m	Society £m	Group £m	Society £m	Group £m	Society £m	Group £m	Society £m
Cost:								
At 1 January 2022	8.4	8.4	59.1	58.0	43.1	43.1	110.6	109.5
Additions	0.2	0.1	0.1	0.1	7.1	7.1	7.4	7.3
Disposals	–	–	(1.7)	(1.7)	(1.2)	(1.2)	(2.9)	(2.9)
At 31 December 2022	**8.6**	**8.5**	**57.5**	**56.4**	**49.0**	**49.0**	**115.1**	**113.9**
Depreciation:								
At 1 January 2022	3.0	3.0	37.8	37.3	33.2	33.2	74.0	73.5
Charge for the year	1.0	0.9	1.2	1.2	3.9	3.9	6.1	6.0
Impairment in the year	–	–	0.4	0.4	–	–	0.4	0.4
Disposals	–	–	(0.7)	(0.7)	(0.9)	(0.9)	(1.6)	(1.6)
At 31 December 2022	**4.0**	**3.9**	**38.7**	**38.2**	**36.2**	**36.2**	**78.8**	**78.1**
Net book value:								
At 31 December 2022	**4.6**	**4.6**	**18.8**	**18.2**	**12.8**	**12.8**	**36.3**	**35.8**
At 31 December 2021	5.4	5.4	21.3	20.7	9.9	9.9	36.6	36.0

23. Property, plant and equipment (continued)

2021	Right of use assets		Land and buildings		Equipment, fixtures, fittings & vehicles		Total	
	Group £m	Society £m	Group £m	Society £m	Group £m	Society £m	Group £m	Society £m
Cost:								
At 1 January 2021	8.1	8.1	54.5	53.4	40.5	40.5	103.1	102.0
Additions	0.3	0.3	5.0	5.0	2.6	2.6	7.9	7.9
Disposals	–	–	(0.4)	(0.4)	–	–	(0.4)	(0.4)
At 31 December 2021	**8.4**	**8.4**	**59.1**	**58.0**	**43.1**	**43.1**	**110.6**	**109.5**
Depreciation:								
At 1 January 2021	2.0	2.0	35.5	35.0	29.1	29.1	66.6	66.1
Charge for the year	1.0	1.0	1.2	1.2	4.1	4.1	6.3	6.3
Impairment in the year	–	–	1.5	1.5	–	–	1.5	1.5
Disposals	–	–	(0.4)	(0.4)	–	–	(0.4)	(0.4)
At 31 December 2021	**3.0**	**3.0**	**37.8**	**37.3**	**33.2**	**33.2**	**74.0**	**73.5**
Net book value:								
At 31 December 2021	**5.4**	**5.4**	**21.3**	**20.7**	**9.9**	**9.9**	**36.6**	**36.0**
At 31 December 2020	6.1	6.1	19.0	18.4	11.4	11.4	36.5	35.9

Investment properties	Group and Society	
	2022 £m	2021 £m
Cost:		
At 1 January	13.0	13.2
Additions	0.1	0.2
Disposals	(0.1)	(0.5)
At 31 December	**13.0**	**12.9**
Depreciation:		
At 1 January	6.7	6.7
Charge for the year	0.4	0.4
Disposals	–	(0.4)
Impairment in the year	0.1	–
At 31 December	**7.2**	**6.7**
Net book value:		
At 31 December	**5.8**	**6.2**

Included within land and buildings additions is £1.7m (2021: £4.9m) on account of assets in the course of construction. With the exception of investment properties, all properties are occupied by the group.

Each year Principality employ an independent third party to complete all valuations of land and buildings. The appointment of the valuer is completed through a thorough tender process, including assessment of the relevant qualifications of the valuer, to ensure competence and independence.

The valuations were compared to the net book values to assess if an asset should be impaired. A £0.5m impairment has been recognised within the retail branch network property portfolio (2021: £1.4m impairment).

The fair value of investment properties as at 31 December 2022 is £13.1m (2021: £11.5m).

24. Shares

	Group and Society	
	2022 £m	2021 £m
Held by individuals	8,117.4	7,941.7
Other shares	2.7	3.2
Fair value adjustment for hedged risk	(6.5)	(1.1)
	8,113.6	7,943.8

25. Amounts owed to credit institutions

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Amounts owed to credit institutions	1,639.0	1,296.2	1,716.3	1,622.1

Included in the above amounts is £305.8m of collateral held under Credit Support Annex (CSA) agreements (2021: £30.6m).

26. Debt securities in issue

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Senior unsecured debt	289.7	298.4	289.8	298.4
Residential mortgage backed securities	177.5	397.6	–	–
	467.2	696.0	289.8	298.4

27. Other liabilities

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Other taxation and social security	1.3	1.2	1.3	1.2
Lease liabilities	4.9	5.7	4.9	5.7
Other creditors	7.5	4.4	7.5	4.4
	13.7	11.3	13.7	11.3

27. Other liabilities (continued)

The undiscounted maturity profile of lease payments at 31 December 2022 is shown below:

2022 Group	Property £m	Cars £m	IT Lease £m	Total £m
Year 1	0.9	0.1	0.1	1.1
Year 2	0.9	-	-	0.9
Year 3	0.8	-	-	0.8
Year 4	0.6	-	-	0.6
Year 5	0.5	-	-	0.5
More than 5 years	1.8	-	-	1.8
Total	**5.5**	**0.1**	**0.1**	**5.7**

The undiscounted maturity profile of lease payments at 31 December 2021 is shown below:

2021 Group	Property £m	Cars £m	IT Lease £m	Total £m
Year 1	0.9	0.1	0.1	1.1
Year 2	0.8	0.1	-	0.9
Year 3	0.8	-	-	0.8
Year 4	0.7	-	-	0.7
Year 5	0.6	-	-	0.6
More than 5 years	2.2	-	-	2.2
Total	**6.0**	**0.2**	**0.1**	**6.3**

28. Deferred tax

The movement in net deferred tax is as follows:

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
At 1 January	(3.1)	0.7	(3.1)	0.6
Income statement charge	(7.5)	(2.5)	(7.5)	(2.4)
Statement of other comprehensive income charge	1.7	(1.3)	1.7	(1.3)
At 31 December	**(8.9)**	**(3.1)**	**(8.9)**	**(3.1)**

The deferred tax (charge)/credit in the income statement comprises the following temporary differences:

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Deferred tax assets:				
Accelerated tax depreciation	1.6	1.7	1.5	1.6
Other temporary differences	1.3	0.6	1.3	0.6
	2.9	**2.3**	**2.8**	**2.2**
Deferred tax liabilities:				
Other temporary differences	(11.8)	(5.4)	(11.7)	(5.3)
	(11.8)	**(5.4)**	**(11.7)**	**(5.3)**

The deferred tax (charge)/credit in the income statement comprises the following temporary differences:

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Accelerated tax depreciation	(0.1)	1.1	(0.1)	1.1
Fair value volatility on financial instruments in securitisation entities	(7.4)	(2.6)	(7.4)	(2.6)
Other movements	-	(1.0)	-	(1.0)
	(7.5)	**(2.5)**	**(7.5)**	**(2.5)**

The rate of corporation tax from 1 April 2022 will remain at 19%; however, the rate will increase to 25% from 1 April 2023. As the deferred tax assets and liabilities are, in the most part, expected to unwind after the rate change, the deferred tax has been calculated at 25%.

The statement of other comprehensive income includes a deferred tax gain of £1.0m (2021: £1.0m loss) arising from the actuarial loss on retirement benefit obligations.

29. Financial commitments and contingent liabilities

a) Other provisions for liabilities and charges

At 31 December 2022, the group holds a provision of £2.8m (2021: £2.7m), which 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.

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 behaviour analysed in order ensure the provision remains appropriate

b) Income receivable under non-cancellable operating leases:

Property rental income earned during the year was £0.9m (2021: £0.6m). At the statement of financial position date, the Society had contracted with tenants for the following future minimum lease payments:

	Group and Society	
	2022 £m	2021 £m
Receivable within one year	0.7	0.7
Receivable between two and five years	3.1	3.2
Receivable after five years	4.4	5.1
	8.2	**9.0**

On 28th January 2011, a 25 year lease of floors one to four of Principality Buildings was granted to Travelodge Hotels Limited.

29. Financial commitments and contingent liabilities (continued)

c) Capital commitments:

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Capital expenditure contracted for but not provided for	5.0	7.2	5.0	7.2

d) Loan commitments:

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Loan commitments contracted but not paid	178.0	129.9	178.0	129.9

30. Financial instruments

Categories of financial instruments

Financial assets and liabilities are measured on an ongoing basis either at fair value or at amortised cost.

The accounting policies note describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following tables analyse the financial assets and liabilities in the statement of financial position by the class of financial instrument to which they are assigned and by the measurement basis.

Group As at 31 December 2022	At amortised cost £m	Fair value through OCI £m	Fair value through profit and loss £m	Total £m
Group assets:				
Cash in hand and balances with Bank of England	1,566.9	-	-	1,566.9
Loans and advances to credit institutions	277.1	-	-	277.1
Debt securities	-	160.2	-	160.2
Derivative financial instruments	-	-	369.0	369.0
Loans and advances to customers	8,795.0	-	-	8,795.0
Total financial assets	**10,639.0**	**160.2**	**369.0**	**11,168.2**
Total non-financial assets				89.1
Total group assets				**11,257.3**
Group liabilities:				
Shares	8,113.6	-	-	8,113.6
Amounts owed to credit institutions	1,637.1	-	1.9	1,639.0
Amounts owed to other customers	255.0	-	-	255.0
Debt securities in issue	478.0	-	(10.8)	467.2
Derivative financial instruments	-	-	63.6	63.6
Total financial liabilities	**10,483.7**	**-**	**54.7**	**10,538.4**
Total non-financial liabilities				40.1
General reserve and other reserves				678.8
Total group reserves and liabilities				**11,257.3**

Society As at 31 December 2022	At amortised cost £m	Fair value through OCI £m	Fair value through profit and loss £m	Total £m
Society assets:				
Cash in hand and balances with Bank of England	1,566.9	-	-	1,566.9
Loans and advances to credit institutions	180.4	-	-	180.4
Debt securities	-	160.2	-	160.2
Derivative financial instruments	-	-	333.4	333.4
Loans and advances to customers	8,714.9	-	-	8,714.9
Loans to and investments in subsidiaries	0.1	-	-	0.1
Total financial assets	**10,462.3**	**160.2**	**333.4**	**10,955.9**
Total non-financial assets				88.3
Total Society assets				**11,044.2**
Society liabilities:				
Shares	8,113.6	-	-	8,113.6
Amounts owed to credit institutions	1,714.5	-	1.9	1,716.3
Amounts owed to other customers	255.0	-	-	255.0
Debt securities in issue	300.5	-	(10.8)	289.8
Derivative financial instruments	-	-	63.6	63.6
Loans from subsidiaries	1.7	-	-	1.7
Total financial liabilities	**10,385.3**	**-**	**54.7**	**10,440.0**
Total non-financial liabilities				36.9
General reserve and other reserves				567.3
Total Society reserves and liabilities				**11,044.2**

30. Financial instruments (continued)

Group As at 31 December 2021	At amortised cost £m	Fair value through OCI £m	Fair value through profit and loss £m	Total £m
Group assets:				
Cash in hand and balances with Bank of England	1,645.8	-	-	1,645.8
Loans and advances to credit institutions	165.8	-	-	165.8
Debt securities	-	76.3	-	76.3
Derivative financial instruments	-	-	52.8	52.8
Loans and advances to customers	8,883.3	-	-	8,883.3
Total financial assets	**10,694.9**	**76.3**	**52.8**	**10,824.0**
Total non-financial assets				83.9
Total group assets				**10,907.9**
Group liabilities:				
Shares	7,943.8	-	-	7,943.8
Amounts owed to credit institutions	1,294.3	-	1.9	1,296.2
Amounts owed to other customers	270.1	-	-	270.1
Debt securities in issue	697.9	-	(1.9)	696.0
Derivative financial instruments	-	-	24.7	24.7
Total financial liabilities	**10,206.1**	**-**	**24.7**	**10,230.8**
Total non-financial liabilities				30.8
General reserve and other reserves				646.3
Total group reserves and liabilities				**10,907.9**

Society As at 31 December 2021	At amortised cost £m	Fair value through OCI £m	Fair value through profit and loss £m	Total £m
Society assets:				
Cash in hand and balances with Bank of England	1,645.8	-	-	1,645.8
Loans and advances to credit institutions	93.7	-	-	93.7
Debt securities	-	76.3	-	76.3
Derivative financial instruments	-	-	50.1	50.1
Loans and advances to customers	8,774.9	-	-	8,774.9
Loans and investments in subsidiaries	0.1	-	-	0.1
Total financial assets	**10,514.5**	**76.3**	**50.1**	**10,640.9**
Total non-financial assets				83.2
Total Society assets				**10,724.1**
Society liabilities:				
Shares	7,943.8	-	-	7,943.8
Amounts owed to credit institutions	1,620.2	-	1.9	1,622.1
Amounts owed to other customers	270.1	-	-	270.1
Debt securities in issue	300.3	-	(1.9)	298.4
Derivative financial instruments	-	-	23.8	23.8
Loans from subsidiaries	16.0	-	-	16.0
Total financial liabilities	**10,150.4**	**-**	**23.8**	**10,174.2**
Total non-financial liabilities				28.2
General reserve and other reserves				521.7
Total Society reserves and liabilities				**10,724.1**

30. Financial instruments (continued)

Carrying and fair values

The table below compares carrying values and fair values of the group's and the Society's financial instruments by category. It is accompanied by an explanation of the methods used to determine fair value.

	Note	2022		2021	
		Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Group assets:					
Cash in hand and balances with Bank of England	i.	1,566.9	1,566.9	1,645.8	1,645.8
Loans and advances to credit institutions	ii.	277.1	284.6	165.8	173.2
Debt securities	iii.	160.2	160.2	76.3	76.3
Derivative financial instruments	iv.	369.0	369.0	52.8	52.8
Loans and advances to customers	v.	8,795.0	8,838.4	8,883.3	9,019.1
		11,168.2	**11,219.1**	**10,824.0**	**10,967.2**
Group liabilities:					
Shares	vii.	8,113.6	8,173.4	7,943.8	7,961.5
Amounts owed to credit institutions	viii.	1,639.0	1,638.9	1,296.2	1,296.2
Amounts owed to other customers	viii.	255.0	255.0	270.1	270.1
Debt securities in issue	ix.	467.2	459.4	696.0	702.3
Derivative financial instruments	iv.	63.6	63.6	24.7	24.7
		10,538.4	**10,590.3**	**10,230.8**	**10,254.8**

	Note	2022		2021	
		Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Society assets:					
Cash in hand and balances with Bank of England	i.	1,566.9	1,566.9	1,645.8	1,645.8
Loans and advances to credit institutions	ii.	180.4	180.4	93.7	93.7
Debt securities	iii.	160.2	160.2	76.3	76.3
Derivative financial instruments	iv.	333.4	333.4	50.1	50.1
Loans and advances to customers	v.	8,714.9	8,760.6	8,774.9	8,909.4
Loans to and investments in subsidiaries	vi.	0.1	0.1	0.1	0.1
		10,955.9	**11,001.6**	**10,640.9**	**10,775.4**
Society liabilities:					
Shares	vii.	8,113.6	8,173.4	7,943.8	7,961.5
Amounts owed to credit institutions	viii.	1,716.3	1,716.3	1,622.1	1,622.2
Amounts owed to other customers	viii.	255.0	255.0	270.1	270.1
Debt securities in issue	ix.	289.8	281.2	298.4	303.8
Derivative financial instruments	iv.	63.6	63.6	23.8	23.8
Loans from subsidiaries	ix.	1.7	1.7	16.0	16.0
		10,440.0	**10,491.2**	**10,174.2**	**10,197.4**

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable and willing parties in an arm's length transaction. The following methods and assumptions have been applied in determining fair value:

i) The carrying amount of cash in hand and balances with the Bank of England are assumed to equate to fair value. Balances are held at amortised cost.

ii) The carrying amount of loans and advances to credit institutions with a maturity of under 12 months is assumed to equate to their fair value. Balances would be considered as a Level 2 item within the hierarchy for fair value disclosures.

iii) Debt securities are measured at fair value by reference to market prices, with balances considered as a Level 1 item within the hierarchy for fair value disclosures.

iv) The fair value of interest rate swaps is calculated by utilising discounted cash flow valuation models. Balances are held as fair value through profit and loss, and a breakdown of the fair value hierarchies can be seen in the table below.

v) The fair value of loans and advances to customers represents the discounted amount of estimated future cash flows expected to be received after taking account of expected loss provisions, expected levels of early repayment and discounting at current market rates. Balances would be considered as a Level 3 item within the hierarchy for fair value disclosures.

vi) The fair value of loans and advances to subsidiaries at a variable rate is considered to be their carrying amounts with the use of transfer pricing mechanisms. Balances would be considered as a Level 3 item within the hierarchy for fair value disclosures.

vii) The fair value of customer accounts represents the discounted amount of estimated future cash flows expected to be paid, with reference to market-observable interest rates and would be considered as a Level 2 item.

viii) The fair values of amounts owed to credit institutions and amounts owed to other customers are considered to be the amount payable at the date of the statement of financial position. Balances are held at amortised cost, and would be considered as a Level 2 item within the hierarchy for fair value.

ix) The fair values of debt securities in issue and subscribed capital are obtained from market prices. Balances are held at amortised cost, and would be considered as a Level 1 item within the hierarchy for fair value.

x) The fair value of loans from subsidiaries is considered to be their carrying value as the loan is repayable on demand. Balances would be considered as a Level 3 item for fair value disclosures.

30. Financial instruments (continued)

	Group			
	2022 £m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	369.0	–	333.4	35.6
Financial assets at fair value through other comprehensive income:				
Debt securities	160.2	160.2	–	–
Total	**529.2**	**160.2**	**333.4**	**35.6**
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	1.9	–	1.9	–
Debt securities in issue	(10.8)	(10.8)	–	–
Derivative financial instruments	63.6	–	27.9	35.7
Total	**54.7**	**(10.8)**	**29.8**	**35.7**

	Society			
	2022 £m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	333.4	–	333.4	–
Financial assets at fair value through other comprehensive income:				
Debt securities	160.2	160.2	–	–
Total	**493.6**	**160.2**	**333.4**	**–**
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	1.9	–	1.9	–
Debt securities in issue	(10.8)	(10.8)	–	–
Derivative financial instruments	63.6	–	27.9	35.7
Total	**54.7**	**(10.8)**	**29.8**	**35.7**

	Group			
	2021 £m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	52.8	–	49.2	3.6
Financial assets at fair value through other comprehensive income:				
Debt securities	76.3	76.3	–	–
Total	**129.1**	**76.3**	**49.2**	**3.6**
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	1.9	–	1.9	–
Debt securities in issue	(1.9)	(1.9)	–	–
Derivative financial instruments	24.7	–	21.1	3.6
Total	**24.7**	**(1.9)**	**23.0**	**3.6**

	Society			
	2021 £m	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**
Financial assets at fair value through profit or loss:				
Derivative financial instruments	50.1	-	49.2	0.9
Financial assets at fair value through other comprehensive income:				
Debt securities	76.3	76.3	-	-
Total	**126.4**	**76.3**	**49.2**	**0.9**
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	1.9	-	1.9	-
Debt securities in issue	(1.9)	(1.9)	-	-
Derivative financial instruments	23.8	-	21.1	2.7
Total	**23.8**	**(1.9)**	**23.0**	**2.7**

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.

Hierarchy for fair value disclosures

Level	Description
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 solely 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 RMBS structures. The valuations are provided by the counterparties 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. There have been no additions or maturities within this category during the year therefore total movements throughout 2022 are due to changes in market rates.

The costs to replace derivatives contracts in the event that a counterparty was unable to honour their contractual obligation are materially equal to the fair value of derivatives disclosed above.

31. Credit risk

The credit risk to which the group is exposed is described in the Risk Overview on pages 27 to 28. Credit risk in relation to loans and advances to customers including first and second charge retail credit risk and commercial lending credit risk is described in section a) below. Credit risk in relation to treasury financial instruments is described in section b).

31. Credit risk (continued)

a) 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		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
In respect of loans and advances to customers:				
Secured by a first charge on residential property	8,720.9	8,528.0	8,720.9	8,528.0
Secured by a first charge on land	299.3	285.1	299.2	285.1
Secured by a second charge on residential property	82.5	109.2	-	-
	9,102.7	8,922.3	9,020.1	8,813.1
Provision for impairment losses	(31.9)	(17.8)	(28.2)	(14.7)
Effective interest rate adjustments	12.7	13.5	11.4	11.2
Fair value adjustments	(288.5)	(34.7)	(288.4)	(34.7)
	8,795.0	**8,883.3**	**8,714.9**	**8,774.9**

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

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
Retail financial services	8,241.4	8,033.3	8,241.3	8,033.3
Commercial lending	762.0	776.3	762.0	776.3
Secured personal lending	80.0	108.4	-	-
Fair value adjustments	(288.4)	(34.7)	(288.4)	(34.7)
	8,795.0	**8,883.3**	**8,714.9**	**8,774.9**

i) Retail financial services and secured personal lending risk

Risk Concentrations

The group provides loans secured on residential property across England, Scotland and Wales and the Society, as a regional building society, has a geographical concentration in Wales.
The geographical concentration of first and second charge retail loans by account and value is shown below:

	Group by account		Group by value	
	2022 %	2021 %	2022 %	2021 %
In Wales	33.1	33.7	29.4	30.3
Outside Wales	66.9	66.3	70.6	69.7
	100.0	**100.0**	**100.0**	**100.0**

The group holds a high quality buy-to-let portfolio with an amortised cost of £2,244.9m (2021: £2,266.5m). At the end of the year, 79% of buy-to-let mortgages were on interest only products, 20% were repayable by capital and interest repayments and 1% a combination of interest only and capital and interest.

Balance to value (BTV) is one of the main factors used to determine the credit quality of loans secured on residential property. The average index linked BTV in respect of the group's loans secured on residential property including mortgages under offer is estimated to be 51.5% (2021: 55.7%). Index-linked BTV banding is shown below:

	Group		Society	
	2022 %	2021 %	2022 %	2021 %
Less than 50%	47.3	38.0	47.3	38.1
More than 50% but less than 75%	40.8	45.2	40.7	45.1
More than 75% but less than 90%	8.6	13.6	8.7	13.6
More than 90%	3.3	3.2	3.3	3.2
	100.0	**100.0**	**100.0**	**100.0**

Performance

The percentage of retail lending cases fully secured by a first charge currently with arrears greater than three months is 0.53% (2021: 0.50%) which compares favourably with the industry average of 0.83% (UK Finance arrears and possession data at 10 November 2022). Residential lending cases fully secured by a first charge which were six months or more in arrears had arrears balances of £1.2m (31 December 2021: £1.2m) with 208 cases (31 December 2021: 228).

The percentage of secured personal loans currently in arrears of two months or more by number is 10.23% (2021: 9.19%), which by value is 11.88% (2021: 11.10%). These increases are due to a combination of an increase in the absolute value of arrears cases in 2022 and also that due to the run off of the book, the arrears proportion makes up a higher proportion of total loans.

The table below provides further information on the first and second charge retail loans secured on residential property by payment due status:

	Group			
	2022		2021	
	£m	%	£m	%
Current	8,253.1	99.1	8,075.7	99.2
Past due up to 3 months	29.9	0.4	28.1	0.3
Past due 3 months up to 6 months	17.0	0.2	14.0	0.2
Past due 6 months up to 12 months	13.2	0.2	13.0	0.2
Past due over 12 months	8.1	0.1	9.7	0.1
Possessions	0.3	-	0.7	-
	8,321.6	**100.0**	**8,141.2**	**100.0**

31. Credit risk (continued)

	Society			
	2022		2021	
	£m	%	£m	%
Current	8,183.3	99.3	7,981.0	99.3
Past due up to 3 months	25.9	0.3	22.9	0.3
Past due 3 months up to 6 months	16.0	0.2	12.5	0.2
Past due 6 months up to 12 months	10.7	0.1	9.9	0.1
Past due over 12 months	5.6	0.1	6.3	0.1
Possessions	0.3	-	0.7	-
	8,241.8	**100.0**	**8,033.3**	**100.0**

Collateral values are updated at the date of each statement of financial position based on the best information publicly available. Land Registry data is used in the Retail Financial Services business segment with Nationwide and Hometrack indices being used in the Secured Personal Lending business segment. Both indices take account of the geographical location of the collateral.

Based on indexed valuations the total collateral held in relation to lending secured against residential property is estimated to be £21,740.1m (2021: £19,401.3m).

The group holds collateral against loans and advances to residential customers in the form of mortgage interests over property. £0.6m (2021: £0.6m) of collateral is held against possession cases. Repossessed properties are made available for sale in accordance with statutory guidelines with proceeds used to reduce or repay the outstanding loan. The group has a statutory duty to obtain the best reasonable price and to sell as soon as it reasonably can. Any collateral surplus on the sale of repossessed properties, after a deduction for costs incurred in relation to the sale, would be returned to the borrower.

Impairment provisions are held against loans and advances to customers in line with the accounting policies which are outlined in note 1. Provisions on retail loans and mortgages by business segment are broken down as follows:

	2022 £m	2021 £m
Retail financial services	15.4	8.3
Secured personal loans	3.7	3.1
	19.1	**11.4**

Forbearance

The group uses a range of forbearance options which are considered based on the borrower's financial circumstances, agreed subject to set criteria and reviewed on a case-by-case basis. Forbearance options include capitalisation of arrears, interest-only concessions, arrangements to underpay and term extensions. Repossession of a property will only take place once all alternatives have been reviewed and there are no other solutions available. 16 properties were taken into possession during 2022 (2021: 10) with balances of £1.3m (2021: £0.9m).

The table opposite sets out the mortgage balances which have had some form of forbearance over the last 12 months. Where accounts have had more than one form of forbearance the balance has been categorised based on the first instance of forbearance.

2022	Revised payment schedule £m	Transfer to interest-only £m	Term extensions £m	Capitalisation of Arrears £m	Other £m	Total £m
Current	5.4	5.9	-	-	9.0	20.3
Past due up to 3 months	5.8	0.5	-	0.1	1.2	7.6
Past due 3 months up to 6 months	5.0	-	-	-	0.2	5.2
Past due 6 months up to 12 months	3.1	-	-	0.2	0.1	3.4
Past due over 12 months	1.6	-	-	-	0.2	1.8
	20.9	**6.4**	**-**	**0.3**	**10.7**	**38.3**

2021	Revised payment schedule £m	Transfer to interest-only £m	Term extensions £m	Capitalisation of Arrears £m	Other £m	Total £m
Current	3.2	10.9	0.1	-	3.7	17.9
Past due up to 3 months	2.9	1.5	-	-	0.5	4.9
Past due 3 months up to 6 months	1.6	0.2	-	-	-	1.8
Past due 6 months up to 12 months	2.0	-	-	-	0.1	2.1
Past due over 12 months	1.0	0.1	-	-	-	1.1
	10.7	**12.7**	**0.1**	**-**	**4.3**	**27.8**

The underlying performance of previous forbearance activities are reflected in the provisioning methodology and are not individually or collectively material.

ii) Commercial lending credit risk

Commercial lending activity is split between lending to private sector landlords and property investors, registered social landlords, and funding for commercial property.

Further detail of the group's risk management strategy in relation to commercial lending is described in the Risk Overview on page 26.

The commercial loan portfolio is managed by a relationship team with many years of experience in the commercial property lending business. All lending is subject to a rigorous underwriting process, operating within a well-defined and conservative lending policy.

31. Credit risk (continued)

Risk concentrations

The group's commercial loan portfolio, excluding impairment provisions and fair value adjustments, comprises the following:

	Group and Society			
	2022		2021	
	£m	%	£m	%
Loans to Registered Social Landlords secured on residential property	166.3	21.4	164.1	20.9
Other loans secured on residential property	318.8	41.1	344.4	43.8
Loans secured on commercial property	290.6	37.5	277.5	35.3
	775.7	**100.0**	**786.0**	**100.0**

Loans secured on commercial property are well diversified by industry type and counterparty. An analysis of commercial property loans by industry is provided below:

	Group and Society			
	2022		2021	
	£m	%	£m	%
Office	101.2	34.8	107.0	38.6
Retail	113.0	38.9	102.7	37.0
Industrial	61.9	21.3	51.9	18.7
Leisure	2.7	0.9	6.1	2.2
Land	–	–	0.6	0.2
Other	11.8	4.1	9.2	3.3
	290.6	**100.0**	**277.5**	**100.0**

The group provides loans secured on commercial property across England and Wales and the Society, as a regional building society, has a geographical concentration in Wales. An analysis of commercial property loans by geographical location is provided below:

Region	Group and Society			
	2022		2021	
	£m	%	£m	%
Wales	357.8	46.1	368.5	46.9
Greater London	231.8	29.9	244.4	31.1
South East/East of England	52.9	6.8	53.7	6.8
Midlands	20.2	2.6	17.6	2.2
South West/South of England	75.3	9.7	56.4	7.2
North West/North of England	13.0	1.7	16.3	2.1
Mixed/other	24.7	3.2	29.1	3.7
	775.7	**100.0**	**786.0**	**100.0**

The average loan to value (LTV) in respect of the group's commercial loans is estimated to be 52.1% (2021: 54.2%). LTV analysis has been undertaken by using a combination of external valuations and internal and external desktop reviews which consider the type and quality of security, lease term/ tenant as well as geographical location.

£12.8m of exposures have an LTV of greater than 100% (2021: £18.4m). Of these, £6.5m are already classified as impaired (2021: £7.2m).

The largest exposure to one counterparty is £26.0m (2021: £26.3m) or 3.4% (2021: 3.3%) of gross balances.

Performance

The commercial lending risk procedure for loans and advances to customers is described in the Risk Overview on page 26.

Using the commercial credit risk grading system the commercial loan portfolio is distributed as follows (the figures exclude provision for loan impairment and fair value adjustments):

	Group and Society			
	2022		2021	
	£m	%	£m	%
Exposures not classified as higher risk	762.9	98.4	767.6	97.7
Watch-list	6.3	0.8	11.2	1.4
Impaired or past due up to 3 months	6.5	0.8	7.2	0.9
	775.7	**100.0**	**786.0**	**100.0**

Under the IRB supervisory slotting approach for specialised lending which includes commercial property lending (Income Producing Real Estate – "IPRE") the book is categorised as follows:

Slot	Standardised £m	Strong £m	Good £m	Satisfactory £m	Weak £m	Default £m	Total £m	%
Registered Social Landlords	166.3	-	-	-	-	-	166.3	21.4
Commercial Investment (including Owner Occupier)	-	6.8	236.8	32.4	3.4	2.0	281.4	36.3
Residential Investment	-	65.9	205.4	7.0	-	1.5	279.8	36.1
Commercial Development	-	3.8	5.4	-	-	-	9.2	1.2
Residential Development	-	-	35.5	0.5	-	3.0	39.0	5.0
	166.3	**76.5**	**483.1**	**39.9**	**3.4**	**6.5**	**775.7**	**100.0**

Watch-list exposures are categorised in line with the perceived severity of the risk to identify cases having the greatest potential cause for concern and to facilitate timely risk mitigation activity. Accounts in the watch-list are typically those which have had a material covenant breach, have persistent arrears (but are not presently >30 days past due) or where there are other concerns about the likelihood of eventual repayment. Defaulted accounts are described as impaired.

31. Credit risk (continued)

The table below provides further information on commercial loans and advances by defaulted and delinquency status:

	Group and Society			
	2022		2021	
	£m	%	£m	%
Unimpaired				
Current	769.2	99.1	778.8	99.1
Past due 1 to 3 months	-	-	-	-
Impaired				
Past due 3 to 6 months	-	-	-	-
Past due 6 to 12 months	-	-	0.2	-
Past due over 12 months	-	-	-	-
Defaulted but not past due	3.6	0.5	4.8	0.6
Law of Property Act (LPA) Receivers appointed	2.9	0.4	2.2	0.3
	775.7	**100.0**	**786.0**	**100.0**

There are no commercial cases (2021: 1) three months or more in arrears. Total arrears of one month or more are nil (2021: £0.2m).

The total collateral held against commercial loans is estimated to be £1,686m (2021: £1,615m). Lending is classified by sector according to the property type held as collateral. The current value of collateral is estimated based on the latest professional valuation adjusted for subsequent commercial property price movements. Where considered necessary, new professional valuations are commissioned.

Provisions are held against impaired loans as follows:

2022	Group and Society		
	Stage 1 £m	Stage 2 £m	Stage 3 £m
Commercial lending provisions	8.6	2.7	1.5
Total provisions	**8.6**	**2.7**	**1.5**

2021	Group and Society		
	Stage 1 £m	Stage 2 £m	Stage 3 £m
Commercial lending provisions	2.2	3.3	0.9
Total provisions	**2.2**	**3.3**	**0.9**

Forbearance

In some cases of default, or in order to avoid a default, action plans are implemented which may require the granting of a concession involving amendments to the contractual terms of a loan. For example, an extension of a maturity, reduction in interest rate or non-enforcement of covenants can often be the best way to avoid default and minimise losses, giving the customer time to take action to improve their situation. Such forbearance activity is always carefully considered with the aim of maximising the benefit and optimising the outcome for both the group and the borrower. In 2022, 56 (2021: 5) accounts with balances totalling £126.4m (2021: £4.7m) in value were granted forbearance concessions. The total exposure in forbearance at December 2022 stands at balances of £135.1m and 61 accounts (2021: £31.1m, 14 accounts). The potential for losses on these accounts is assessed and considered in the level of overall provisions held against the Commercial lending portfolio. Additionally their status in terms of whether deemed impaired, or placed on the watch-list, is also considered on a regular basis.

b) Treasury financial instruments

The treasury credit risk strategy is described in the Risk Overview on page 28.

The classes of financial instruments to which the group is most exposed to Treasury credit risk are loans and advances to credit institutions, debt securities and financial derivatives. For financial assets recognised in the statement of financial position, the exposure to credit risk equals their carrying amount. For loan commitments and guarantees, the exposure to credit risk is the full amount committed. The following table shows the group's estimated maximum exposure to credit risk without taking into account any collateral held or other credit enhancements.

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
UK Government securities	-	-	-	-
UK Supranational securities	48.1	50.3	48.1	50.3
UK Financial institutions	308.2	181.6	211.5	109.5
	356.3	**231.9**	**259.6**	**159.8**

None of these exposures were either past due or impaired and there are no assets that would otherwise be past due or impaired whose terms have been renegotiated.

Collateral is not held over loans and advances to credit institutions and debt securities. Collateral of £305.8m (2021: £30.6m) is held over derivative financial instruments.

The following table shows the exposures broken down by Fitch ratings:

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
AAA to AA-	101.0	128.0	101.0	128.0
A+ to A-	255.3	101.9	158.6	29.8
BBB+ to BBB-	-	2.0	-	2.0
	356.3	**231.9**	**259.6**	**159.8**

The geographical distribution of these exposures is as follows:

	Group		Society	
	2022 £m	2021 £m	2022 £m	2021 £m
UK	308.2	181.6	211.5	109.5
Multilateral development banks	48.1	50.3	48.1	50.3
	356.3	**231.9**	**259.6**	**159.8**

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.

32. Liquidity risk

The following tables analyse the gross contractual principal cash flows payable under financial liabilities.

2022	Undefined maturity £m	Less than 3 months £m	Between 3 months and 1 year £m	Between 1 year and 5 years £m	More than 5 years £m	Total £m
Group:						
Non-derivative liabilities						
Shares	-	4,840.8	1,590.6	1,688.6	-	8,120.0
Amounts owed to credit institutions	311.2	31.8	966.3	327.9	-	1,637.2
Other customers	-	202.6	51.5	-	-	254.1
Debt securities in issue	-	7.4	323.5	147.1	-	478.0
	311.2	**5,082.6**	**2,931.9**	**2,163.6**	**-**	**10,489.3**
Society:						
Non-derivative liabilities						
Shares	-	4,840.8	1,590.6	1,688.6	-	8,120.0
Amounts owed to credit institutions	305.7	37.8	971.9	399.1	-	1,714.5
Other customers	-	202.6	51.5	-	-	254.1
Debt securities in issue	-	-	300.5	-	-	300.5
	305.7	**5,081.2**	**2,914.5**	**2,087.7**	**-**	**10,389.1**
Group:						
Derivative liabilities						
Interest rate swaps	-	0.6	16.6	43.4	2.1	62.7
	-	**0.6**	**16.6**	**43.4**	**2.1**	**62.7**
Society:						
Derivative liabilities						
Interest rate swaps	-	0.6	16.1	44.8	2.1	63.6
	-	**0.6**	**16.1**	**44.8**	**2.1**	**63.6**

2021	Undefined maturity £m	Less than 3 months £m	Between 3 months and 1 year £m	Between 1 year and 5 years £m	More than 5 years £m	Total £m
Group:						
Non-derivative liabilities						
Shares	-	5,072.7	1,102.7	1,769.5	-	7,944.9
Amounts owed to credit institutions	31.2	179.3	915.1	168.7	-	1,294.3
Other customers	-	192.7	77.4	-	-	270.1
Debt securities in issue	-	18.3	55.9	623.6	-	697.8
	31.2	**5,463.0**	**2,151.1**	**2,561.8**	**-**	**10,207.1**
Society:						
Non-derivative liabilities						
Shares	-	5,072.7	1,102.7	1,769.5	-	7,944.9
Amounts owed to credit institutions	30.6	194.0	957.7	438.1	-	1,620.4
Other customers	-	192.7	77.4	-	-	270.1
Debt securities in issue	-	-	0.8	299.5	-	300.3
	30.6	**5,459.4**	**2,138.6**	**2,507.1**	**-**	**10,135.7**
Group:						
Derivative liabilities						
Interest rate swaps	-	0.6	5.8	12.3	5.9	24.6
	-	**0.6**	**5.8**	**12.3**	**5.9**	**24.6**
Society:						
Derivative liabilities						
Interest rate swaps	-	0.6	5.8	11.5	5.9	23.8
	-	**0.6**	**5.8**	**11.5**	**5.9**	**23.8**

33. Market risk

Market risk can be sub-divided into interest rate risk and currency risk.

Interest rate risk

Interest rate risk is the risk that the value of, or income arising from, the group's assets and liabilities changes as a result of movements in market rates. The group reviews the potential impact that six interest rate scenarios (a range of parallel and non-parallel market rate shifts) could have on the market value of its financial assets and liabilities, on a discounted cashflow basis. Account is also taken of those assets and liabilities with embedded optionality, such as pipeline and prepayment risk on fixed rate mortgages.

The group monitors its position daily and operates within parameters set by the Board Risk Committee. The results of each of the six interest rate scenarios (parallel and non-parallel) are actively managed by the Finance Committee to ensure they remain consistent with the Society's current interest rate view. As market risk can manifest itself as both an impact on the group's economic value and/or the group's earnings (or Net Interest Income), both metrics are considered when assessing the level of Interest Rate Risk in the Banking Book and are monitored via Finance Committee and the Board Risk Committee. As at 31 December 2022, the Economic Value of the

33. Market risk (continued)

Group's balance sheet would have decreased by £10.1m in the case of a short rate down. A short rate down scenario is where rates fall in the short term (less than 2 years), while rates in the medium to longer term increase.

Currency risk

The group has no material exposure to foreign exchange rate fluctuations or changes in foreign currency interest rates.

34. Related party transactions

The remuneration of the Directors (including Non-Executive Directors), who are the key management personnel of the group, is set out in the Report of the Remuneration Committee.

Loans to and shares held by Directors

There were no outstanding balances in respect of secured advances made prior to, or during the year, to Directors at the end of the financial year (2021: £0.1m).

In so far as it is required under Section 68(1) and Section 68(3) of the Building Societies Act 1986, details of such loans are maintained in a register kept at Principality Buildings, Queen Street, Cardiff, and a statement containing requisite particulars will be available for inspection by members at the same address for the period of 15 days prior to the Annual General Meeting to be held on 21 April 2023.

As required by the Society's rules, each Director has a share account. The Society's duty of confidentiality to its members precludes individual disclosure of these details; the aggregate total of deposits held by Directors was £0.2m (2021: £0.1m).

Directors' transactions

There were no other transactions with Directors during the year.

Transactions with group companies

The Society undertook the following transactions with group companies during the year:

	Interest paid to Society £m	Fees paid to Society £m
Year ended 31 December 2022		
Nemo Personal Finance Limited	-	-
	-	**-**
Year ended 31 December 2021		
Nemo Personal Finance Limited	1.4	-
	1.4	**-**

At the year-end the following balances were outstanding:

	Surplus cash paid to Society 2022 £m	Surplus cash paid to Society 2021 £m
Nemo Personal Finance Limited	1.7	16.0
	1.7	**16.0**

Financial Statements

Annual Business Statement

for the year ended 31 December 2022

1. Statutory percentages

	At 31 December 2022 %	At 31 December 2021 %	Statutory limit %
The lending limit	3.3	3.2	25.0
The funding limit	19.1	20.1	50.0

The percentages are calculated in accordance with, and the statutory limits are those prescribed by, Sections 6 and 7 of the Building Societies Act 1986 (as substituted by the Building Societies Act 1997) and are based on the consolidated statement of financial position.

2. Other percentages

	2022 %	2021 %
As a percentage of shares and borrowings:		
Gross capital	6.9	6.3
Free capital	6.3	5.7
Liquid assets	20.5	18.5
As a percentage of mean total assets:		
Profit for the year as a percentage of statutory mean total assets	0.34	0.44
Management expenses as a percentage of statutory mean total assets	0.90	0.84

- Gross capital – the aggregate of general reserve, available for sale reserve, subscribed capital and subordinated liabilities.
- Free capital – gross capital plus collective impairment provisions less intangible assets and property, plant and equipment.
- Liquid assets – the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities.
- Mean total assets – the average of the total assets in the consolidated statement of financial position at the beginning and end of the year.
- Management expenses – the aggregate of administrative expenses, depreciation and amortisation.

3. Directors

Details of Directors are contained on pages 39 to 43.

Details of Directors' service contracts are included in the report of the Remuneration Committee on page 78.

Documents may be served on any of the Directors c/o Eversheds Sutherland, Reference RP, 1 Callaghan Square, Cardiff CF10 5BT.

No Director or other officer, including connected persons, has any right to subscribe for share capital in, or debentures of, any connected undertaking of the Society.

Subsidiary companies
Nemo Personal Finance Limited
Chief Executive:
Iain Mansfield

Glossary

Additional Tier 1 capital	A component of regulatory capital comprising Permanent Interest-Bearing Shares (PIBS) and other qualifying instruments after regulatory adjustments.
Administered rate	A rate which is set by the Society, such as SVR, and that is at the Society's discretion to change, subject to the terms and conditions of the product.
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.
Basel III	In December 2010, the Basel Committee on Banking Supervision issued the Basel III rules text, which presents the details of strengthened global regulatory standards on bank capital adequacy and liquidity.
Brand Consideration	Brand Consideration measures whether a respondent would consider taking a product or service from Principality.
Buffer eligible liquid assets	Includes high quality debt securities issued by a government or central bank, securities issued by a designated multilateral development bank or reserves in the form of sight deposits with a central bank in an EEA State or Canada, the Commonwealth of Australia, Japan, Switzerland or the United States of America.
Business assets	The total assets of the Society and its subsidiary undertakings as shown in the statement of financial position plus provision for loan impairment, less fixed assets and liquid assets.
Capital Requirements Directive (CRD IV)	European legislation to implement Basel III, which includes the Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD).
Carbon Net Zero	We will reduce our carbon emissions to as low as they can possibly be, across all scopes.
Commercial lending	Secured loans to a commercial borrower.
Commercial property	Includes office buildings, industrial property, medical centres, hotels, retail stores, shopping centres, multi-family housing buildings, warehouses and garages.
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.
Covered bonds	A type of wholesale funding backed by cash flows from mortgages.
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.
Credit Valuation Adjustment (CVA)	An adjustment that represents an estimate of the change to fair value that a market participant would make to incorporate the credit risk inherent in counterparty derivative exposures.
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.
Defined contribution pension scheme	A scheme into which the group and the employee pay fixed contributions without any obligation to pay further contributions.
Delinquency	See Arrears.
Effective Interest Rate method (EIR)	The group uses the EIR method to recognise income for certain financial instruments held at amortised cost. To calculate the appropriate EIR, the group makes assumptions of the expected lives of financial instruments and the anticipated level of early redemption charges.
Euro Medium Term Note (EMTN)	Medium term flexible debt instrument.
Expected Loss (EL)	A regulatory capital calculation to estimate the potential losses on current exposures due to potential defaults over a one-year time horizon. It is the product of PD, LGD and EAD.
Exposure	The maximum loss that a financial institution might suffer if a borrower or counterparty fails to meet its obligations to the group.

Exposure	The maximum loss that a financial institution might suffer if a borrower or counterparty fails to meet its obligations to the group.
Exposure At Default (EAD)	A regulatory capital parameter used to estimate the amount outstanding at the time of default.
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.
Financial Services Compensation Scheme (FSCS)	A protection fund for depositors of failed institutions. This is funded by the financial services industry and each firm, including the Society, is obliged to pay an annual levy.
Forbearance strategies	Strategies to assist borrowers in financial difficulty, such as extending loan terms, temporarily converting loans to an interest-only basis and agreeing a temporary reduction in payments. Forbearance strategies aim, if possible, to avoid foreclosure or repossession.
Funding limit	The proportion of shares and borrowings not in the form of customer accounts held by individuals.
Impaired loans	Loans where there is evidence to suggest a measurable decrease in the present value of expected cash flows that has occurred after initial recognition of the asset, but before the statement of financial position date.
Individually/collectively assessed impairment allowances	Impairment is measured individually for assets and collectively where a portfolio comprises homogenous assets and where appropriate statistical techniques are available. Collective assessment also covers losses that have occurred but are not yet individually identified on loans subject to individual assessment.
Individual Liquidity Guidance (ILG)	Guidance from the PRA on the required quantity of a firm's liquidity resources and the firm's funding profile.
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.

International Swaps and Derivatives Association (ISDA) master agreement	A standardised contract developed by ISDA and used to enter into bilateral derivative transactions. The contracts grant legal rights of set-off for derivative transactions with the same counterparty. This reduces the credit risk of the derivatives to the extent that negative values offset positive values.
Internal Ratings Based (IRB)	An approach for measuring exposure to credit risks. IRB approaches are more sophisticated and risk sensitive than the standardised approach and may be Foundation or Advanced. IRB approaches may only be used with PRA permission.
Lending limit	The proportion of business assets not in the form of loans fully secured on residential property.
Leverage ratio	A Basel III ratio which measures Tier 1 capital against total on and off balance sheet assets.
LIBOR	London Inter Bank Offered Rate.
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.
Liquidity and funding risk	The risk that the group does not hold sufficient liquidity, in terms of quantity and quality, to meet its liabilities as they fall due.
Loan To Value ratio (LTV)	A ratio showing outstanding loan balance as a percentage of the value of the security.
Loss Given Default (LGD)	The difference between Exposure At Default (EAD) and the net amount of the expected recovery expressed as a percentage of EAD.
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.
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.

Net retail mortgage lending	Total movements in the retail mortgage book; includes all inflows and outflows in respect of retail lending.
Net retail savings growth	Total movements in the retail savings portfolio; includes all inflows and outflows in relation to retail savings.
Net Stable Funding Ratio (NSFR)	A liquidity ratio, currently proposed under Basel III, to calculate the proportion of long-term assets that are funded by stable, long-term funding sources (customer deposits and long-term wholesale funding).
Operational risk	The risk of loss arising from inadequate or failed internal processes, people and systems, or from external events.
Overnight Indexed Swap rate (OIS)	A rate reflecting the overnight interest typically earned or paid in respect of collateral exchanged. OIS is used in valuing collateralised interest rate derivatives.
Plevin	In November 2014, the Supreme Court ruled in Plevin v Paragon Personal Finance Ltd (Plevin) that a failure to disclose a commission payment on a PPI policy made the relationship between a lender and the borrower unfair under the Consumer Credit Act.
Prudential Regulation Authority (PRA)	The UK prudential regulator, which is a part of the Bank of England and alongside the FCA has responsibility for the oversight of building societies, banks and insurers. The PRA's objective is to promote the safety and soundness of regulated firms.
Probability of Default (PD)	A regulatory capital parameter used to estimate the probability that a borrower will default on their credit obligations in the next 12 months.
Recovery and Resolution Plans	The recovery plan outlines the steps the Society can take to prevent failure. The resolution plan includes the data required by the Bank of England to establish an orderly resolution of the Society's affairs, in the event that recovery cannot be achieved.
Regulatory capital	Capital allowable under regulatory rules, less certain required regulatory adjustments and deductions.
Repurchase agreement (repo)/Reverse repurchase agreement (reverse repo)	A repurchase agreement (repo) is a transaction in which the borrower agrees to sell a security to the lender subject to a commitment to repurchase the asset at a specified price on a given date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the counterparty to the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or reverse repo.

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.
Risk appetite	The articulation of the level of risk that the group is willing to take (or not take) in order to safeguard the interests of the Society's members whilst achieving business objectives.
Risk-Weighted Assets (RWA)	A regulatory measure that adjusts the value of assets to reflect their level of risk when calculating capital requirements.
Securitisation	A process by which a group of assets, usually loans, is aggregated into a pool, which is used to back the issuance of new securities. A company transfers assets to a special purpose entity (SPE) which then issues securities backed by the assets. The group has established securitisation structures as part of its funding activities. These securitisation structures use retail mortgages as the asset pool.
Senior unsecured debt funding	Bonds issued by corporate bodies and financial institutions, which are not secured by any collateral and are not subordinated to any other liabilities of the Society.
Shares	Money deposited by members in a retail savings account with the Society and held as a liability in the statement of financial position.
Shares and borrowings	The total of shares, deposits from banks, other deposits, amounts due to customers and debt securities in issue.
Solvency ratio	A component of regulatory capital measuring of the group's total regulatory capital as a proportion of the group's Risk Weighted Assets.
Special Purpose Entities (SPEs)	Entities that are created to accomplish a narrow and well defined objective. There are often specific restrictions or limits around their ongoing activities. The group uses an SPE set up under a securitisation programme. Where the group has control of these entities or retains the risks and rewards relating to them they are consolidated within the group's results. This term is used interchangeably with SPV (special purpose vehicle).

Standardised approach	The basic method used to calculate credit risk capital requirements under Basel III. In this approach the risk weights used in the capital calculation are determined by PRA supervisory parameters. The standardised approach is less risk-sensitive than IRB.
Stress testing	Various techniques that are used by the group to gauge the potential vulnerability to exceptional but plausible events.
Tier 1 capital ratio	Tier 1 capital as a proportion of Risk-Weighted Assets.
Tier 2 capital	A further component of regulatory capital comprising subordinated debt less certain regulatory deductions.
Value at Risk (VAR)	A technique that estimates the potential loss that could occur on risk positions as a result of future movements in market rates and prices over a specified time horizon and to a given level of statistical confidence.


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ARA 03/23-1

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